DEBT FOR NATURE

OPPORTUNITY IN LAO PDR

DESIGN FEASIBILITY STRATEGY

AUTHOR OF THE PUBLICATION

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CONTENTS

ACRONYMS

ASEAN	Association of Southeast Asian Nations
BRI	Belt and Road Initiative
EDL	Electricite du Laos
ESG	Environmental, social and governance
GDP	Gross domestic product
IMF	International Monetary Fund
NGO	Non-governmental organization
NSEDP	National Socioeconomic Development Plan
SDG	Sustainable Development Goals
SDR	Special Drawing Rights
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme

EXECUTIVE SUMMARY

A debt-for-nature swap is an agreement between a debtor and creditor where the repayment obligations of an existing public debt are suspended, reduced, cancelled or otherwise restructured, with the funds allocated instead to achieving domestic biodiversity outcomes. This lowers foreign debt obligations and provides a net improvement in a government's fiscal position.

Lao People's Democratic Republic (PDR) is among the countries with the greatest potential for a debt restructure of this kind. It has globally important natural resources, a high ratio of debt to gross domestic product (GDP) and significant debt-servicing obligations, and substantial economic impacts from COVID-19.

Since early 2021, the Government of Lao PDR, with support from UNDP, has mobilized resources and expertise to explore potential debt-for-nature options to unlock fiscal space as the government grapples with the triple challenges of unsustainable debt, climate vulnerability and biodiversity destruction. This report explores preliminary design considerations and scenario proposals. Much further analysis and negotiation would be needed to develop a full proposal.

The debt-for-nature opportunity is consistent with and supports the objectives of the Ninth National Socioeconomic Development Plan (9th NSEDP), the Lao National Green Growth Strategy, the National Agenda for Addressing Economic-Financial Difficulties, the 9th NSEDP Financing Strategy and Lao Resilience Framework, Lao PDR's commitments to the Sustainable Development Goals (SDGs), the Nationally Determined Contribution under the Paris Agreement on climate action and the Lao National Biodiversity Strategy and Action Plan under the Convention on Biological Diversity.

A cross-ministry Debt-for-Nature Technical Working Group was established in 2021 to provide technical inputs to a debt-for-nature proposal for the Government. The design options discussed in this report include:

- The mechanism for restructuring or reducing debt obligations (the transaction agreement)
- The target for use of the proceeds (the environmental objective and outcome).
- The mechanism for delivery of funding (including holding, verification and reporting requirements).
- The scale of the agreement (and the scale of the proceeds generated).
- The target creditors (can be multiple creditors)
- The target debt (loans or projects) subject to a restructuring agreement.
- The third parties or other partners to an agreement.

Three scenario proposals have been discussed:

1. Engagement with multilateral debt relief initiatives.
2. A waiver of principal or interest reduction with a bilateral creditor.
3. The issuance of new debt instruments for conversion of existing debt obligations.

Based on initial considerations, this report recommends that the Government of Lao PDR continue to pursue opportunities for a debt restructure that can unlock fiscal capacity for financing biodiversity and climate outcomes, towards protecting and maximizing the economic value of the country's natural assets.

As an immediate first step, it proposes that the Prime Minister's Office issue a high-level directive or decree to move the debt-for-nature initiative forward, specifically to:

- Confirm that the Government is exploring the debt-for-nature potential.
- Revise the membership and chairing

arrangements of the Technical Working Group to facilitate improved alignment with existing ministerial responsibilities.
- Reiterate that the targets of the debt-for-nature proposal will remain nature and climate focused, and seek inputs from relevant ministries.
- Issue an instruction to the Technical Working Group to bring a detailed debt-for-nature proposal to the Government for consideration by a specific date.

A debt-for-nature swap would be a valuable early step for several reasons:

- It would demonstrate the Government's policy intent for consideration by development and financing partners.
- It would help to test and demonstrate capacity for compliance with the monitoring, reporting and verification requirements associated with such instruments.
- It would result in a net improvement in the government's debt position, which would contribute, inter alia, to a future strengthening of the sovereign credit rating.
- It would provide an opportunity to pilot a green bond issuance that could be replicated in future years.

A debt-for-nature swap could help alleviate immediate financial pressures. But it is not a silver-bullet solution to the country's economic challenges. It should be considered as part of a continuum of policy reforms that will support the Government in addressing long-term financing needs, accessing new sources of green finance, identifying and resolving obstacles, and promoting new avenues for foreign investment.

1.0 INTRODUCTION

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1.1 CONTEXT

This report analyses the potential for the Government of Lao PDR to develop an agreement with one or more of its creditors to restructure the terms of its existing sovereign debt. The purpose would be to alleviate debt-servicing obligations and unlock domestic fiscal resources for meeting the government's environmental objectives.

The report is part of the technical and financial support that UNDP provides to the Government of Lao PDR in assessing innovative credit-restructuring mechanisms for nature.

1.2 THE DEBT-FOR-NATURE OPPORTUNITY IN LAO PDR[1]

Lao PDR has some of the highest forest coverage in South-East Asia. Forest ecosystem services support key economic sectors including energy, agriculture and tourism. Natural capital is a major source of wealth and crucial to the economy, providing goods and services essential to reducing poverty, securing livelihoods and driving sustainable growth.

Investments in biodiversity conservation can support local jobs and revenues, including through nature-based tourism and non-timber forest products. Recognizing the importance of green growth, the Government of Lao PDR has articulated a vision for it with specific biodiversity management and forest conservation targets, and described its aspirations under the 9th NSEDP Financing Strategy 2021–2025.

As Lao PDR emerges from the COVID-19 pandemic, the economic impacts of reduced tourism and trade, together with a high level of sovereign debt servicing, have resulted in very constrained financial resources. The Government will spend around half of its projected revenues for the next few years on sovereign debt repayments, an expense of approximately $1.3 billion per year. With current plans including austerity measures and prioritized expenditures, it is expected that protected areas will see increasingly limited funding from the national budget.

A lack of sustainable financing for protected area management has been a critical ongoing challenge. Already, budget allocations to the Forest Protection Fund have decreased significantly from over $700,000 in 2017 to around $170,000 in 2021. This leads to a real risk of decline in ecosystem services and asset values, reduced production in associated sectors such as tourism, agriculture and energy, and substantial impacts on local communities and livelihoods. It poses a major economic loss and threat to development, even as Lao PDR transitions from its status as a least developed country in coming years.

A debt-for-nature swap is an agreement between a debtor and creditors where the repayment obligations of an existing loan are suspended, reduced, cancelled or otherwise restructured, and the funds are allocated instead to achieving biodiversity outcomes. This type of debt restructure, with a focus on environmental outcomes, has been around since the 1980s. It has been successfully implemented in various countries in Africa, Latin America and South-East Asia. Most recently, Belize (2021) and the Seychelles (2018) applied this model to secure financing for marine protected areas. Work is ongoing across several nations to secure debt-for-nature agreements with creditors.

Lao PDR is among the countries with the greatest potential for a debt restructure of this kind, given its globally significant natural resources, high debt-to-GDP ratio and debt-servicing obligations, and the substantial economic impacts of COVID-19. A debt-for-nature swap agreement could provide the Government with expanded fiscal capacity for financing domestic priorities.

UNDP is therefore providing technical support to the Government to explore a potential debt-for-nature restructure, including its design and how financial resources could be allocated to domestic green growth objectives, as identified in the 9th NSEDP Financing Strategy and the national Forestry Strategy.

1.3 PREPARATORY WORK

This report builds on earlier analysis under the UNDP "SAFE Ecosystems Project," implemented with the Ministry of Agriculture and Forestry from 2016 to 2021 to support the management of national protected areas. It contributes to and is supported by the "Poverty-Environment Action for Sustainable Development Goals: Sustainable and Responsible Investment in Lao PDR'' project implemented by UNDP and UNEP.

Preliminary research, the preparation of a concept paper and informal consultations on Lao PDR's debt-for-nature potential commenced in December 2020. A proposal to develop a debt-for-nature swap emerged from dialogues and meetings with key ministries, in consultation with the Department of Forestry. It was approved by the Minister of Agriculture and Forestry in February 2021.

From February 2021, a series of meetings across four key ministries provided a conceptual orientation for government officials and an introduction to the debt-for-nature opportunity. This early engagement increased recognition of the potential and fostered collaboration across ministries. The Debt-for-Nature Technical Working Group was established to guide the design process. Initial analysis of Lao PDR's debt stock and creditor dynamics resulted in a scoping report shared with the Government. UNDP published a debt-for-nature policy note to stimulate dialogue with key government partners.

Externally, consultations involved the International Institute for Environment and Development, Boston University's Global Development Policy Centre and the Finance for Biodiversity Initiative. Informal discussions took place with the Lao PDR country offices of the World Bank and Asian Development Bank. UNDP's Biodiversity Finance Initiative and Innovative Financing Hub have been consulted along with UNEP's Bangkok Regional Hub.

Early analysis identified China as a potential partner for a debt-for-nature restructure. Preliminary discussions with advisors to the China Council for International Cooperation on Environment and Development resulted in a presentation on Lao PDR's debt-for-nature potential at a working-level meeting in April 2022. This led to a proposal to include the Lao PDR opportunity as a pilot initiative or case study in a next phase of the council's policy research, but ultimately, this did not focus on debt-for-nature options. UNDP Lao PDR also collaborated with the Paulson Institute, contributing to a chapter on the Lao PDR debt-for-nature opportunity in a report submitted to the Green Finance Committee of the Chinese Society for Finance and Banking.

2.0 GOVERNMENT PRIORITIES AND CAPACITY TO IMPLEMENT A DEBT-FOR-NATURE AGREEMENT

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2.1 MACROECONOMIC AND POLITICAL CONTEXT

In recent years, the Government of Lao PDR has targeted key goals that include pursuing green growth, poverty reduction and early childhood education, along with aims to become the "battery of South-East Asia" and transform to a "land-linked" country. Over the last two decades, the economy has grown consistently, driven by large-scale infrastructure investment, particularly in mining, transport and hydropower. In 2021, Lao PDR met the criteria for graduation from being a least developed country. It anticipates achieving this transition by 2026.

Even before the COVID-19 pandemic, however, GDP growth in Lao PDR had begun to decelerate, from 6.3 per cent in 2018 to 5.5 per cent in 2019 to 3.3 per cent in 2020, the lowest level in three decades. At that point, Lao PDR was already at high risk of debt distress, according to IMF assessments.[5] Estimated total public and publicly guaranteed debt increased from about 70 percent of GDP in 2019 to 88 percent in 2021.[6]

In 2022, the war in Ukraine compounded pandemic fallout, generating uncertainty in global oil and gas markets, and sending energy prices soaring. Over the 12 months to October 2022, the value of the Lao kip fell by over 60 percent against the US dollar; inflation topped 37 percent.[7] A nationwide fuel shortage in June 2022 threatened to further erode economic output, with compounding impacts on industrial and agricultural production and food security. The Asian Development Bank is currently forecasting that Lao PDR's economy will grow by 2.5 percent in 2022 and 3.5 percent in 2023. Growth is unlikely to recover to pre-pandemic levels in the near term.

The Government has tried to adapt to the changing global situation but has very limited fiscal space for manoeuvre. The 9th NSEDP Financing Strategy provides an overarching vision for the country's development from 2021 to 2026 but the macroeconomic and structural challenges are substantial. In particular, a high level of sovereign debt is constraining fiscal capacity, fuelling economic instability and threatening development goals. Near-term debt servicing obligations are a major and immediate concern, amounting to about $1.3 billion annually between 2023 and 2026, equivalent to the country's entire foreign exchange reserves.[8]

2.2 LAO PDR'S DEBT PROFILE

In recent years, the Government of Lao PDR has invested heavily in major infrastructure, particularly hydropower, mining and transport projects. This has resulted in a substantial external debt profile. Total public and publicly guaranteed debt increased from 68 percent of GDP ($12.5 billion) in 2019 to 88 percent ($14.5 billion) in 2021, the highest ratio in South-East Asia. The energy sector accounts for around 40 percent of this debt stock, including on-lending and guaranteed debt. The most recent projections are that the level of debt to GDP will exceed 100 percent by the end of 2022.[9]

Credit rating agency assessments indicate the degree of debt sustainability. In 2020, FitchRatings estimated Lao PDR's debt repayment obligations to be around $1.1 billion annually until 2024, while foreign exchange reserves were estimated at less than $1 billion, and net external debt was projected to exceed 85 per cent of GDP. By August 2022, Fitch had downgraded the rating for Laos to CCC–, reflecting increasing

FIGURE 1: Growth in Lao PDR sovereign debt-servicing obligations, 2015–2025

Source: Ministry of Finance 2021.

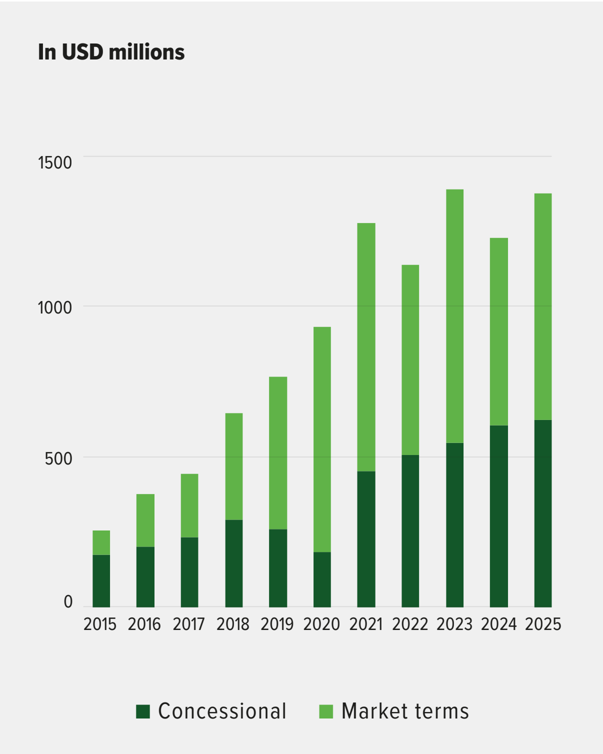
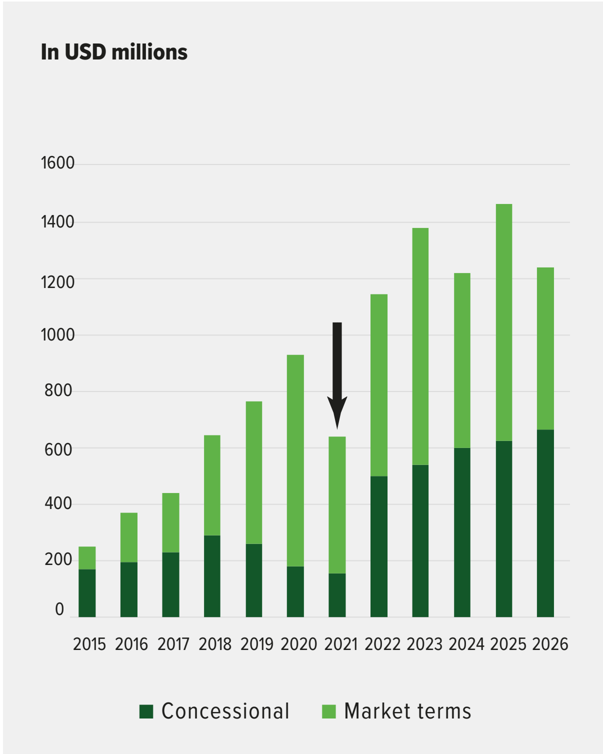


FIGURE 2: Growth in Lao PDR sovereign debt-servicing obligations, 2015–2026

Source: Ministry of Finance 2022.



external liquidity risks driven by the spike in commodity prices and tightening global financing conditions. In October 2022, Fitch withdrew further ratings for Lao PDR, citing commercial reasons.[10]

In May 2021, the Thai Rating and Information Service downgraded the sovereign rating for Lao PDR to 'BBB–' with a 'negative' outlook. The downgrade reflected deepening deterioration in the country's fiscal position and execution risks in the Lao Government's liquidity management plan. The rating was held at this level in May 2022. In June 2022, Moodys cut its sovereign debt rating for Lao PDR to 'Caa3', warning of a high risk of default, due to increasing inflation and currency weaknesses.

Analyses of the World Bank, Asian Development Bank and IMF have shared a similar assessment of the country's challenges, which are compounded by widening deficits and weaker growth under the impact of the COVID-19 downturn.

In 2021, the Ministry of Finance published a summary of debt statistics and servicing obligations projected to 2025.[11] This was issued again in 2022, with the statistics and projections extended to 2026.[12] The growth in debt-servicing obligations from 2015 to 2025 from the earlier publication is illustrated in Figure 1. Figure 2 shows the updated growth in debt-servicing obligations from 2015 to 2026, based on the most recent publication.

As can be seen, actual debt payments for 2021 (Figure 2) were markedly different from what had been projected in the previous year. This was due to a debt renegotiation with China, which involved the suspension of some payments in 2021. This helped to reduce immediate debt service pressures. The World Bank Economic Monitor estimates that deferrals for 2020, 2021 and 2022 will reach 8 percent of GDP.

The projections for servicing obligations over the coming years remain extremely high and demonstrate ongoing challenges for the Government in managing its debt situation. Repayment obligations in 2023 are projected at around $1.4 billion.

Lao PDR has been a major recipient of China's foreign direct investment and infrastructure

FIGURE 3: 2023 Lao PDR debt-serving obligations, concessional and market terms

Source: Ministry of Finance 2022.

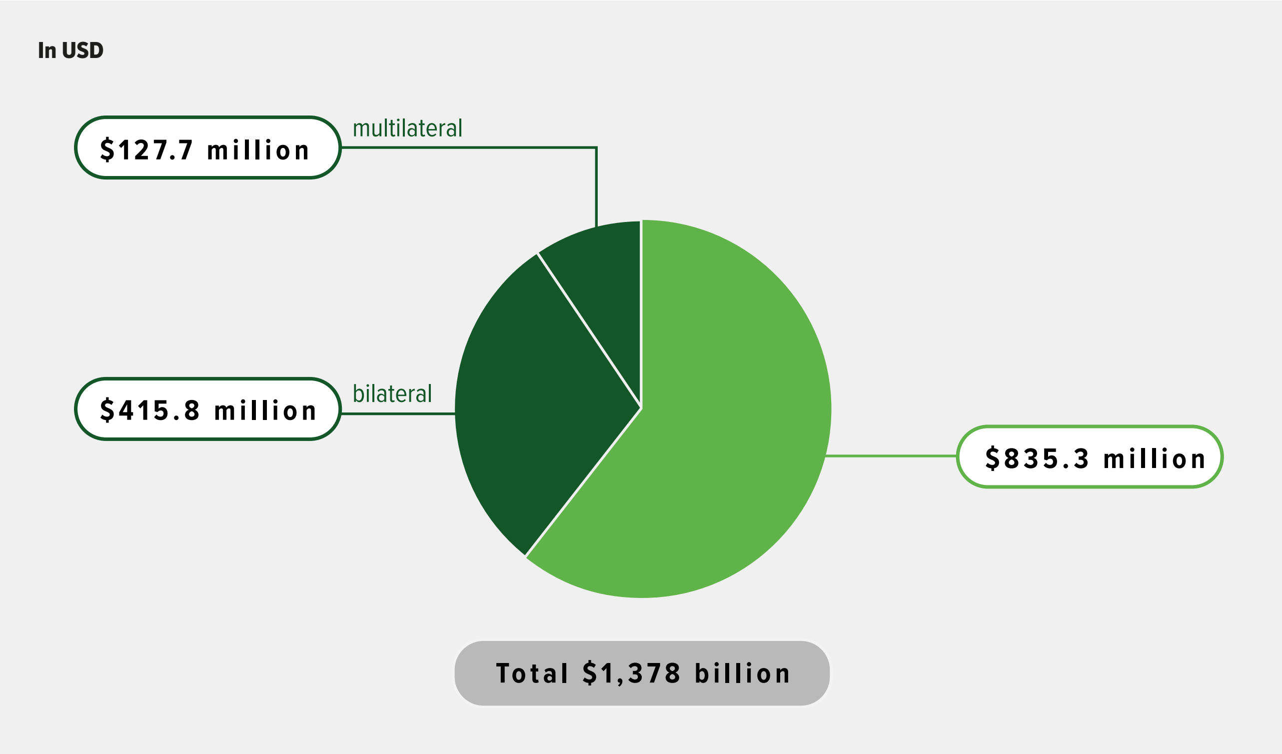


FIGURE 4: 2023 Lao PDR debt-servicing obligations, concessional

Source: Ministry of Finance 2022.

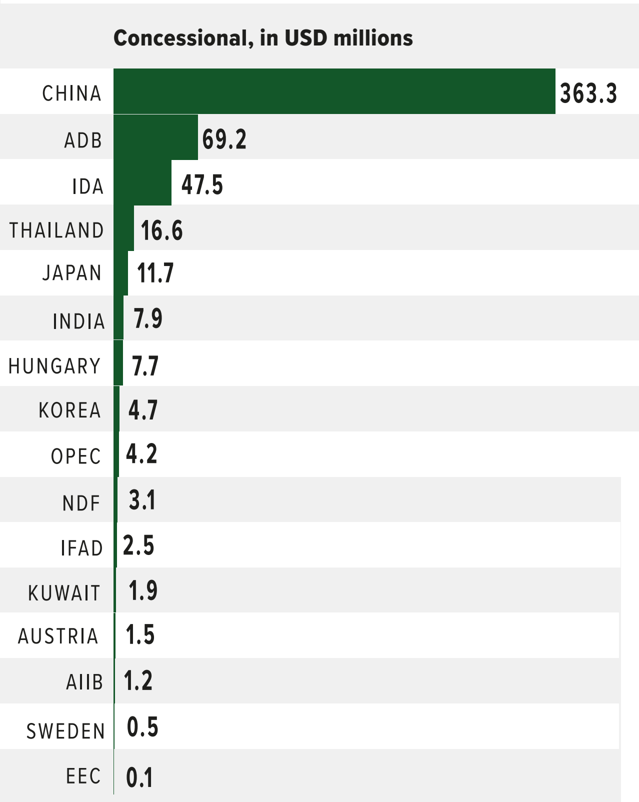
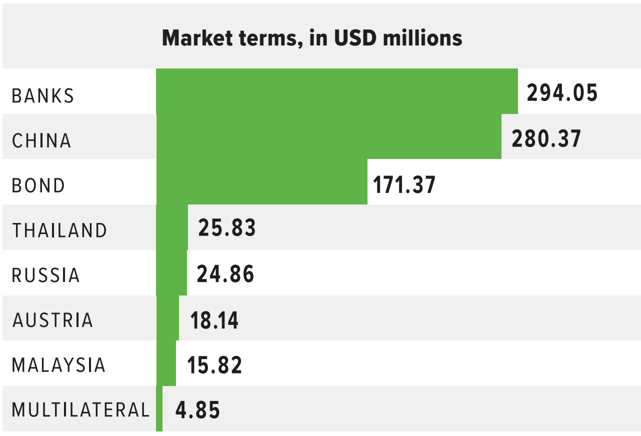


FIGURE 5: 2023 Lao PDR debt-servicing obligations, market terms

Source: Ministry of Finance 2022.



lending through its Belt and Road Initiative (BRI), including investments in the Vientiane-Boten high speed rail project, major road expressway construction, hydropower development and mining. Close to half (48.8 percent) of Lao PDR's total external public debt stock in 2021 was held by China, followed by the Asian Development Bank and the World Bank (15.6 percent), ex-China bilateral loans (14.8 percent) and the commercial bond market (9.8 percent).

Figures 3 to 5 show the breakdown of 2023 obligations across different creditors.

In terms of immediate repayment obligations, the pressure is most significant from commercial loans and bonds with $835 million due in 2023 (Figure 6).

Although 60 percent of external debt is concessional, commercial debt accounted for most debt service payments. In 2021, bond amortization accounted for 57 percent of total debt service payments, followed by an additional 18 percent relating to the repayment of commercial bank loans.[13]

2.3 REGIONAL AND GLOBAL BIODIVERSITY

Lao PDR is a historically, culturally and environmentally rich country with very diverse landscapes, ecosystems and cultures. Compared to its surrounding neighbours, it has relatively low population density and a lower rate of natural resource exploitation. As a result, it remains one of the most biodiverse countries in South-East Asia. Its forests and other habitats are part of the Indo-Burma biodiversity hotspot, one of the most biologically important regions of the planet.[14]

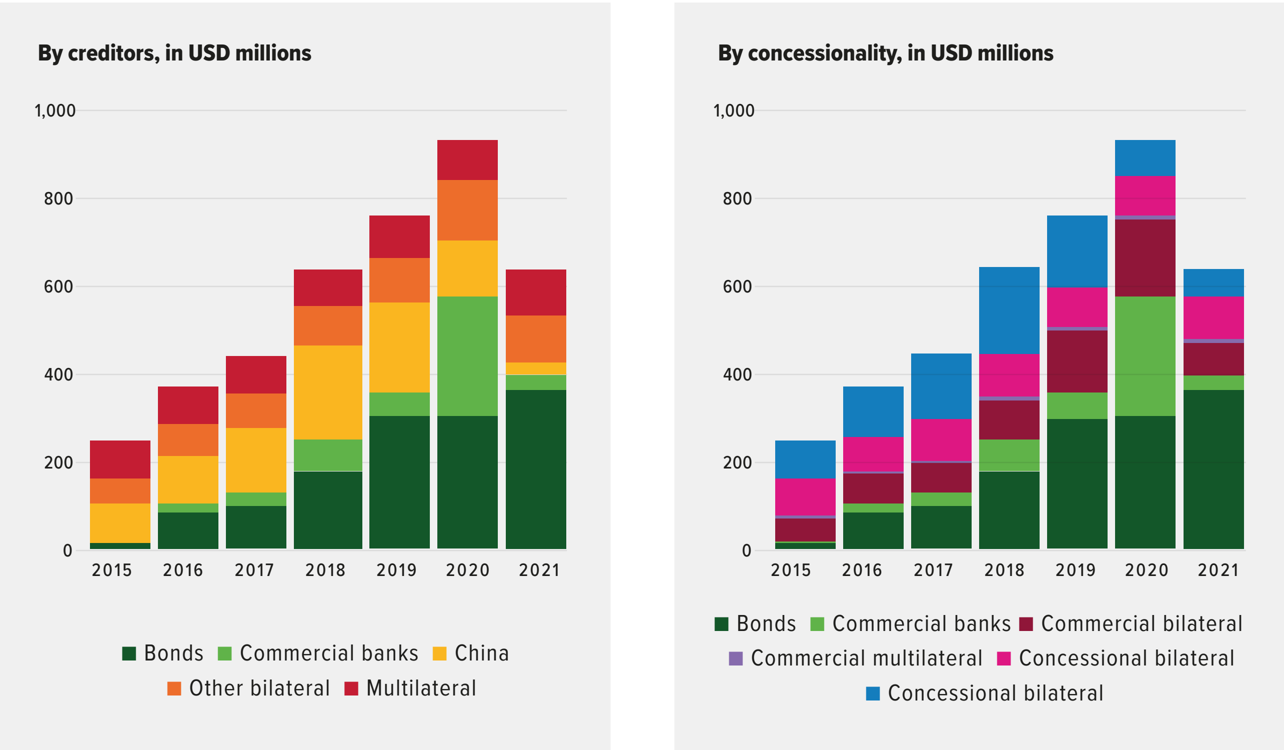
Lao PDR is home to approximately 166 species of reptiles and amphibians, 700 birds and over 247 mammals. The Mekong River and its tributaries contain approximately 500 species of indigenous fish. The country has an estimated 8,000 to 11,000 species of flowering plants.

The national protected areas

Given the significance of Lao PDR's biodiversity assets, it has established a network of national protected areas across four ecologically diverse regions: the Northern Highlands, the Annamites

FIGURE 6: Lao PDR's external public debt repayments

Source: World Bank, 2022, Lao PDR Economic Monitor.



Range, the Indo-Chinese karst landscapes and the Mekong plain. Major threats to these ecosystems include climate change, illegal logging and the wildlife trade, habitat clearing for cultivation, forest degradation and fragmentation from infrastructure development in and around the protected areas.

Lao PDR's national protected area system is the cornerstone of national efforts to protect biodiversity (Figure 10). The Department of Forestry's Master Plan for the National Protected Areas of Lao PDR (2020–2025) is based on the country's Forestry Strategy, which provides guidance on the sustainable management and development of the forestry sector, in line with national policies, strategies and priority programmes for national socioeconomic development and environmental conservation.[15]

National protected areas are also critical economic assets for Lao PDR, providing valuable ecosystem services. They hold important revenue-generating potential through nature-based tourism, identified as a valuable future growth industry and a key priority of the 2030 National Green Growth Strategy and the 9th NSEDP. There is increasing potential to develop nature-based tourism as a strategic sector.[15,16] Growing connectivity with the Chinese market through new rail and roads offers a significant export opportunity, with additional investment in both tourism infrastructure and preservation of natural resources. Given immediate debt-servicing imperatives and the projected profile of repayments over the next 5 to 10 years, however, the Government may not be able to allocate required financing without continuing external support or a debt restructure.

2.4 INTERNATIONAL COMMITMENTS

The Government of Lao PDR acceded to the Convention on Biological Diversity in 1996. The first National Biodiversity Strategy and Action Plan in 2004 laid out steps to 2010 and a strategy to 2020.

An assessment conducted by the International Union for Conservation of Nature in 2011 found that despite substantial progress in a range of areas, significant underachievement remained on key issues such as improving human resources capacity for biodiversity management, and ensuring that social and economic benefits from natural resources effectively accrue to the nation.[18] The report highlighted how despite several important and successful projects, a lack of institutional direction and the donor-driven nature of most projects, without consistent domestic funding, were limiting longer-term sustainable improvements.

In 2015, the Ministry of Natural Resources and Environment prepared an updated National Biodiversity Strategy and Action Plan for 2016-2025. This provides Lao PDR's overarching commitments as a signatory to the Convention on Biological Diversity, with recommendations to contribute to global targets and achieve national ones leading up to 2025. The plan articulates a vision where the people of Lao PDR value their biodiversity resources in terms of the immediate and long-term environmental, economic and poverty-alleviating benefits they provide, not only to themselves but to the global community.

The goal for 2016 to 2025 is to enhance biodiversity as a source of national heritage and substantial contributor to poverty alleviation and sustainable and resilient economic growth. The plan aims to protect economically important ecosystems and species and the genetic diversity within them by addressing direct pressures on key ecosystems. It sets targets inside and outside the network of national and local protected areas.

Parties to the Convention on Biological Diversity are developing a new global framework for biodiversity expected to identify financing needs of up to $700 billion per annum by 2030. Achieving this target requires both private and public sector resources. The Fifteenth Conference of Parties to the Convention, although delayed by the pandemic, was presided over by China.

In recent years, China has made considerable efforts to ensure that BRI infrastructure projects do not impact adversely on the environment in countries where projects are developed, and that infrastructure assets do not become stranded by subsequent physical or economic changes, particularly climate-related risks. In parallel, China has demonstrated a strong commitment to leadership in green finance, including as host of the 2016 Group of 20 (G20) processes, through domestic initiatives and regulations and as the dominant issuer of green bonds in global capital markets. The two main Chinese policy banks for financing BRI projects, the China Development Bank and China Export-Import Bank, actively promote the 'green BRI' vision and their own green finance credentials.

In the context of COVID-19 recovery, China's BRI and the Convention on Biological Diversity, there is an opportunity for debt negotiations between the Government of Lao PDR and Chinese creditors to include a specific component focused on the environment, either as a standalone bilateral agreement or in parallel with other bilateral or multilateral partners.

2.5 GOVERNMENT TARGETS AND PRIORITIES

The Government has articulated a vision for the country's development that highlights green growth, contributions to international biodiversity and climate change objectives. The 9th NSEDP recognizes the economic importance of Lao's natural capital and includes targets and activities to mitigate climate change, biodiversity loss and pollution.

Outcome 4 of the plan, on enhancing environmental protections and reducing disaster risks, has three key outputs:

- **Output 1:** natural resources sustainably used and managed.
- **Output 2:** green growth promoted, and actions taken towards climate change mitigation.
- **Output 3:** capacities for disaster prevention, management and recovery enhanced.

A debt-for-nature restructure could improve domestic fiscal capacity to allocate funds for achieving these objectives. It would also help to address macroeconomic and structural problems, as targeted in outcome 1 of the plan, on continuous quality, stable and sustainable economic growth. This includes managing contingent liabilities and public debt prudently as part of robust and stable macroeconomic management.

The 2018 National Green Growth Strategy also reflects the importance of environmental considerations in Lao PDR's development.

In August 2021, in recognition of the increasing financial challenges facing the country, the Lao National Assembly approved a National Agenda on Addressing Economic-Financial Difficulties (2021–2023).[19] It focuses on macroeconomic stabilization and an improved climate for business and investment. The National Agenda comprises an overview of the causes of current challenges as well as principles, priorities, expectations and responsibilities for businesses and the public sector in resolving the situation.

Under proposed solutions for ongoing debt challenges, the National Agenda includes debt restructuring through negotiation with foreign creditors and the issuance of panda bonds in the Chinese market to maintain liquidity and the capacity to service debt obligations. In September 2021, the Prime Minister issued Executive Order #18/PM, with instructions to ministries on specific measures to implement the National Agenda. Although a debt restructure was not specifically and publicly outlined, the instructions did include supporting activities: a review of concessional project revenue compliance, renegotiation of tax exemptions and tariff agreements, and potential further reforms to state-owned enterprises such as Electricite du Laos (EDL).[20]

Priority 3 of the National Agenda focuses on fiscal consolidation, maximizing returns on public investments, and managing both domestic and foreign debt. Solutions proposed already include negotiations with foreign creditors on debt restructuring, extension or replacement, and potential currency swaps. Proposed improvements in revenue collection from hydropower concession operators, reforms to state-owned enterprises and issuance of new debt instruments would further support this priority.

In 2021 and 2022, the United Nations country team in Lao PDR supported the Government in developing a Financing Strategy for the 9th NSEDP, guided by the integrated national financing framework approach. Ministries and national institutions validated the final draft of the strategy in September 2022. The strategy presents a range of policy targets, actions and implementation arrangements to address Lao PDR's financing constraints and increase investment needed to achieve 9th NSEDP objectives.

In relation to debt-for-nature, the Financing Strategy proposes exploring innovative solutions such as debt swaps, particularly for investments in the protection of nature or in climate adaptation and mitigation.

Under the 9th NSEDP Financing Strategy, specific and relevant actions include:

- The study and exploration of multilateral debt alleviation and suspension initiatives to free fiscal space in support of development investments and provide Lao PDR with sufficient time to increase the ratio of revenue to GDP (policy area 1.3, sustainable debt management)

- The continuation of debt consolidation through renegotiations to: (1) cancel or reduce debt repayments and/or lengthen the maturity of loans to the second half of the 2020s without losing access to future loans and (2) explore debt swaps with major creditors (policy areas 5.3, green and climate finance, and 1.3, sustainable debt management)

- The preparation of a medium-term debt issuance and management strategy, including the long-term exploration of green bonds, assuming the progressive return to a more manageable financial situation allowing for debt issuance (policy areas 5.3, green and climate finance, and 1.3, sustainable debt management).

The Financing Strategy notes that debt-for-nature swap proposals, which can unlock resources otherwise destined for interest repayments, can be integrated into broader negotiation strategies to alleviate the debt burden. Green bonds could later be explored to mobilize affordable resources for specific activities, subject to managing overall debt liabilities.

2.6 GOVERNMENT STAKEHOLDERS

Developing a debt-for-nature restructure requires the highest level of cross-ministerial cooperation and collaboration. It must be considered in the context of Lao PDR's broader national development plan, the 9th NSEDP Financing Strategy, and its post-COVID-19 national recovery and resilience planning. Other frameworks governing fiscal and debt management as well as existing national policy objectives such as the National Green Growth Strategy, commitments to the SDGs, the Nationally Determined Contribution under the Paris Agreement on climate change, and the National Biodiversity Strategy and Action Plans and Aichi Targets under the Convention on Biological Diversity.

A top priority of initial work has been to build support for the concept and its potential within relevant government ministries.

The **Ministry of Finance** has a leading role in managing the debt situation and allocating available fiscal resources. The ministry could provide advice on:
- Which loans and creditors might be suitable targets.
- How a debt-for-nature proposal may align with, or be incorporated within, ongoing debt management negotiations.
- How resources saved through a restructure could be effectively allocated in line with the Government's fiscal rules.

The **Ministry of Planning and Investment**, as the lead planning and coordination agency, can offer important insight on how a debt-for-nature agreement would contribute to financing the targets of the 9th NSEDP, including:
- The reallocation of proceeds within the government's capital budget and annual investment plans.
- How a debt-for-nature agreement aligns with (and can be coordinated with) other priority actions under the 9th NSEDP
- How to engage with Chinese creditors and development financiers, including through the Lao-China Cooperation Committee and International Cooperation Department.
- How to align negotiations for a debt-for-nature agreement with ongoing evaluations of concession agreements, tax exemptions and the development of future concession projects.

The **Ministry of Agriculture and Forestry** is responsible for managing protected areas warranting the investment of debt-for-nature proceeds. The ministry could provide advice on:
- An estimation of the financing required for protected area management across the country
- Existing funding mechanisms, such as the Forest Protection Fund, as well as processes to hold or deliver new financing and steps needed to build capacity for this.

- Current capacities and mechanisms for verifying and reporting on the financing and the environmental targets.

The **Ministry of Natural Resources and Environment** has a key role in environmental management and conservation objectives across the country, including representing Lao PDR on key international climate change and biodiversity conventions. Contributions would be expected to include:

- Defining opportunities for a debt-for-nature swap to support environmental expenditures apart from protected area management.
- Specifying how additional financing from a debt-for-nature restructure could be most effectively allocated to environmental outcomes.
- Detailing the capacity of the Environmental Protection Fund to receive, manage, disburse and report on additional financial resources from a debt-for-nature agreement.
- Determining how such investments could contribute to Lao PDR's engagement in and commitments under the Convention on Biological Diversity and United Nations Framework Convention on Climate Change, such as through the Nationally Determined Contribution and National Biodiversity Strategy and Action Plan.

Under the Law on Public Debt Management (2018), the National Assembly, Bank of Lao PDR and Ministry of Finance have specific responsibilities to deliberate and approve the issuance of new debt instruments, to approve the allocation of investment programmes funded through debt financing, and to manage the flow of financing from debt instruments according to fiscal rules.

2.7 THE DEBT-FOR-NATURE TECHNICAL WORKING GROUP

In recognition of the cross-ministry nature of the debt-for-nature implementation process, the Debt-for-Nature Technical Working Group was established in 2021 to guide the design process, under the authority of the Minister of Agriculture and Forestry as the responsible minister for the national protected areas.

Officials from the Ministry of Agriculture and Forestry, Ministry of Finance, Ministry of Planning and Investment and Ministry of Natural Resources and Environment serve on the Technical Working Group to provide technical inputs to a detailed a debt-for-nature proposal. Formal meetings of the group took place in December 2021 and July 2022.

3.0 DESIGN OPTIONS FOR A DEBT-FOR-NATURE AGREEMENT

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For a debt restructure to provide the financial capacity to improve environmental outcomes in Lao PDR, the scale or rate (or both) of debt-servicing obligations must decline. This can be achieved in different ways, including through the amendment of the principal, interest rates or timeframes for repayments. A debt restructure is not a grant of new money. It *repurposes* the Government's own revenue for allocation to domestic priorities instead of foreign debt payments. The specific terms for reallocating revenue and the conditions for restructuring a debt are determined by mutual agreement between a government and its creditor.

The design of a debt-for-nature restructure can be complex. While there is no single optimal solution for all country and creditor circumstances, some general design issues to consider include:

- The mechanism for restructuring or reducing debt obligations (the transaction agreement)
- The target for use of the proceeds (the environmental objective and outcome).
- The mechanism for delivering funding (including holding, verification and reporting requirements).
- The scale of the agreement (and the scale of the proceeds generated).
- The target creditors to participate in a debt-for-nature swap (can be multiple creditors)
- The target debt (loans or projects) subject to a restructuring agreement.
- The third parties or other partners to an agreement.

3.1 DEBT REDUCTION MECHANISMS

There are several ways to structure a debt-for-nature transaction. At the simplest level, a debt-for-nature swap is about reducing a debt burden that is unsustainable. It is an agreement between a creditor and debtor (such as the Government of Lao PDR) to change the terms of an existing loan, based on a legal amendment to a contract agreed between the parties. The Ministry of Finance debt bulletin describes this type of action as a 'debt reorganization' that can include debt forgiveness, rescheduling and refinancing operations.

A debt-for-nature swap reduces debtor obligations under a particular loan contract while lowering the debt burden overall. Savings are then available for spending on domestic priorities as stipulated in the amended agreement.

An amendment to a loan agreement could include one or more of the following things:

1. A reduction or waiver of principal (*debt forgiveness*) or a reduction in the interest rate for the life of the loan.

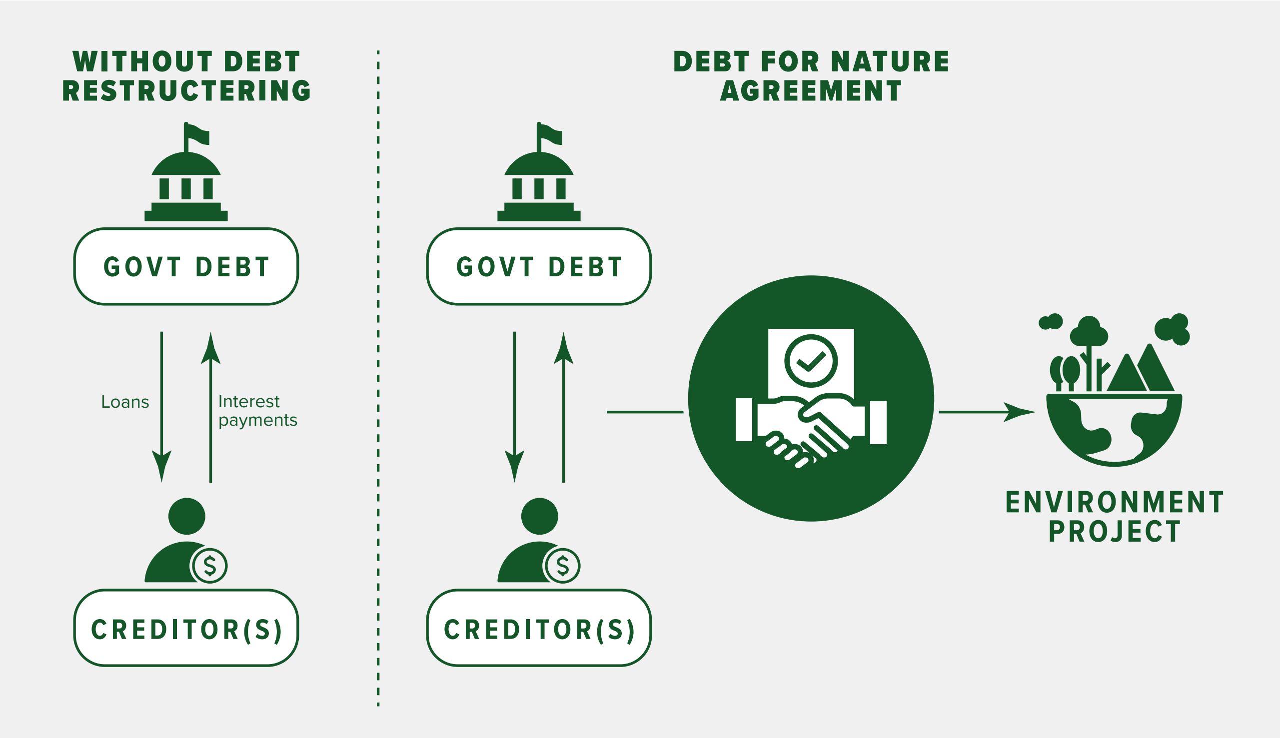
2. A deferral of the annual interest or principal payments, resulting in the same or lower present value over the life of the loan (*debt rescheduling*).

3. A replacement of existing debt with new instruments (*debt refinancing*).

The simplest debt relief option entails reducing some portion of the principal amount that was loaned. This is also known as debt forgiveness. It can be partial or in full. In most examples, full or partial debt forgiveness is only applied to debt with very low interest rates, in some cases, zero interest loans. While it is not clear if Lao PDR's debt portfolio includes zero interest loans, there are many examples of concessional (low-interest rate) loans that would be contenders for this type of relief.

A second way to provide increased financial capacity is to modify the schedule of loan repayments. Most simply, providing a pause in repayments for a period (e.g., one to two years) can provide a debtor government with temporary fiscal

FIGURE 7: Illustration of a debt-for-nature swap through a reduction in principal or interest or a deferral agreement



space to apply to domestic purposes. This was the approach of the G20 Debt Service Suspension Initiative, including for Chinese bilateral debt.

Alternatively, an extension in the term or tenure of a loan agreement can be agreed to allow a longer period to pay off the loan. This can reduce annual servicing obligations for a particular loan, although it may mean that the total amount paid back over time increases. In considering this type of restructuring, the Government would need to examine if any additional amount paid over the long term is sufficiently offset by the benefits of improved fiscal capacities during temporary economic difficulty, such as the COVID-19-induced economic downturn.

Figure 7 offers a simple illustration of a waiver of principal. The same structure would apply to a reduction of interest or deferrals.

A third type of restructuring agreement includes creating new kinds of debt instruments (bonds) that can be swapped for an existing debt at a discount and then traded in secondary bond markets.

This refinancing approach has been demonstrated through the Brady bonds applied in earlier financial crises, particularly in Latin America.

Figure 8 shows a Brady bond approach that could be replicated under a debt-for-nature agreement. An existing commercial loan could be substituted with newly issued green bonds under more favourable conditions than the original debt.

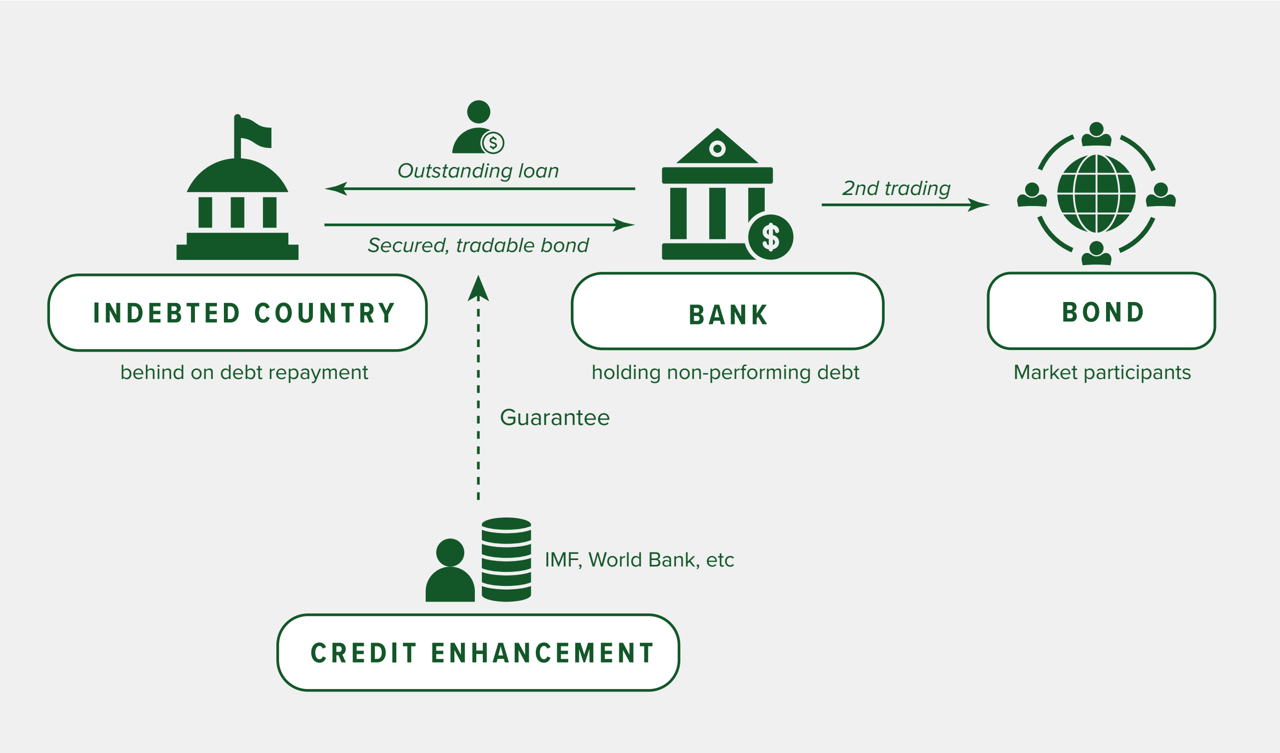
Both previous examples entail a two-party debt restructure, meaning an agreement between the creditor and the debtor government.

Another type of debt swap has been used more recently in Belize and the Seychelles. These agreements involved the participation of a third party—an environmental non-governmental organization (NGO)—in the transaction structure. They created a trust fund for delivering funding. This kind of swap agreement focuses on the purchase of sovereign bonds on the secondary market via an agreement to convert the debt for new sovereign bonds at a more favourable rate. The proceeds or savings are then channelled through a newly established environmental trust fund, managed by the NGO, to local conservation projects (Figure 9).

Although this kind of swap could conceivably work for Lao PDR, the limited depth of trading of its bonds on secondary markets and the requirement for NGO inclusion would make it a less feasible option.

FIGURE 8: A ‘Brady-like’ bond transaction structure

Source: Ying Qian. 2021. Brady Bonds and the Potential for Debt Restructuring in the Post-Pandemic Era. Global Development Policy Center GCI Working Paper 18.



The choice of a debt reduction mechanism depends on several factors, including the chosen creditor(s). A waiver or deferrals are more likely for concessional financing. This is perhaps the simplest route for Lao PDR.

Alternatively, refinancing commercial debt to more favourable terms with a new debt instrument (a green debt conversion bond) could offer improved environmental, social and governance (ESG) value to creditors and increase access to the liquidity of secondary trading markets.

Involvement of third parties such as international NGOs would be possible but potentially more complex and difficult.

Recommendations

The Lao debt-for-nature proposal should apply the mechanism of: Waiver of principal/deferral of principle/interest payments (for concessional loans) or Refinancing to more favourable terms by conversion of commercial loans with new debt instruments (green debt conversion bonds).

3.2 USE OF PROCEEDS

A debt-for-nature agreement aims to reduce the debt burden of a country while contributing to a domestic environmental outcome. The proceeds or fiscal savings from a debt-for-nature swap (or at least an agreed percentage of the savings) need to be spent on a domestic alternative determined by the creditor and the government. This use of proceeds would be established in advance and then monitored and verified for an agreed number of years.

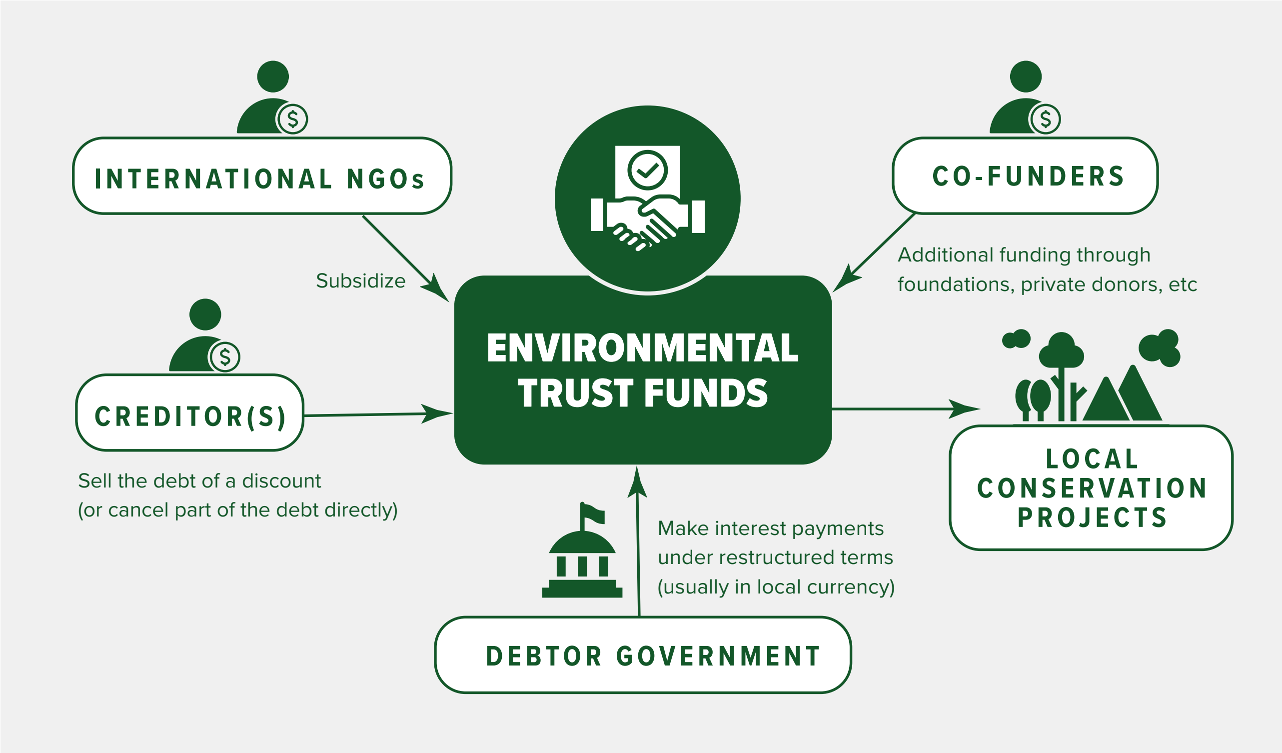
The Government of Lao PDR can determine such a target in line with its own policy objectives. It effectively sets its own priorities or conditions for the restructure of debt, rather than simply complying with conditions imposed by creditors.

The Government can propose existing activities or targets that it lacks sufficient financing to achieve. These could include targets under the 9th NSEDP, the National Green Growth Strategy, the Nationally Determined Contribution or the National Biodiversity Strategy and Action Plan.

Ideally, creditors will value and find attractive the targeted use of proceeds from a debt-for-nature

FIGURE 9: Illustration of a debt-for-nature agreement involving third parties (NGOs)

Source: Yue, M., and C. Nedopil Wang. 2021, Debt-For-Nature Swaps: A Triple-Win Solution for Debt Sustainability and Biodiversity Finance in the Belt and Road Initiative (BRI)? Beijing: Green BRI Center, International Institute of Green Finance.



swap. Allocation examples include regionally and globally significant biodiversity assets, such as national protected areas, and sectors with the highest potential for sustainable economic output, such as nature-based tourism.

This report does not explore a potential debt-for-climate agreement, although there are many parallels. Additional carbon mitigation and climate adaptation benefits could certainly be described and packaged as part of a transaction. Similarly, other targets under the SDGs could be included in a broader debt restructure, although this diversification of objectives is more likely to be associated with a more comprehensive debt relief package.

A roadmap for national protected areas management and financing

The Government of Lao PDR recently conducted lengthy consultations with development partners and environmental NGOs to revise the Decree on Protected Areas and replace Decree 134 of 2015. Once the new decree is approved, management of the national protected areas will enter a challenging adaptation phase. Various plans, institutions, procedures and financing will undergo changes.

In parallel, and in anticipation of the new decree, the Wildlife Conservation Society is developing a "Roadmap for National Protected Area Management and Sustainable Financing in Lao PDR." This will review the current state of financing and benefit-sharing mechanisms, and identify methodical, timed and costed steps to implement the new decree.

The roadmap could support the Government in defining targets for a debt-for-nature agreement by providing **an investible portfolio of costed projects and reforms**. It could also lay out a specific role for the Department of Forestry in facilitating successful debt-for-nature 'implementation', such as by setting the target timeframe for developing all national protected area management plans and for establishing institutional arrangements for monitoring and verification.

The Wildlife Conservation Society is coordinating its work with government and non-governmental stakeholders towards operationalizing the new protected areas decree and legislation by mid-2023.

Recommendations

To attract creditors, the proceeds of a debt-for-

FIGURE 10: National protected areas of Lao PDR

nature agreement should be allocated to the 'jewels' of the country's assets. The agreement should be described as an investment in natural capital of regional and global significance, towards maintaining their value into the future. In Lao PDR, the national protected areas fit this criterion well. Establishing a sustainable financing base for managing them is a worthy objective.

The forthcoming "Roadmap for National Protected Area Management and Sustainable Financing in Lao PDR" is expected to provide specific actions and costings for effective management under the new protected area decree. Implementation may offer precise, actionable targets for the Government to implement as part of a debt-for-nature agreement. The Department of Forestry should work closely with the Wildlife Conservation Society in designing and costing the roadmap.

3.3 MECHANISMS FOR DELIVERING FUNDING

Environmental Protection Fund

The Environmental Protection Fund, established in 2005, is a financially autonomous organization to strengthen environmental protection, sustainable natural resources management, biodiversity conservation and community development in Lao PDR. Following an initial endowment capitalization of $5 million under the Asian Development Bank's Environment and Social Programme, it received additional resources from the World Bank and other multilateral donors as well as fees collected through concession agreements between private infrastructure developers and the Government.

The fund has established a strong organizational structure with about 40 staff and an annual operating cost of around $750,000. It is governed by a board with expansive sector representation of 12 vice-ministers chaired by the Minister of Natural Resources and Environment. A comprehensive set of governing documents approved by the board include a decree, bylaws, a five-year strategy, a business plan and operations manuals.

The World Bank and GIZ have been the major international organizations channelling resources for environmental protection through the fund. The largest amount has gone to biodiversity and forest conservation. From 2016 to 2020, the fund's biodiversity financing window disbursed $13.5 million to 36 recipients, supporting protected area management, forest inspection, improved policies and regulations, and higher-education and research capacity-building.

The Environmental Protection Fund is endeavouring to diversify its sources of funds. The Green Climate Fund has identified it as a potential direct access entity and is supporting readiness activities.

Under a debt-for-nature swap agreement, resources could be reallocated annually or as a lump sum in advance to the Environment Protection Fund, with disbursements then provided to national protected areas on an agreed schedule under the biodiversity financing window or a similar arrangement.

Forest Protection Fund

The Forest Protection Fund (formerly the Forest Resources Development Fund) was established in 1996 as a mechanism to reinvest revenue from timber and associated forestry products in the forest estate, including protected areas. Recently, resources for protected areas channelled through the fund have declined significantly because it depends on income generated by the Department of Forestry, which has historically been dominated by logging fees and revenues from plantations and forest products.

The 2019 Revised Forestry Law identifies the Forest Protection Fund as the source of funding for protected areas and other investments in the forest estate, with revenue contributions from the private sector, international partners and payments for forest ecosystem services, among other sources. It collects and mobilizes funds from forestry activities and the use of forest resources and obtains contributions from domestic and foreign sources.

The Forest Protection Fund is also expected to manage carbon revenue from both domestic and international sources and will disburse results-based payments to a variety of beneficiaries. The Government is currently strengthening the fund's capacity in multiple areas, including governance, financial management, reporting, safeguards, monitoring and evaluation, and functional IT systems.

Resources saved through a debt-for-nature swap could be reallocated annually or provided as a lump sum in advance to the Forest Protection Fund, with disbursements provided to national protected areas on an agreed schedule.

Conservation Trust Fund and private conservation concession agreements

Capital raised through debt-for-nature swaps can be applied through separate trust funds or foundations specifically set up to channel funding to biodiversity conservation. While both the Environmental Protection Fund and Forest Protection Fund have the capacity and remit to transmit funding to protected areas or other conservation efforts, there is not an institutionalized requirement to allocate specific amounts. This could be part of a debt swap agreement with creditors. Alternatively, a separate conservation trust fund could be established and capitalized with the proceeds of the debt restructure.

A separate conservation trust fund could allocate sustainable financing to support the management of an area within or adjacent to a national protected area under a private conservation concession agreement. This would likely require the involvement of an international NGO such as The Nature Conservancy, in partnership with a locally based conservation organization able to manage and implement a concession.

Recommendations

The Lao PDR debt-for-nature proposal should include a mechanism for delivering funding that can be effectively monitored and verified according to creditors' requirements. This could be through the Government of Lao PDR's standard budgetary processes.

If a separate funding mechanism is required, or an allocation of upfront seed capital, using the Environment Protection Fund is recommended as it has the required organizational capacity and track record.

3.4 SCALE

The scale of a debt-for-nature swap agreement is difficult to determine in advance. Ultimately, it will be the subject of negotiations between the Government and the creditor(s) involved. The scale will depend on whether the agreement is a standalone one or part of a broader debt restructure. The scale of proceeds made available depends on whether the mechanism entails a simple relief or waiver of principal, a reduction of interest, some combination of both, or conversion with a new green debt instrument. Ideally, a debt-for-nature swap would have a substantial impact on the capacity to finance domestic environmental objectives and contribute to improving the sustainability of the overall debt position.

One example involves the ongoing financing requirements for effective management of the national protected areas. They cover around 18 percent of the country's total land area (4.2 million hectares) across diverse landscapes. The costs of managing them vary greatly depending on conservation objectives, the size and terrain of the area, and the potential impacts of immediate threats. Not all areas have established or up-to-date management plans and budgets. Some of these are being prepared or updated. The Master Plan for National Protected Areas of Lao PDR 2020–2025 provided preliminary estimates for a programme of activities over five years totalling $48 million.

As an alternative approach, an estimation of park management costs within Lao PDR can be obtained through comparison with equivalent national parks in the region. This indicates that a benchmark of $5.50 per hectare can be considered a reasonable average. Using this benchmark, we can estimate an annual management cost for all areas at around $23 million. This is of course much higher than the current budget allocation for the national protected areas and greatly exceeds available revenues under the Forest Protection Fund.

While some financing requirements for the national protected areas in coming years may be met with increased support from international sources (donors, grants, loans, carbon credits, etc.) and user fees and technical revenues (concession licences, watershed protection fees, royalties, etc.), we can easily envisage a shortfall of $10 million per year. Preliminary modelling conducted by the Wildlife Conservation Society estimated the financing gap to be between $11 million and $15 million per year.

If we look at some potential debt-for-nature proceeds, a debt waiver of $50 million could be expected to fund the shortfall in national protected area management costs for around five years. As noted already, this could be allocated in different ways, including as a seed capital endowment in the Forest Protection Fund accumulating interest or as an annual budget allocation from the Ministry of Finance.

Examples of potential scale:

▸ Example 1 (low):
Reduction in principal and interest payments totalling $62.5 million over five years, the equivalent of $12.5 million per annum.

This equates to approximately 0.6 percent of the current debt stock and 0.9 percent of projected debt servicing obligations over the next five years.

If we assume that 50 percent of the proceeds could be made available to finance environmental objectives, the debt-for-nature agreement could provide sufficient funding to supplement the management costs of half of the national protected areas for up to five years.

- Funding of $6.25 million per year (supplementary financing for selected national protected areas).

▸ Example 2 (moderate):
Reduction of principal and interest payments totalling $175 million over five years, the equivalent of $35 million per annum
This equates to approximately 1.7 percent of the current debt stock and 2.7 percent of projected debt servicing obligations over the next 5 years.

If we assume that 50 percent of the proceeds are made available to finance environmental objectives, this agreement could provide funding for all national protected areas for up to five years, with additional co-investment options:

- Funding of $12 million per year (supplementary financing across the entire network of national protected areas.)
- Funding of $2 million per year across the network of provincial and district-level conservation and protection forests (an additional 1.5 million hectares).

- Funding of $2 million per year for ecosystem service payments to support village communities in and around protected areas.
- Funding of $2 million per year in a facility to catalyse private sector investment and support compatible industry development such as ecotourism and sustainable forestry.

▶ Example 3 (one part of broader debt restructure):

To achieve a more substantial impact on the country's debt service obligations, the Government may prefer to include an environmental financing component as just one element of a much broader debt restructure that also targets other sectoral priorities, such as health, education, the targets of the NSEDP and the SDGs. While the upper boundary of this financing is not possible to determine, it is assumed that this would be less likely to occur outside multilateral debt relief and budget support channels.

Recommendations

The Lao PDR debt-for-nature proposal should be ambitious enough to have an impact on a scale that delivers net proceeds of between $10 million to $20 million per year. This could provide a tangible reduction in the debt burden and sufficient fiscal capacity to achieve significant environmental outcomes.

3.5 TARGET CREDITORS

Choosing the target creditor or creditors for a debt-for-nature swap requires considering:

- Who holds a significant portion of Lao PDR's debt (enough to make a debt-for-nature deal worth the effort)?
- Who has provided commercial lending? Who has offered concessional loans?
- Which creditors may have an interest (or track record) in debt-for-nature options?

Multilateral potential: According to the Public Debt Bulletin published by the Ministry of Finance, in 2021, Lao public debt stock from multilateral creditors was $1.743 billion in concessional loans and $52 million in loans on market terms. Debt on concessional terms, the majority of the total, is dominated by loans from the Asian Development Bank ($902 million) and the World Bank's International Development Association ($721 million).

In relation to debt relief, the World Bank usually operates in partnership with the IMF and other multilateral partners. Previous debt relief programmes have included the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative. In response to the COVID-19 pandemic, the World Bank and the IMF worked with G20 countries to establish the Debt Service Suspension Initiative to provide temporary suspension of debt repayments for eligible countries.

In April 2021, the G20 developed the Common Framework for Debt Treatment beyond the Debt Service Suspension Initiative to facilitate negotiations over debt restructuring into 2022 and beyond. The Common Framework is an agreement by the G20 and Paris Club countries to coordinate and cooperate on debt treatments for low-income countries eligible for the Debt Service Suspension Initiative. Debt treatments under the Common Framework are initiated at the request of a debtor country on a case-by-case basis. The framework includes Paris Club members as well as G20 official bilateral creditors such as China, India, Saudi Arabia and Turkey that are not members of the Paris Club.

To benefit from the Debt Service Suspension Initiative or Common Framework, a country must have an IMF-supported programme, such as an Extended Credit Facility. If it does not already have such a programme, it would need to request one in conjunction with a request for a debt treatment.

Although Lao PDR was ranked in the top five countries globally in terms of potential savings under the Debt Service Suspension Initiative, as a percentage of GDP, it did not participate in the initiative and by November 2022 had not sought assistance under the Common Framework.

In 2021, some efforts globally sought to establish a multilateral mechanism to link climate change and biodiversity outcomes with debt relief. In April 2021, the Managing Director of the IMF, Kristalina Georgieva, noted that green debt swaps could spur accelerated action on climate change in developing countries and pledged to work with the World Bank to "advance that option" in time for the Glasgow climate conference. A Task Force on Climate, Development and the International Monetary Fund led efforts to develop a multilateral framework but these were not finalized by the climate talks.

In August 2021, the IMF allocated $650 billion in Special Drawing Rights (SDRs), its international reserve asset, to support liquidity and foster global economic resilience in the wake of COVID-19. Due to the IMF's quota system, however, the SDRs flow mainly to high- and some middle-income countries that don't face the same liquidity challenges of other countries. In response to this issue, Group of 7 leaders pledged to rechannel upwards of $100 billion of their allocations to countries most in need. The G20 backed a plan by the IMF and World Bank to develop and implement a Resilience and Sustainability Trust that would allow wealthy countries to channel SDR allotments to low- and middle-income countries. Most recently, members of the Task Force on Climate, Development and the International Monetary Fund have proposed using the trust to support a credit enhancement facility for issuing concessional debt.

As an active member of the task force, the International Institute for Environment and Development has supported efforts in various countries to develop nature- and climate-related debt swaps in the context of economic recovery from COVID-19. Its 2020 report, *Tackling the Triple Crisis. Using Debt Swaps to Address Debt, Climate and Nature Loss Post-COVID-19*, was one of the first to highlight the potential to address simultaneously the crises of debt, climate and biodiversity destruction through a system of debt-for-climate and debt-for-nature swaps. The institute recently published a guide for governments seeking to develop debt instruments for climate and nature.[25]

In 2022, an IMF paper explored the potential for climate-related debt relief within the IMF system.[26] The paper determined that debt-for-climate swaps can be appropriate in some circumstances and even offer an efficiency advantage over separately providing debt relief and subsidizing climate action, depending on the individual country situation.

The paper noted several items relevant to Lao PDR. First, policies that support debt swaps involve many of the same monitoring and verification structures that also support climate-conditional lending instruments. The link to climate action is likely to incentivize both bilateral official and commercial creditors to provide debt relief. Second, debt swaps might be preferable to a comprehensive debt restructuring if the latter involves reputational costs or economic dislocations that debt swaps can avoid.

Finally, there is a pragmatic case for debt-climate swaps when concessional financing, alternative debt relief or some combination of both are not available in sufficient amounts. If debt-for-climate or debt-for-nature swaps can expand fiscal support for needed actions, they are worth pursuing.

Options for multilateral debt relief in exchange for nature or climate commitments are likely to remain limited, however, unless Lao PDR requests support from the IMF. In 2022, Lao PDR did not approve the publication of IMF staff findings from its most recent Article IV consultations. This objection and the ongoing lack of engagement with IMF and G20 debt relief initiatives has been interpreted as the Government preferring to negotiate privately with its bilateral creditors to manage debt liabilities and obligations. The reluctance to engage may also stem from the contractual terms of loans from Chinese creditors. Debt relief negotiations with Paris Club lenders may trigger cross-default clauses in such contracts.

Bilateral potential

According to the Ministry of Finance Public Debt Bulletin, the stock of Lao PDR debt owed to Chinese creditors in 2021 was $3.5 billion in concessional loans and $1.586 billion in loans on market terms. This was equal to 47 percent of total public debt stock. Involving Chinese creditors in a restructure would have the most substantial impact overall on Lao PDR's debt-servicing obligations. Lao PDR is one of the original six corridors under the BRI, with links to Kunming through major transport corridors.

In 2021, China's Ministry of Commerce and Ministry of Ecology and Environment jointly issued the *Green Development Guidelines for Overseas Investment and Cooperation*. These encourage Chinese businesses to integrate green development throughout the overseas investment process. They send a clear signal to state-owned enterprises, where the Ministry of Ecology and Environment's policies have regulatory oversight, that the environmental credentials of the BRI are important to the State leadership. These enterprises include key BRI actors such as the China Development Bank, China Export-Import Bank and Sinosure, China's export credit insurance agency.

At the Convention on Biological Diversity summit in October 2021, Chinese President Xi Jinping promoted China's concept of an 'ecological civilization', which envisions the mainstreaming of biodiversity across decision-making and increasing financial, technological and capacity-building support to developing countries. The Kunming Biodiversity Fund was established with an initial commitment of 1.5 billion yuan ($233 million) to protect fauna and flora in developing countries.

China has already demonstrated a willingness to engage in debt negotiations with Lao PDR, including recent deferrals. A number of co-benefits would encourage Chinese creditors to participate in a specifically nature-focused restructure. These include:

- Demonstrating the 'green BRI' vision by mitigating the environmental impacts of unsustainable debt.
- Environmental co-benefits from transboundary natural resource management, building on work to protect biodiversity corridors that extend across the Yunnan-Phongsali-Oudomxai-Louang Namtha region.
- Supporting the stability of Lao PDR's economy as a neighbour and trading partner for China, avoiding default impacts on Chinese creditors and safeguarding BRI investments.
- Opportunities for future investment in related industries such as nature-based tourism, as an emerging destination for Chinese tourists following the pandemic, and with the completion of the Lao-China railway.

Although the most tangible opportunity for bilateral restructuring appears to be with Chinese creditors, a circumstance of both location and timing, there is no need to limit options to just one creditor or type of creditors. Other bilateral creditors, such as Japan, the Republic of Korea and Thailand, could also be considered. Multilateral institutions could be involved as outlined above. Given the historical connections and recent issuance of debt in the Thai market, Thailand could also be a suitable target. The record of other bilateral creditors with respect to debt relief has not been assessed here but would be worth considering. G20 countries, however, such as Austria, Japan and the Republic of Korea, may prefer debt negotiations through existing avenues such as the Debt Service Suspension Initiative and Common Framework.

Recommendations

The Lao debt-for-nature proposal should target a bilateral debt restructure with either Chinese or Thai creditors, or both but separately.

3.6 TARGET DEBT (PROJECTS/LOANS)

Target debt is a complex issue because Lao PDR's debt profile is not a single aggregate number. The total stock of sovereign debt comprises individual loan agreements usually relating to specific projects or subproject components. A debt restructure would require amending the terms, subject to agreement by both creditor and debtor parties. Defining a precise target or specific project loan depends on the Government's choice.

Some details of individual project agreements are quite well understood; others are less clear. For example, the China-Laos Railway project (Figure 11) combines debt and equity components, some of which have been financed by concessional loans and some through commercial borrowing.

Many detailed terms of individual loans are not publicly available, although some recent examples can offer insights into the likely contractual conditions. In September 2021, the United States-based institute AidData released a data set on international development finance from China, including agreements between Chinese financiers and foreign entities, particularly sovereign entities, from 2000 to 2017. It includes funding agencies and recipients, principal amounts, loan terms and interest grace periods and maturity, among other details. A subset of the data included 240 examples of financing in Lao PDR; this was reviewed through earlier work.

Recommendations

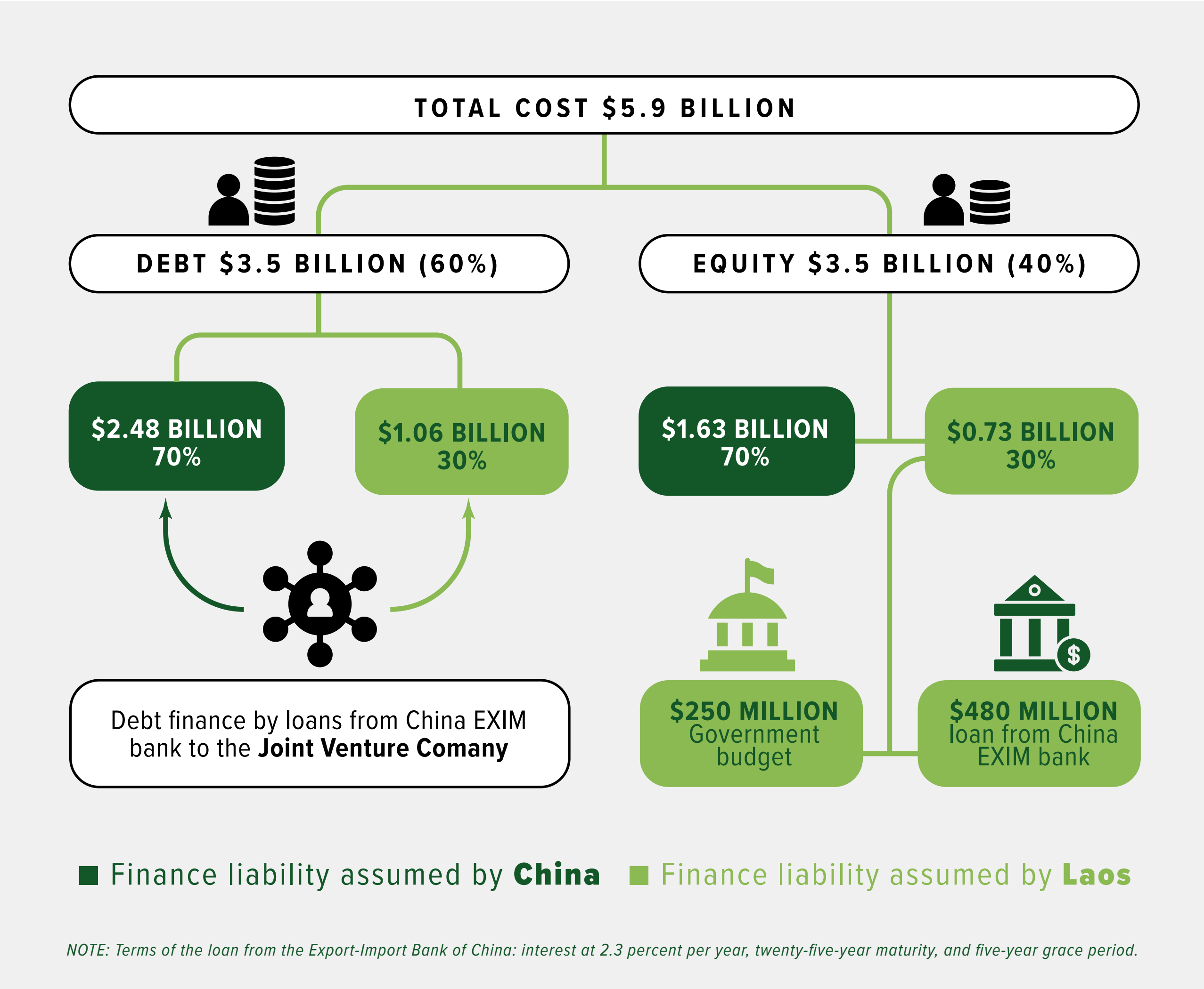
The target debt should be a sufficient combination of scale (size) and expense (servicing rate) to justify the complexity of a debt swap negotiation and agreement.

A simple waiver or deferral is more likely to be successful for concessional financing.

For commercial debt, refinancing with a new debt instrument (green bond) is a more attractive option. It could offer improved ESG value and access to the liquidity of secondary markets for creditors.

FIGURE 11: China-Laos Railway project financing structure

Source: World Bank. 2020. From Landlocked to Land-Linked: Unlocking the Potential of Lao-China Rail Connectivity.



3.7 PARTNERS AND THIRD PARTIES

A debt-for-nature agreement can involve several potential partners, in addition to the creditor and debtor.

- Development partner agencies, multilateral organizations and bilateral governments can provide advice on the financial structure of a transaction, and the elements of a contractual amendment.
- Environmental NGOs can provide useful insights and data on critical gaps in funding for biodiversity, conduct monitoring and verification of results and offer third-party assurances on the achievement of targets.
- Credit rating agencies are important to include in consultations to provide insights on the potential (positive) effects of a debt-for-nature restructure, particularly if it results in improved overall debt sustainability, reduced risks and high ESG credentials for the creditor or debtor party.
- A country such as Lao PDR with a low credit rating will need to seek the support of a development finance insurer or guarantor if the debt-for-nature structure includes the issuance of new debt instruments.

Recommendations

The Government of Lao PDR should engage with different partners that can provide technical and financial support as it develops, negotiates and implements a debt-for-nature swap.

Multilateral development banks and bilateral partners can offer technical advice on the design. Local NGOs such as the Wildlife Conservation

Society could contribute to other aspects such as the costing and prioritization of projects, implementation of management plans for national protected areas, monitoring and reporting.

Summary of recommendations

The table below provides a summary of the recommendations described in preceding sections and provided to the Technical Working Group. (table 1)

3.8 SCENARIO PROPOSALS

Given the range of design parameters that are both unknown and would be subject to choices by the Government of Lao PDR and its creditors, it is not possible to finalize a single recommended design for a debt-for-nature swap. The Technical Working Group is tasked with providing guidance on the design for the Government to consider but has limited ability to offer this advice.[28]

The following sections outline some potential scenarios, with assumptions about the most feasible or favourable options for Lao PDR. The scenarios considered are: (1) engagement with a multilateral debt relief initiative, (2) pursuing a bilateral waiver of principal or interest reduction with China, and (3) issuing new debt instruments for the conversion of existing debt obligations.

Scenario proposal 1: multilateral debt relief package

While the Government has so far chosen not to participate in multilateral initiatives such as the

Table 1: Summary of the recommendations

ISSUE	RECOMMENDATION(S)
MECHANISMS FOR RESTRUCTURE	• Waiver and/or deferral (concessional debt). • Refinancing with new debt instrument (market).
USE OF PROCEEDS	• High-value biodiversity assets, e.g., national protected areas. • Investment in nature-based tourism.
MECHANISMS FOR FUNDING	• Environment Protection Fund. • Forest Protection Fund.
SCALE	• \$10 – \$20 million per year, at least five years. • Around a 3 percent interest rate difference on a \$500 million loan.
TARGET CREDITORS	• China (commercial and concessional). • Thailand (commercial loans and bonds).
TARGET DEBT/LOAN/PROJECTS	• China-Laos Railway project. • Others...
PARTNERS AND THIRD PARTIES	• Technical support from development partners. • Not to be involved in transaction structure.

Debt Service Suspension Initiative and Common Framework, avenues for multilateral support remain open. As outlined above, these multilateral debt relief initiatives exist alongside an emerging interest in climate-related and nature-related debt relief within multilateral institutions. Programmes require participation in an IMF-led package of reforms, however. If a country does not already have an IMF-supported programme, it would need to request one.

To date, the Government has held only informal discussions on the potential for a debt-for-nature swap with the country offices of the World Bank and Asian Development Bank. Although options for multilateral financiers' participation are somewhat limited by the Government's reluctance to pursue IMF support, it is worth reiterating that, beyond arranging the restructuring of existing multilateral debt, multilateral institutions have multiple avenues to participate in bilateral debt-for-nature initiatives. These include:

- Data and technical expertise could support economic and financial analysis of sovereign debt, prioritization of green project expenditures for greater efficiency, and enhanced monitoring and verification protocols.
- Capital contributions, such as seed endowments to national environmental trust funds, could catalyse co-financing contributions and potentially be repaid over time.
- Credit enhancement and risk guarantee support could be particularly effective in reducing barriers to bilateral relief and incentivizing contributions from the private sector.

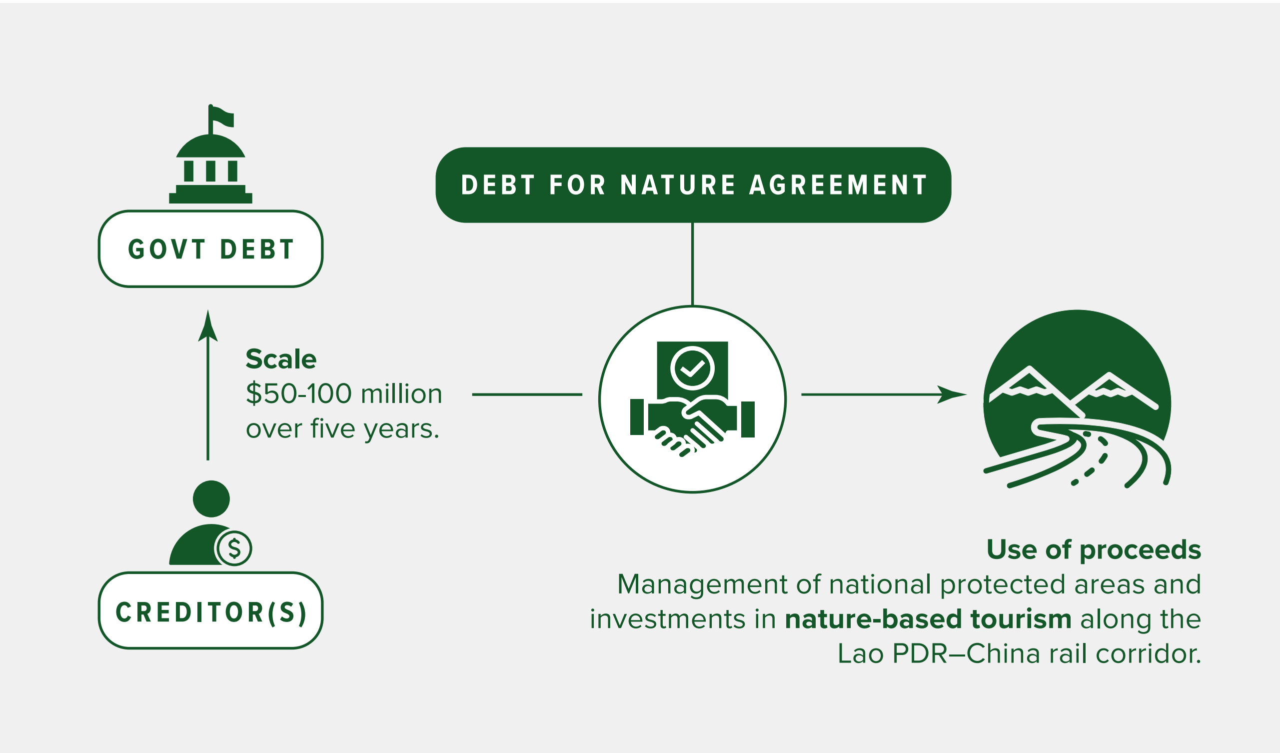
Scenario proposal 2: bilateral deferral or waiver

The second scenario proposal is a deferral or waiver of *concessional* loan repayments from bilateral creditors, most likely China.

Initial analysis has identified China as the most likely (but not the only) potential partner for a bilateral debt-for-nature restructure.[29] China clearly holds the most substantial bilateral portion of Lao PDR's debt, including both concessional and commercial lenders. Involving Chinese creditors could therefore yield the highest impact.

A deferral of some debt obligations to China took place in 2021. In 2020, a currency swap deal resulted in the division of EDL into separate entities. Existing negotiations and co-benefits

FIGURE 11: Scenario proposal 2, bilateral deferral or waiver



would encourage Chinese creditors to participate in a debt-for-nature swap.

Scenario proposal 3: green debt conversion bonds

The third scenario proposal involves issuing a new sovereign (or state-owned-entity-issued) green bond for refinancing existing commercial debt on more favourable terms. Under this scenario, Lao PDR could issue a new debt obligation to swap for an existing debt (at a discount) that could then be traded in secondary bond markets. The name suggested is 'green debt conversion bonds' or simply 'green panda bonds'.

The bonds would be issued on the Chinese interbank bond market by the Bank of Lao PDR (or a state-owned entity such as EDL) in a private placement with an existing Chinese creditor. This would follow the recent model of green panda bonds issued by Hungary[30] but with a debt-for-nature swap agreement attached. The debt-for-nature agreement between Lao PDR and the creditor would specify the scale of existing debt obligations that would be replaced with new debt instruments, the target use of proceeds, and any other conditions such as monitoring and verification of the funding within Lao PDR in coming years.

The bonds would be designated as green panda bonds, where proceeds are earmarked for green assets or projects, in accordance with China's 2021 green taxonomy and related guidance documents. The bonds would be designed to be eligible under the regulatory framework for the Chinese green bond market and issued under the regulations of China's National Association of Financial Market Institutional Investors.[31]

To achieve an acceptable credit rating for a new debt issuance, such as the green panda bonds, Lao PDR would likely need some form of credit enhancement or underwriting guarantee provided by an export finance institution. This could be the World Bank's Multilateral Investment Guarantee Agency, the Asian Development Bank's Credit Guarantee and Investment Facility, the Japan International Cooperation Agency/Japan Bank for International Cooperation, Sinosure or a syndicated group of these. Underwriting by Paris Club lenders may enhance the attractiveness of a debt-for-nature agreement for Chinese creditors, as it would spread the financial costs, reduce the sovereign default risk and improve ESG credentials, and generate a tradable instrument for the Chinese secondary bond market.

This scenario follows the 'Brady bond' model discussed earlier (Figure 8), which could be replicated under a debt-for-nature agreement. An existing commercial loan would be substituted with newly issued green bonds under more favourable conditions than the original debt.

Scale: The proceeds of this scenario would depend on the size and interest rate [c] of the original loan. To yield net proceeds (interest savings) of approximately $10 million per year, a green panda bond issuance could be, for example:
$500 million (at c–2 percent interest rate)
$250 million (at c–4 percent interest rate)

Use of proceeds: conversion of existing debt to a new debt instrument would yield savings to invest in high-value biodiversity conservation and ecosystem regeneration.

4.0 FEASIBILITY AND NEXT STEPS FOR A DEBT-FOR-NATURE PROPOSAL

4.0 FEASIBILITY AND NEXT STEPS FOR A DEBT-FOR-NATURE PROPOSAL

Debt-for-nature is an innovative tool. While its potential is widely acknowledged, and some preparatory steps have been taken in Lao PDR, developing this opportunity is far from complete.

Some debt-for-nature models demonstrated in other countries may be less feasible in Lao PDR, for various reasons. These include the Government's level of engagement with the IMF, appetite for involvement of third parties such as international NGOs, the liquidity of Lao PDR's sovereign bonds on secondary trading markets, the conditionality that may be applied to debt restructuring by certain creditors and the contractual terms of individual loan agreements. Nevertheless, the debt-for-nature potential remains a feasible and attractive option as Lao PDR navigates the economic challenges of the pandemic.

The Government of Lao PDR should continue to pursue opportunities for debt restructuring that can unlock fiscal capacity for financing biodiversity and climate outcomes, towards protecting and maximizing the economic value of the country's natural assets.

Any future decisions on whether and how to pursue a debt-for-nature swap will be taken by the most senior members of the Government of Lao PDR, in negotiation with its creditors. This report supports understanding of how to pursue this opportunity by compiling the most useful and accurate information for the Government to consider.

Many details integral to designing a debt restructure are not yet available. The examples and guidance materials published by various parties can provide background and insights but the specific details of a proposal will need to be determined by the Government. This underlines the critical role of the Technical Working Group.

It is therefore timely to consider the contributions of the group and how it may best operate moving forward. Work to date was initiated through consultations with the Department of Forestry of the Ministry of Agriculture and Forestry as it was responsible for implementing the UNDP "SAFE Ecosystems Project" and because it manages the national protected areas. The ministry does not have technical expertise in, or responsibility for, Lao PDR's financial policy and sovereign debt agreements, however. As a result, key decisions and guidance from the Technical Working Group have been delayed. It seems logical to now transfer responsibility for chairing the Technical Working Group to the Ministry of Finance to facilitate better alignment with its existing responsibilities for debt management.

4.1 IMMEDIATE NEXT STEPS —A HIGH-LEVEL DIRECTIVE

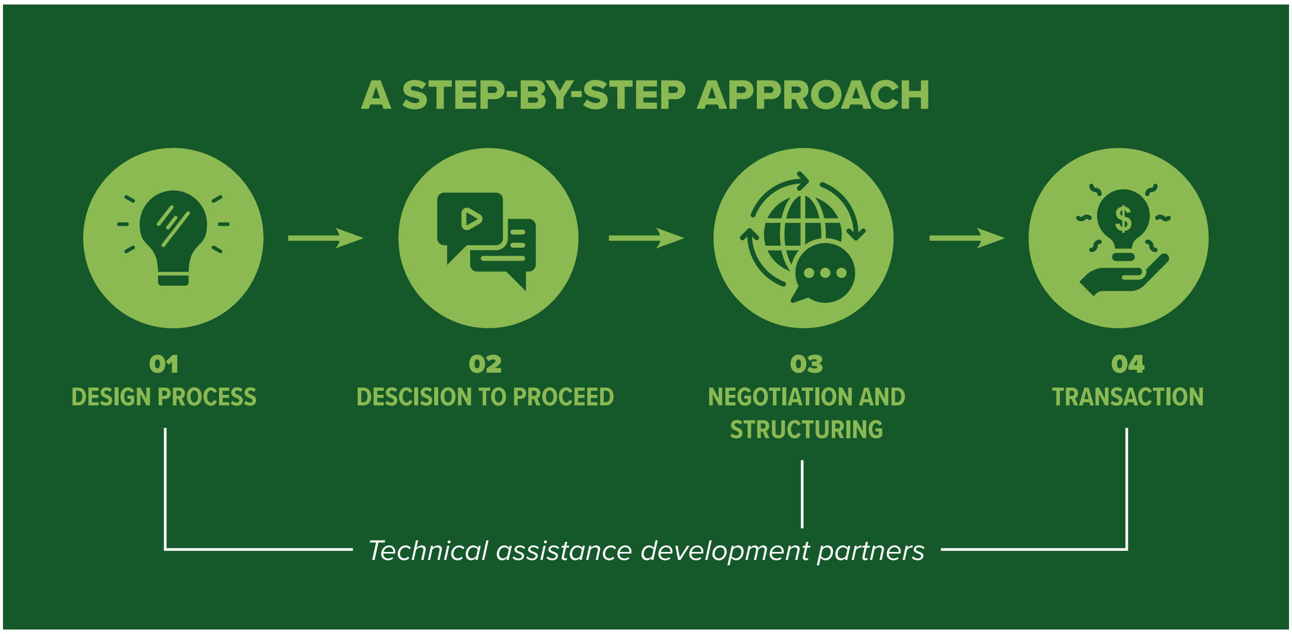
It is recommended that the Prime Minister's Office issue a high-level directive to move the debt-for-nature initiative forward.

The debt-for-nature concept is innovative and previously untested in Lao PDR. Many different stakeholders and ministries are involved. Building a common understanding of the concept and support from key stakeholders has been slow and challenging.

At a practical and immediate level, the Government could issue a directive to its ministries on how it wishes to proceed. This should likely come from the Prime Minister's Office to the relevant ministries in the Technical Working Group.

The directive could provide the following clarity:

- Notification that the Government of Lao PDR is exploring the debt-for-nature potential and



that no formal decisions have been made to proceed.

- Establish that the Ministry of Finance (Department of External Finance and Debt Management) will chair the Technical Working Group, or co-chair it with the Ministry Agriculture and Forestry, to facilitate better alignment with existing responsibilities for debt management and debt negotiations.
- Establish that the Ministry of Finance (Department of External Finance and Debt Management) will chair the Technical Working Group or co-chair it with the Ministry Agriculture and Forestry to facilitate better alignment with existing responsibilities for debt management and debt negotiations.
- Issue an instruction to the Technical Working Group to bring a detailed debt-for-nature proposal to the Government for consideration by February or March 2023. The proposal could include design options currently being developed, a strategy for embedding the debt-for-nature component in other ongoing negotiations, the implications for ongoing efforts to reform state-owned enterprises, and ministerial responsibilities for negotiating and implementing the debt-for-nature transaction.

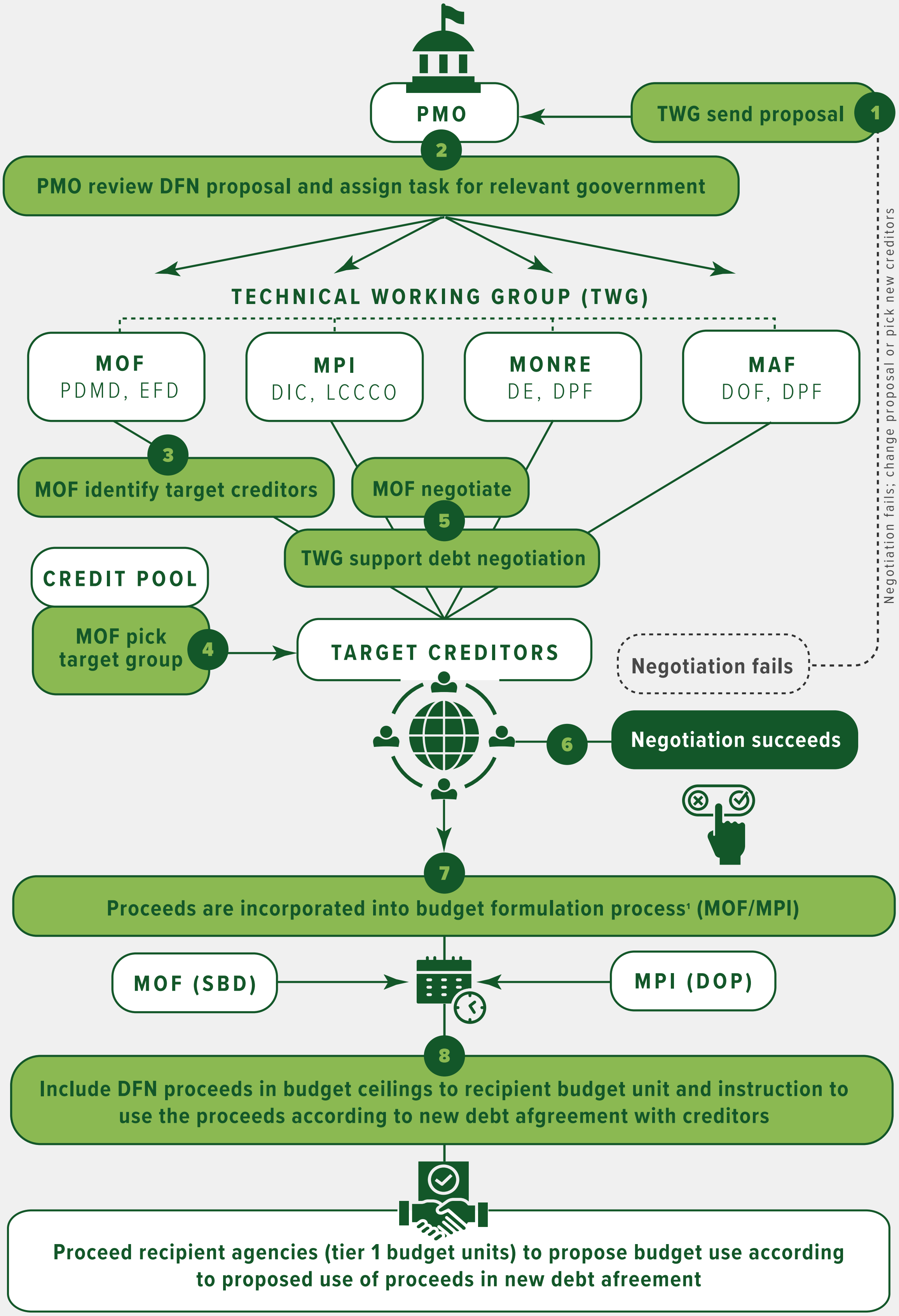
The Government of Lao PDR can determine whether to make this a public directive, whether to appoint additional members or observers to the Technical Working Group, and whether to seek further support from development partners such as UNDP.

Specific actionable steps for each ministry's contribution to the Technical Working Group should include:

- The Ministry of Finance to determine suitable target creditors, specific loans, scale, funding allocation rules and mechanisms, and relevant contractual issues such as collateral and confidentiality.
- The Ministry of Planning and Investment to provide oversight and guidance on steps for bringing the proposal to the Cabinet and/ or the National Assembly, and for ensuring alignment with existing NSEDP objectives and other relevant planning frameworks.
- The Ministry of Agriculture and Forestry to provide details of financing needs for the national protected areas, the capacity of existing mechanisms such as the Forest Protection Fund to manage funding flows, and monitoring and reporting against targets.
- The Ministry of Natural Resources and Environment to provide advice on relevant international obligations and potential targets (Convention on Biological Diversity, Nationally Determined Contribution) and the capacities of the Environmental Protection Fund to manage funding flows.

Figure 12 offers a potential illustration of the responsible parties and decision steps that could be included in a decree. It will be important to clarify when and how the savings of a debt-for-nature agreement would be allocated within

Figure 12. Parties and decision steps in developing a debt-for-nature agreement in Lao PDR



1 Budget allocation process. SBD and DOP will be involved during the information of budget ceiling for annual budget formulation which is approximately **April** of the prior year.

the annual budget preparation cycle, including critical decision points and endorsement of key institutions such as the Ministry of Finance and the National Assembly. This is understood to be around April, based on the annual budget cycle outlined in Appendix 4.

4.2 A STEP-BY-STEP APPROACH

The following section broadly outlines the steps for developing and implementing a debt-for-nature agreement in Lao PDR. These steps may not necessarily be sequential; a more iterative approach may be followed.

Step 1: Design process

- **Prioritization**: The Government of Lao PDR identifies the sectoral and specific targets (such as national protected areas and biodiversity conservation projects) that it would propose to the creditor. These would reflect existing national priorities and commitments.
- **Scoping**: The Government identifies specific loans, creditors and a scale to target for a debt-for-nature agreement.
- **Technical support**: The Government can decide whether to seek additional expertise or advice from development partners on feasible design parameters and negotiations.
- **Publicity**: The Government has the option to announce its plans to develop debt-for-nature deals with creditors. This would help it gain visibility and support for its commitments.

Step 2: Negotiation and agreement between creditors and the Government of Lao PDR

- **Negotiation of terms**: The Government discusses and negotiates with chosen creditor(s), including a transaction structure, incentives for creditors, a policy roadmap, and regulatory and financing targets.
- **In-principle agreement**: The agreed terms of the debt-for-nature proposal are delivered to the Cabinet and National Assembly for endorsement.

Step 3: Executing the transaction

- **Legal and regulatory authority**: The Government issues a decision/decree to proceed with a debt-for-nature proposal.
- **Contractual agreement**: The Government finalizes and signs contractual debt-for-nature agreements with creditor(s).
- **Reorganization and issuance**: The Ministry of Finance issues instructions to the Bank of Lao PDR to issue conversion bonds or alternative debt instruments (if applicable).

Step 4: Implementing the agreement

- **Funding**: The Ministry of Finance allocates the agreed proceeds of the debt-for-nature transaction to the agreed target budget items through the annual budget process, or upfront to an agreed environmental trust fund.
- **Delivery**: Funding from the agreed source is provided to agreed projects or administrative units to implement actions that support biodiversity conservation.
- **Verification and reporting**: The Government of Lao PDR provides verification and reporting to the creditor as required under the terms of the debt-for-nature agreement.

The work to date has focused on the design phase of a debt-for-nature process. To get to the first decision stage, some preliminary discussions both within the Government and with external creditors on the viability of this idea would be useful. This could be done quite transparently and without commitment. For example, the Government could flag its interest in exploring new sources of green finance as one of its future priorities.

5.0 A STRATEGIC APPROACH TO DEBT-FOR-NATURE

5.0 STRATEGIC APPROACH TO DEBT-FOR-NATURE

Following the 2008 global financial crisis, the United Nations and the Organisation for Economic Co-operation and Development led the development of green growth and green economy reform proposals, including concepts, narratives and initiatives that continue to the present day. Governments, multilateral institutions and civil society organizations around the world recognize that a sustainable recovery from the COVID-19 crisis must include elements of a 'green recovery'. In South-East Asia, the Asian Development Bank argues that a green recovery is critical to reduce the risk of future pandemics, address climate change, create jobs, increase competitiveness and achieve the SDGs. In Lao PDR, UNDP has noted that current financial challenges provide an important opportunity for advancing reforms.[33]

Alongside health, education and other social investments, green stimulus and green transformation assistance has been a highlight of donor support for developing countries. This includes repayable loans, grants and, increasingly, debt-restructuring agreements. International attention to debt-for-nature/climate options continues to grow; Lao PDR is increasingly recognized as a good candidate for these.

The debt-for-nature opportunity is not a silver-bullet solution to the country's economic challenges. But it could be one component of broader efforts to address financing needs and access capital and investment financing over the next decade.

5.1 MOTIVATIONS FOR LAO PDR

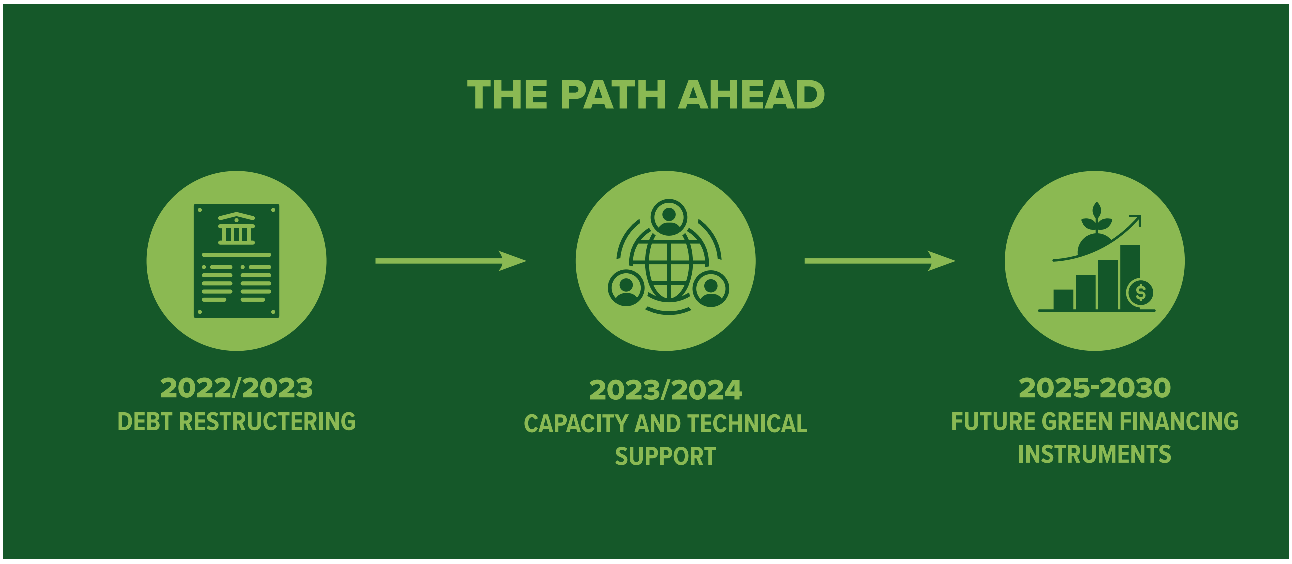
The Government of Lao PDR has actively pursued a greener growth path for some years, working closely with the Global Green Growth Institute and including environmental protection as one of the key outcome targets for its latest NSEDP. While some future financial support for managing natural resources will come through the Green Climate Fund, the focus will be more on agroforestry than biodiversity.

An investment in biodiversity can and should be seen as an economic opportunity for Lao PDR, since protecting natural assets and resources leads to future economic growth and food security. This investment should not be seen as a conditionality of a debt restructure. This distinction between opportunity and conditionality is critically important, for both debtor and creditor(s).

The Government of Lao PDR has many good reasons to invest in better protection of its native forests. Biodiversity is already well recognized as an economic priority for resilient green growth. Nature-based tourism is being promoted as a strategic sector and export opportunity, with increasing connectivity to the Chinese market through new rail and road systems.

Safeguarding existing investments in hydropower assets is another motivating factor, as improving the protection of watersheds to reduce siltation can prolong the economic life of these assets. This is particularly important for tributary reservoirs with native forest catchments (as opposed to the mainstream Mekong dams) as many of these assets are only being transferred to government ownership after 20 or 30 years of leased operation. Another issue is mitigating the costs of environmental degradation, such as from reduced flood risks, air and water pollution, riverine fishery impacts and soil degradation. The World Bank estimates these costs in Lao PDR at over $800 million per annum.[34]

The new protected areas decree is expected to be finalized soon but the financial capacity to implement its reforms is lacking. Importantly, revenue legislated for financing protected areas will include innovative financing mechanisms, such as forest carbon credits and payments for ecosystem services. The proceeds of a debt restructure could be allocated within existing



governance structures, either the Forest Protection Fund or the Environment Protection Fund. This could either be through an annual budgetary allocation or a seed capital endowment to sustain the fund over many years.

Debt restructuring can effectively support fiscal capacity to implement existing and ongoing domestic priorities. A debt-for-nature deal can also advance progress in implementing international agreements on biodiversity and climate action and achieving the SDGs.

From a purely financial perspective, a debt-for-nature swap could help improve overall debt sustainability and more positive assessments by credit rating agencies. This could be aligned with parallel efforts to bolster credibility through increased transparency and a strategic approach to debt management.

Finally, a debt-for-nature deal can demonstrate the Government's policy intent to develop this sector of its economy, to build internal institutional capacity, to gain access to different sources of green finance and to consolidate investments in green growth.

5.2 MOTIVATIONS FOR CREDITORS

The debt-for-nature opportunity can and should be described as an offer of something valuable from Lao PDR to its creditors. This includes the opportunity to support global biodiversity and climate mitigation, and to invest in nature-based tourism or other growth industries. These aims have tangible value already acknowledged in global markets. A debt-for-nature swap is about capturing that value for Lao PDR.

For creditors, the benefits include significantly reducing exposure to financial loss, and avoiding the risk of default. This kind of arrangement can also improve ESG ratings and regulatory compliance. That in turn can expand the ability of financiers to leverage additional sources of finance, including from sources that specifically target higher ESG credentials at a premium rate.

There is also potential access to equity stakes or favourable future investment terms and other opportunities. For Lao PDR, this could include access to investment in nature-based tourism opportunities that will develop post-COVID-19.
In considering why any creditor might agree to this kind of green debt relief, it is useful to consider the global market for green bonds. Over the last 10 to 15 years, the issuance of green bonds and the development of this market segment has increased exponentially, particularly in China. There are different types of green bonds, and differences in standards between the Association of Southeast Asian Nations (ASEAN), China and global markets. But demand for these instruments is massive and rising.

This is driven by increasing requirements for environmental and climate risk disclosure, and the growing understanding of the value of these improved ESG credentials. For a financial institution, green bonds add value to their financial portfolio through alleviating risk and improving ESG reputation, both of which are subject to increasingly regulated disclosure requirements.

This is happening within China as in any other financial market.

Why is that relevant to debt-for-nature? Since green bonds are debt issuance before implementation of a green project, a debt-for-nature restructure can be considered the equivalent conversion of an existing debt into a green bond portfolio.

This is being demonstrated in Lao PDR on the commercial debt market. In 2022, Xayabouri Power issued a green bond in the Thai market of 10 billion baht ($270 million).[35] This bond issuance is being used to refinance a portion of the bank and shareholder loans for developing the Xayabouri hydroelectric power plant. It is refinancing an existing debt by conversion with fresh green bonds, just as has been proposed here. Conceivably, a state-owned entity such as EDL could apply this kind of model in a debt-restructuring agreement with its creditors and improve the sovereign debt liability position overall.

5.3 PART OF BROADER EFFORTS TO ACCESS GREEN FINANCE

The 9th NSEDP Financing Strategy already includes important recommendations and priority actions to enhance access to new sources of green and climate financing. The Government of Lao PDR is demonstrating progress, including a memorandum on a programme of work between the Bank of Lao PDR and the International Finance Corporation.[36] This work will start with a market readiness assessment to review the current framework for green finance and identify market opportunities for potential green financing products. It will explore the regulatory and policy framework for green finance in Laos, the enabling environment for innovative green financial products and debt instruments, as well as capacity-building and knowledge-sharing with key institutions.

This aligns well with the recommendations of the Financing Strategy's policy area 5.3 on green and climate finance:

The preparation of a medium-term debt issuance and management strategy, including the long-term exploration of green bonds, assuming the progressive return to a more manageable financial situation allowing for debt issuance.

Both the Financing Strategy and the proposed programme by the Bank of Lao PDR and the International Finance Corporation emphasize a long-term perspective. Pursuing new green debt instruments (bonds and loans) is not expected for several years, as this would require both a return to a more sustainable credit rating and substantial capacity development within relevant financial institutions in Lao PDR.

A debt-for-nature swap, however, would be a valuable early step for several reasons:

1. It would demonstrate the Government's policy intent for consideration by development and financing partners.
2. It would help to test and demonstrate capacity for compliance with the monitoring, reporting and verification requirements associated with such instruments.
3. It would result in a net improvement in the Government's debt position, which would contribute, inter alia, to a future strengthening of the sovereign credit rating.
4. It would provide an opportunity to pilot a green bond issuance that could be replicated in future years.

A demonstration of a green debt restructure could be accompanied by technical support from development partners to build more capacity within the Ministry of Finance, Ministry of Planning and Investment and the Bank of Lao PDR to ensure compliance with ASEAN and international standards and principles that govern access to green finance. This would include defining the eligibility criteria for using proceeds under green debt instruments, and improvements to the monitoring, reporting and verification capacity of relevant agencies.

Looking further into the future, with an improved overall debt position and management, these early steps could support a pilot issuance of new sovereign green bonds for target projects or performance outcomes.

There is a long trajectory for green finance in Lao PDR. A debt-for-nature swap would be a valuable beginning in alleviating immediate financial pressures. It should be considered part of a continuum of reforms as the Government seeks green finance, identifies and resolves obstacles, and promotes new avenues for foreign investment.

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