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

Summary of key highlights from UNDP Policy Dialogue

November 2023

Disclaimer

The summary note was prepared by Violante di Canossa, with the support of Yali Wang (UNDP China) and Sudyumna Dahal (UNDP RBAP). It solely reflects the perspectives collected during the discussion held during UNDP high-level policy dialogue "Reorienting sovereign debt to support Nature and the SDGs", held on 6 July 2023. It should not be viewed as the expression of views by any government or organization, including UNDP. UNDP does not guarantee the accuracy of the data included in this document and accept no responsibility for any consequence of their use. The mention of specific institutions or products does not imply that they are endorsed or recommended by UNDP in preference to others of a similar nature that are not mentioned. By making any designation of or reference to a particular territory or geographic area, or by using the term "country" in this document, UNDP does not intend to make any judgments as to the legal or other status of any territory or area.

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1 Setting the Scene

This year, the UNDP Regional Bureau for Asia and the Pacific (RBAP), with support from the UNDP China country office jointly led the preparation of the report '*Re(orienting) Sovereign Debt to Support Nature and the SDGs: Instruments and their Application in Asia-Pacific Developing Economies*'. The report focuses on assessing the feasibility of debt for nature swaps instruments as part of possible debt relief and reorganization efforts of countries within the Asia-Pacific region, building on existing UNDP work in the region and the growing role of emerging creditors such as China and India. The report also leverages increasing global interest following successful cases in the Caribbean and Latin America, among others, as well as renewed attention to nature finance on the back of the Kunming-Montreal Global Biodiversity Framework.

In parallel with the release of the report, UNDP RBAP, with the support of the China office, organized a high-level policy dialogue to enhance mutual understanding around different governance systems for debt reorganization in the Asia-Pacific region. The dialogue focused on showcasing and promoting debt-for-SDGs mechanisms as part of the solutions mix to tackle the dual challenges of nature and debt distress. This note summarises the key insights discussed during the event (agenda in the Appendix), complementing points raised in the report with perspectives shared by key partners at the event.

Speakers firstly touched upon the current context and the multiple factors stalling progress towards the SDGs. These include the multiple and interconnected crises affecting people and planet, from the lingering impact of the pandemic, the cost-of-living crisis, Nature and climate-change induced emergencies, and lack of affordable financing leading to increasing debt vulnerability and insecurity. Against this difficult context, there is a risk of diluting the attention towards the SDGs and investment in natural assets on which development and livelihoods depend.

The financing gap for the SDGs has increased and is estimated to have reached USD 4.2 trillion[1]. One in three countries are in fiscal distress, while 25 developing economies paid more than 20% of total government revenue in debt service on public and publicly guaranteed external debt in 2022, a number not seen since 2000 at the beginning of the Heavily Indebted Poor Countries (HIPC) initiative.[2]

Against this background , it is essential for both multilateral and bilateral partners to support countries in financial distress, and the roles of emerging creditors such as China and India under the framework of South-South Cooperation will be increasingly important in addressing challenges.

Speakers called for a reliable global mechanism to assist developing countries facing debt crises, based on enhanced joint efforts to cope with debt pressures on multiple fronts, including:

1 https://www.oecd.org/dev/OECD-UNDP-Scoping-Note-Closing-SDG-Financing-Gap-COVID-19-era.pdf

2 https://www.undp.org/publications/dfs-building-blocks-out-crisis-uns-sdg-stimulus-plan

- **A wider mobilisation of funds** from all stakeholders, with developed countries and the private and public sector coming together to close the SDG financing gap, following the principle of fair burden sharing, thereby jointly improving current mechanisms.

- **Improving the effectiveness of development financing projects and enhancing innovation in development finance.** This is particularly important in light of the differing stages of development of partner countries and the effectiveness and impact of current solutions against emerging needs (e.g., the green transition) as well as increasing financing needs. The situation calls for financial institutions to innovate and flexibly adapt products and services to better meet the needs of developing countries.

Under the broader imperative of advancing progress towards the 2030 Agenda for Sustainable Development, the sharing sessions revolved around a central question: How can we balance the need to reduce environmental pressure whilst also mobilizing the necessary finances to advance human development? Put another way, how do we accelerate development momentum and facilitate greater flows of finance towards the achievement of the SDGs,– without adding further debt stress?

2 Debt for nature swaps as part of the solution to address multiple crises: lessons learned from transactions in Latin American and the Caribbean

It was noted that debt for nature swaps (DNS) are among the rapidly evolving tools, alongside other options such as guarantees and contingency clauses explored by development finance institutions (DFIs).

Box 1 - Contingency clauses.

It was noted that the latter – also known as 'pause clauses', has been widely used in other jurisdictions and by the Inter-American Development Bank as part of the toolkit available to countries vulnerable to climate change. Mainstreaming pause clauses would imply increasing efforts towards changing the perception of debtors and creditors, taking out the stigma of "delaying debt payments".

Speakers started by listing a series of elements that are necessary to consider during the decision-making process. These include the complexity (e.g., for the Maldives, as also highlighted in section 2.1.3 of the report) and length of a DNS transaction, resources and capacity demands, along with the level of strong stakeholder commitment required. The risks and the lack of a framework for international collaboration and roadmaps to guide such negotiations were also highlighted among the elements to consider during the decision-making process. In more details, key points raised by speakers sharing their experiences and lessons learned from DNS deals in Barbados, Belize and Ecuador were:

DNS broader goals: DNS transactions aim at achieving goals that go beyond pure debt management. Also, they require engaging a variety of different stakeholders for assessing actual impact, including technical experts to independently verify such development impact. For example, in Ecuador, DNS addressed three main goals set by the Government: i) raise resources for new marine reserves, ii) close the financing gap for the Galapagos through a long-term financial mechanism that iii) does not rely on fiscal resources.

Cost effectiveness: finally, it was highlighted that for the transactions discussed, financing costs were not considered "high". In Barbados, for example, the financing cost of the DNS amounted to 1.3% of the loan, including fees for banks, lawyers, credit agencies, etc.

The following elements for success were emphasised by the speakers:

» **Strong commitment from all parties.** The participation of financial, legal and non-financial entities and stakeholders is vital for an inclusive process that addresses the socioeconomic implications on areas impacted by the DNS. For example, in the case of the Maldives , marine resources are critical for the livelihood of local communities and regions and their interests need balancing with protection needs of marine areas.

» **Political will and leadership towards a specific goal.** In Belize, for example, DNS was utilized as a tool to address concerns over a superbond; the Barbados Government's aim was to 'future-proof' the debt including through "pause clauses"; in Ecuador, the emphasis was on long-term financing mechanisms for the Galapagos.

» **Collaboration and teamwork across different departments.** Mainstreaming nature and climate agendas across the whole of the government calls for patience, negotiation and coordination of resources and capacities anchored around a shared vision. It was also highlighted that external partners, such as international and non-governmental organizations, can play the important role as verifiers, ensuring accountability.

» **Comprehensive, existing understanding of the environmental challenge that the DNS transaction is attempting to address as well as how the funds will be used in the long-term.** In Ecuador, the choice of the natural asset to protect – the Galapagos – was based on long-term work on specific natural assets that pre-dated the DNS transaction. In Barbados, the ongoing long-term engagement between the Government and IDB on work around the Nationally Determined Contributions (NDCs) and the country's blue economy roadmap was critical: "DNS is grounded on years and years of collaboration".

» **'Additionality', meaning the ability to create impact from both the environmental and fiscal perspective.** In the Ecuador case, for instance, the transaction is expected to generate savings worth USD 323 million to finance nature conservation.[3]

» **The role of multilateral development banks (MDBs) and DFIs:**

- **to provide credit enhancement mechanisms,** leveraging AAA rating to crowd-in private investors for the transaction (e.g., Belize was in selected default, while in Ecuador, the cost of borrowing achieved by the DNS was a third of where the secondary market was trading). To this point, it was noted that guarantees are provided on the back of governments' commitments, pathways and strategies towards sustainability, based on credible targets to be advanced over years.
- **MDBs are also critical for their long-term engagement** in the country and knowledge and partnerships across different government entities and departments. This was mentioned by speakers as an important factor for risk mitigation, enhancing the attractiveness of the deals for external investors (e.g., to buy blue bonds).
- **MDBs can provide financial and resources for technical assistance** building required capacity to manage the transactions over the years.

3 https://www.iadb.org/en/news/ecuador-completes-worlds-largest-debt-nature-conversion-idb-and-dfc-support

3 Feasibility of debt for nature swaps in the Asia-Pacific region

Currently, DNS have not found any concrete application in the Asia-Pacific region. However interest is growing and there is an opportunity to focus discussions and exchanges on their feasibility and applicability and how these mechanisms can address the long term (fiscal and financial) sustainability of developing countries in the Asia-Pacific region.

Speakers from the region spoke to the ongoing work and efforts towards building inclusive solutions for multiple crises and advancing the SDGs. They touched upon the challenges and opportunities for DNS as well as other financial tools and mechanisms, highlighting the importance of sharing knowledge and enhanced international cooperation. More specifically, they highlighted the following points for consideration:

» **The case for early action:** exploring whether debt conversations could be implemented ahead of a debt crisis as an incentive to invest in nature, and not necessarily to deal with debt distress. This is particularly relevant as there is a need to confront the risk of not investing in nature as well, given its impact on long-term debt and overall macroeconomic resilience and sustainability. Speakers shared the view that investing in nature is not only about managing debt but also about managing and investing in growth.

» **Strengthening the evaluation of Nature's contribution to development in order to support evidence-based investment decision-making.** Investments should be anchored around measures that quantify and evaluate the contribution of Nature to the socioeconomic development of regions and countries. The analysis would help determine what type of investment would be required, and what reforms and policy changes would facilitate such investment. The identification of specific targets and commitments need to underpin debt conversation deals.

» **The case for a mix of actions.** In a debt distressed environment, macroeconomic reforms are necessary, alongside concrete steps to curb deficits. These should come alongside concessional and long-term financing, a broadening of the investor base, as well as borrowing instruments. Underpinning these multiple actions, it is clear that a medium- and long-term debt management strategy that is transparently implemented, is also required.

» **The role of MDBs.** The Asian Development Bank, for example, is setting up a "Nature solution finance hub" aimed at scaling financing for nature in light of the significant financing gap in this area. The hub will provide support to planning and offer workshops and training programmes to sensitize stakeholders for the need to invest in nature and incorporate DNS where appropriate.

» **The need for enhanced understanding on multiple aspects,** including the creditors' objectives and the range of facilities to reduce debt.

4 Perspective from an emerging creditor: China

According to the speaker, from a theoretical perspective, DNS could be a feasible way for China in dealing with debt distress of partner countries. Readiness, however, may be limited, albeit increasing, as relevant government departments may still lack a deeper understanding around appropriateness of debt swaps and other challenges concerning general debt restructuring, information asymmetry across debtor and creditors and projects underpinning the swap deal.

Two issues were listed as hindering the uptake of DNS in China. First is China's limited experience given the relatively short history in dealing with international debt crisis. Preferential loan guaranteed by the sovereign started in 1995, and export buyer's credit in 2002. Both these instruments, however, were only scaled up from 2010 onwards. Without sufficient international lessons to draw on, China mainly takes reference from how its central government deals with local provincial debt when handling overseas debt negotiations. The major avenue China has taken in debt restructuring is reduction and forgiveness, mainly to exempt China's interest-free loans. Only recently has China started to participate in debt treatment under multilateral mechanisms, such as the Debt Service Suspension Initiative (DSSI) and the G20 Common Framework, as well as rechannelling SDRs.

Second, challenging coordination across line ministers given the overlapping responsibilities and interests embedded in debt conversions. In China, debt is used to be treated as a pure financial matter and handled by the Ministry of Finance and major financial institutes such as China Development Bank and Export and Import Bank of China. However, international dialogues about debt restructuring, including about debt swaps usually take place on platforms focusing on development issues, speaking more to Chinese foreign aid authorities instead of financial authorities. As of now, only in the case of restructuring concessional loans, the two spheres have intersected (refer also to Chapter 4 of the report). Exchanges are thus critical to raise understanding and coordination between different authorities and departments. Research institutes, such as the Chinese Academy of International Trade and Economic Cooperation (CAITEC), have been engaging government stakeholders providing technical support with the aim to highlight that debt conversation could be possible, bringing together both financial and foreign aid authorities.

From a creditor perspective, three areas were suggested for consideration and informed decision making around feasibility and applicability of DNS in the current Asia-Pacific context:

a. **Liquidity considerations.** The suggestion was to go back to the original purpose of debt management: alleviate very urgent liquidity problems and shortage of funds in developing countries to promote debt sustainability. Thus, the emphasis should not only be on the specific theme of the debt conversion (e.g., climate, nature, health) but also on liquidity issues. This would include an understanding of how much the swap transaction would enhance the debtor's macroeconomic resilience and its capacity to deliver sustained economic growth and social benefits. Commitments should then be linked to indicators that go beyond the DNS's thematic area (e.g., nature-related KPIs, such as afforestation or biodiversity conservation targets) and include indicators of economic development (e.g., impact on industrial development, nature-based solution indicators) and debt management (e.g., support to liquidity).

b. **Multiple stakeholders' engagement.** In light of the complexity of the transaction and multiple actors involved, a starting point for less experienced partners would be to identify and start engaging 'indispensable' stakeholders to build awareness and consensus. In China's case, these would include financial and foreign aid authorities. Other relevant stakeholders, including the technical agencies, such as UN agencies and NGOs, may play assisting roles in this preliminary stage.

c. **Other information required include willingness and readiness of debtor countries** and the impact of the transaction on their local economies; as well as **the role and responsibilities of other stakeholders** like commercial creditors and MDBs when dealing with DNS within broader debt restructuring (e.g. under the G20 Common Framework).

Box 2 – China Export and Import Bank's ongoing initiatives in support of green development and sustainable developing in developing countries:

» *Green credit supply (e.g., Karot hydropower project in Pakistan, expected to save about 1.4 million tons of standard coal and reduce carbon dioxide emissions by 3.5 million tons each year, while meeting electricity consumption needs of 5 million people[4]).*

» *Equity investment, such as through the China-ASEAN investment Cooperation Fund, leveraging capital to support infrastructure projects and providing credit enhancement for economic development.*

» *Issuing, underwriting and investing in green bonds: since 2016, EXIM issued nine green and carbon-neutral bonds for a total value of RMB 28 billion (USD 3.9 billion).[5]*

» *Active engagement in green development initiatives, including the Green Investment Principles (GIP) and a joint initiative of the China banking sector in support of the dual carbon and biodiversity conversation targets.*

» *International cooperation: In 2022, EXIM and AIIB signed a memorandum of understanding launching the USD 200 million Green On-Lending Facility Project providing practical reference to the construction and improvement of EXIM's green credit system of the Bank.[6]*

4 https://english.news.cn/20230619/0ef960a81a0e4bb486305dc191a9552f/c.html

5 http://english.eximbank.gov.cn/News/WhitePOGF/202301/P020230106613030856905.pdf and http://eximbank.gov.cn/info/notice/notice/202303/t20230329_47925.html

6 http://www.eximbank.gov.cn/info/ztzl/lsxdzdhz/202302/P020230201390185031891.pdf and https://www.aiib.org/en/projects/details/2022/approved/China-EXIM-Bank-Green-On-lending-Facility.html

5 Key takeaways from speakers

Speakers shared the view that addressing debt and nature/climate distress is critical, as well as freeing fiscal space to invest in Nature. To this end, DNS can be part of the tools at disposal of decision makers, concluding that debt conversations are applicable and feasible in the Asia-Pacific region. Emerging creditors can play a role, learning from others' experience.

As all new tools, DNS come with new challenges. These are complex transactions not least because of the range and multitude of stakeholders involved, including local communities and should be part of broader mix of solution. The identification of projects underpinning the deals and the right departments and authorities to advance the negotiation are also key. Other factors to be considered include the impact (both environmental and fiscal) of such transactions, as well as the degree of additionality (financial and non-financial) and concessionality (including the use of guarantees as de-risking tools) they can deliver to solve the dual challenges of debt and environmental distress.

Annex – Agenda

Bangkok time	Speakers
8:00	**Moderator:** Ms Beate Trankmann, UNDP Resident Representative for China
8:05	**Welcome and Keynotes**
	Welcome Remarks • Ms Kanni Wignaraja, Assistant Secretary General, UNDP Assistant Administrator and Regional Director for Asia and the Pacific
8:15-8:45	**Keynote speeches**
	• Hon'l Ms Mariyam Manarath Muneer, Deputy Minister of Finance, Maldives Government • H.E. Dr. Palitha Kohona, Ambassador of Sri Lanka to China • Dr. ZHANG Wencai, Vice President, China Export-Import Bank • Mr. Jean-Marc Fenet, Minister Counsellor for Economic Affairs, Embassy of France in China
8:45-9:45	**Panel discussion I. Feasibility of SDG-aligned debt instruments in the Asia Pacific region & Experience sharing from other regions**
	Moderator: Mr Philip Schellekens, UNDP RBAP Chief economist **Presentation of key findings of the report** • Dr. Christoph Nedopil, Green Finance & Development Center, Fudan University. Lead author of the paper: *(Re)orienting Sovereign Debt to Support Nature and the SDGs: Instruments and their Application in Asia-Pacific Developing Economies* **Experience sharing session** • Ms. Jennifer Doherty-Bigara, Senior Climate Change Specialist, Inter-American Development Bank • Mr. Ramzi Issa, Managing Director, Credit Suisse • Mrs. Monica Chavez, Director of Sectoral and Intersectoral Policies, Ministry of Economy and Finance, Republic of Ecuador **Q&A**
9:45-10:00	**Break**
10:00-11:00	**Panel Discussion II. Perspectives from key stakeholders in the Asia Pacific**
	Moderator: Ms Radhika Lal, SDG Finance Policy Advisor, UNDP RBAP & Ms Violante di Canossa, Head of Research and Policy Team, UNDP China **Speakers** • Mr. Narayan Iyer, ADB's focal for Natural Capital Lab, Asian Development Bank • Mr Theutthoune Soukaloun, DDG, Department of Public Debt Management, Ministry of Finance of Lao PDR • Ms. WANG Luo, Director, Institute of International Development Cooperation, Chinese Academy of International Trade and Economic Cooperation, Ministry of Commerce of China • Mr. Yahya Akhunzada, Joint Secretary, Economic Affairs Division, Ministry of Economic Affairs, Government of Pakistan **Q&A**
11:00	**Concluding remarks** by Mrs Beate Trankmann, UNDP Resident Representative for China