



UNLOCKING FISCAL SPACE FOR BIODIVERSITY AND CLIMATE FINANCING IN LAO PDR THE DEBT-FOR-NATURE OPPORTUNITY

Lao PDR has some of the highest forest coverage among countries of the region, with forest ecosystem services supporting key economic sectors including energy, agriculture, and tourism. **Natural capital is a major source of wealth** for the country and is crucial to the Lao economy, providing goods and services that are essential to reduce poverty, secure livelihoods, and drive sustainable growth.



The significance of Lao PDR's biodiversity assets is well recognised, with a network of National Protected Areas (NPAs) established across four ecologically diverse regions: the Northern Highlands; the Annamites Range; the Indo-Chinese karst landscapes; and the Mekong plain. **Major threats to these ecosystems have been identified**, including climate change, illegal logging, the illegal wildlife trade, habitat degradation and fragmentation from infrastructure development in and around protected areas.

Investments in biodiversity conservation can support local jobs and revenue, including through nature-based tourism and non-timber forest products. The Government of Lao PDR recognises the importance of this, and has articulated a vision for the country's green growth that includes specific biodiversity management and forest conservation targets, and described under the 9th National Socio-Economic Development Plan (NSEDP) for 2021-2025.

However, 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 limited financial resources for the government to allocate to domestic priorities**. Around half of the government's projected revenues for the next few years will need to be spent on sovereign debt repayments – an expense of approximately \$1.3 billion USD per year. With current plans including austerity measures and prioritised expenditures, it is expected that protected areas will receive increasingly limited funding allocations from the national budget. Already, budget allocations to the Lao Forest Protection Fund have decreased significantly from over \$700,000 USD in 2017 to around \$170,000 USD in 2021. This leads to **real risk of economic consequence for the country**, through 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.

Debt For Nature

Parties to the UN Convention on Biological Diversity (CBD) are currently developing a new global framework for biodiversity that is expected to identify **financing needs of up to \$700 billion per annum by 2030**.

To achieve this target, both private and public sector resources will be necessary. With the economic impacts of the COVID-19 pandemic, there is increasing global awareness of the potential for sovereign debt restructuring to contribute to financing for biodiversity and climate outcomes.

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

Lao PDR has been identified as one of the countries with the greatest potential for a debt restructure of this kind, with its globally significant natural resources, high debt/GDP ratio and servicing obligations, and the substantial economic impacts of COVID-19 on its economy. **UNDP is providing technical support to the Government of Lao PDR in exploring a potential debt-for-nature restructure**, the design of such a proposal, and how financial resources could be allocated to domestic green growth objectives, as identified in the country's NSEDP and Forestry Strategy. This could include, for example, establishing a capital endowment in the Lao Forest Protection Fund, filling a critical gap in sustainable financing of National Protected Areas.



The mechanics for a debt restructure could take various forms, including partial cancellation, pause of repayments, refinancing interest or principal terms, currency swaps, and re-purchase of debt by third parties such as impact investors or NGOs. Creditors would benefit from **improved security of investments**, and reduced likelihood of default. Improved ESG and CSR metrics and reputation may be conducive to **future investment opportunities and capital raising potential** with like-minded co-financiers. Regional investors in Lao PDR's energy infrastructure and tourism markets would benefit from supporting the country's biodiversity assets. Financing could potentially be directed towards supporting eco-tourism ventures in the country's NPAs, such as through a collaborative financing approach with co-investors.

Innovative new debt instruments such as nature or climate performance bonds, or 'hybrid' refinancing, may have a role. **Biodiversity outcomes could be safeguarded** by linking the debt mechanics to specific performance indicators, such as alignment with targets of the CBD's new framework. Financing could be made available to specific projects, such as protection of watersheds in hydropower catchments, or to enable broader capacity for such efforts through existing mechanisms. The established environmental trust funds in Lao PDR (an Environment Protection Fund and a Forest Protection Fund) already provide a structure through which financial inputs and expenditures could be tracked, disbursed, reported and audited.



There are many possibilities and options to consider. However **the window of opportunity for Lao PDR to implement a debt-for-nature swap is limited by imminent financial and fiscal realities**. In developing this potential, it will be useful to capitalize on momentum that is generated by the 15th Conference of Parties to the CBD, hosted in Kunming, China in 2021 and 2022.



Whether involving multilateral, bilateral or commercial creditors, any future agreement on debt restructuring would of course require **private negotiations** between the Government of Lao PDR and its creditors.

Development partners have many avenues to support this. Data and technical expertise could support economic and financial analysis of sovereign debt, prioritization of new expenditures for greater efficiency and sustainability, and rigorous 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 guarantees provided by multilateral financing institutions could reduce barriers to greater contributions from the private sector.

Ultimately, **the protection of Lao PDR's natural capital assets for future generations need not be sacrificed** to meet the short-term financial challenges that have been imposed by the pandemic.

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