



United Nations
Economic Commission for Africa

Africa's quarterly economic performance and outlook

Are debt-for-nature swaps a viable solution for addressing the triple crises of debt, climate finance and nature conservation in Africa?

July–September 2023

Key messages

- » Growth in Africa is projected to decline to an average of 3.6 per cent in 2023, 0.5 percentage points below May projections.
- » The growth prospects of the African continent in the short to medium term are anticipated to be negatively affected by the persistently slow global economy, tight global financial conditions and the relatively high inflation rates and debt levels in African countries.
- » Since 2010, public debt in Africa has increased by 183 per cent, four times faster than the growth of the gross domestic product (GDP) of African countries in dollar terms, with the median level of public debt projected to persist above the pre-pandemic level of 61 per cent of GDP through 2025.
- » Debt-for-nature swaps represent a potential mechanism to partially address debt-related concerns in Africa. Debt-for-nature or climate swaps are deals that allow a country to restructure its debt at a lower interest rate or longer maturity, with the proceeds being allocated to conservation or green projects.
- » Linking sovereign debt to climate and nature outcomes could have numerous benefits for African countries in the short and medium term, such as creating greater fiscal space and reducing their public debt burdens.

1. Introduction

Many African countries are among the world's most vulnerable to changes in ecological and climatic conditions. Moreover, nearly all countries of the continent are currently heavily indebted. They are thus caught in a vicious cycle: debt servicing reduces the fiscal space available for investments in climate change adaptation and mitigation or to address environmental degradation. At the same time, climate change lessens productive capacity and causes natural disasters, which require costly reconstruction, making it even more difficult for countries to service their debt.

Environmentally linked financial instruments could be a highly efficient means of addressing the multifaceted needs of African countries. These innovative financial mechanisms are called debt-for-nature and climate swaps and provide an incentive for creditors to participate in debt relief in exchange for environmental investments. Debt-for-nature and climate swaps allow countries with valuable biodiversity to charge others for its protection and provision as a global public

good. Therefore, they could attract new funds or stakeholders and even generate additional revenue for these countries. However, despite their great potential, debt-for-nature and climate swaps remain, for the moment, a niche instrument in the financial market. In addition, there are still questions regarding the comparative advantage of debt swaps versus alternative measures, such as conditional grants and comprehensive debt restructuring.

In the present report, the feasibility of implementing debt-for-nature and climate swaps in Africa is assessed, together with their potential to leverage additional finance for climate actions while also reducing debt burdens. Consideration is given to how African countries could take advantage of the growing interest among investors in these instruments that protect biodiversity and respond to the climate crisis. The report also contains recommendations on how to best realize the promise of debt-for-nature swaps.

In the following section, consideration is given to the recent growth performance of Africa and the significance of the continent's debt and fiscal

deficits, informing the need to use new financial mechanisms to reduce debt burdens. In section 3, the concept of debt-for-nature and climate swaps is discussed, together with their potential in African countries. Section 4 concludes with suggested policy recommendations to assist African countries in fully exploiting the benefits of debt-for-nature and climate swaps, leveraging additional finance for environmental conservation and climate actions in Africa while also reducing debt burdens.

2. Economic performance of Africa in the global economy

A. Growth performance and outlook for Africa

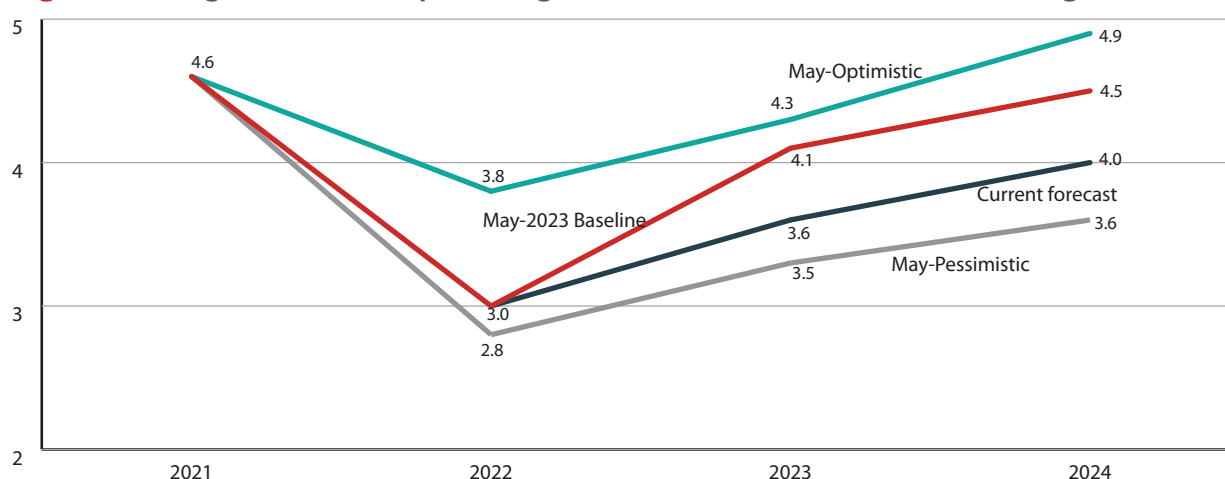
The growth of African economies is projected to decline to an average of 3.6 per cent in 2023, 0.5 percentage points below internal May projections by the Economic Commission for Africa (ECA), mainly owing to the tightened monetary policy to curb inflationary pressures in many countries and the war between the Russian Federation and Ukraine, which has affected both global economic activity and demand for African exports. Projected growth remains below the May optimistic scenario but above the pessimistic scenario. Growth is expected to pick up to an average of 3.9 per cent from 2023 into 2024, signalling the bottoming out of the slowdown in 2023 (see figure I).

The persistently sluggish global economy, tight global financial conditions, high debt levels among African countries and relatively high inflation rates are expected to weigh on the region's growth prospects in the short to medium term. This will be exacerbated by the impacts of climate change, especially in the North African subregion, and the political instabilities in the Sahel and Gabon.

B. Continuing high inflation in African countries

Inflation is expected to remain at an average of 16 per cent in 2023, above the long-term average of about 11 per cent (Department of Economic and Social Affairs, 2023), and all signs point to continued high inflation into 2024. Authorities in certain markets, such as Egypt, Ghana and Nigeria, have hiked policy rates in order to tame inflation and anchor inflation expectations. Inflation in Nigeria increased in September, with the headline print for August 2023 coming close to the 26.0 per cent year-on-year mark for the first time since 2005 (Nigeria, National Bureau of Statistics, 2023), driven by rising food prices, fuel and transportation costs and imported inflation (Oxford Economics, 2023). Following a period of significant deflation, two consecutive increases in inflation in May and June, driven by food price inflation, have prompted the Central Bank of Ghana to act cautiously and once more raise its monetary policy rate by 50 basis points to 30 per cent in July (Ghana, Bank of Ghana, 2023). Nonetheless, the easing of food price pressure led the inflation rate in Ghana to

Figure I: Real gross domestic product growth in Africa, 2021–2024 (Percentage)



Source: ECA estimates and forecasts, September 2023.

fall to 38.1 per cent in September, from 40.1 per cent in August (Ghana, Ghana Statistical Service, 2023). Due to inflationary pressures, particularly on food prices, the Central Bank of Egypt decided to raise key policy rates in August, increasing the overnight deposit rate, overnight lending rate and the main operations rate by 100 basis points, to 19.25 per cent, 20.25 per cent, and 19.75 per cent, respectively. The discount rate was also raised by 100 bps to 19.75 per cent (Egypt, Central Bank of Egypt, 2023a). Inflation in the country has witnessed a slight decline for two consecutive months to 40.7 per cent and 40.4 per cent in July and August 2023, respectively, compared to 41.0 per cent in June 2023 (Egypt, Central Bank of Egypt, 2023b). In September, the Central Bank of West African States also hiked its key policy rate by 25 basis points to 3.25 per cent. Growing regional uncertainty and sticky inflationary pressures were the main motivators behind its decision to resume monetary tightening measures (BCEAO, 2023).

On the other hand, other central banks, including the South African Reserve Bank and the Bank of Mauritius have kept policy rates steady, owing to easing inflationary pressures in those countries.

C. Weakness of many African currencies against the dollar

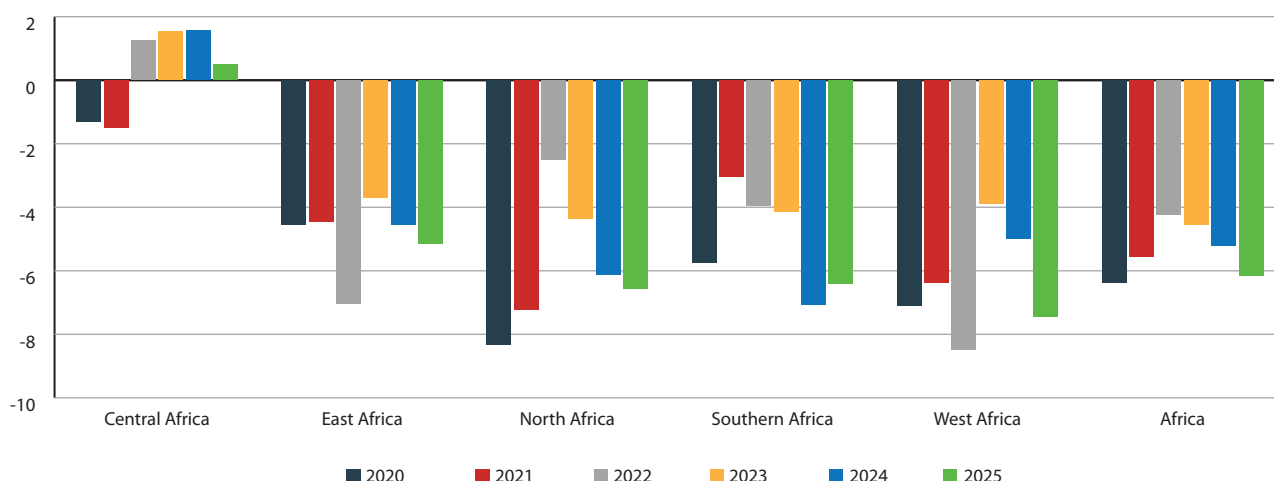
Many African currencies have continued to lose ground against the dollar in the third quarter of 2023. In Nigeria, after the naira was allowed to float in June 2023, it depreciated by more than 70 per cent against the dollar and reached approximately 750 naira to the dollar in September (Nigeria, Central Bank of Nigeria, 2023). Recent pressure on the country's balance of payments and foreign currency reserves have contributed to this volatility (Oluoch and Bala-Gbogbo, 2023). Since the beginning of July, the Kenya shilling has steadily depreciated by 4 per cent owing to insufficient dollar reserves in the country. The depreciation is anticipated to continue until the end of the year (Ombok and Genga, 2023). The Ethiopian birr has also been slowly depreciating in the third quarter of 2023, having lost approximately 1 per cent of its value against the dollar as of mid-September

(Ethiopia, National Bank of Ethiopia, 2023). The trend coincides with the news that the country is seeking to borrow at least \$2 billion from the International Monetary Fund (IMF) as part of a broader reform programme (Do Rosario, 2023) and that IMF is likely to urge liberalization of the exchange rate regime, which would mean closing the gap between the official and unofficial exchange rates through a devaluation (Clynch, 2023). Since June 2023, the Burundi franc, Ghanaian cedi and Tanzanian shilling have all depreciated against the dollar as well. On the other hand, the South African rand has been volatile against the dollar recently but has not depreciated significantly. It depreciated in May but rebounded in July and again fell in September, as the country continues to experience electricity shortages.

Weaker currencies have contributed to higher prices, increased public debt and deteriorating trade balances. IMF has demonstrated that, excluding North Africa, the continent has been exhibiting a high exchange rate pass-through to inflation in 2023. For every percentage point of depreciation against the dollar, the inflation rate increases by an average of 0.22 percentage points in the following year. This is greater than the increases seen in emerging Asia (0.15 percentage points) and Latin America (0.18 percentage points) (IMF, 2023b). To address the external imbalances in African countries, fiscal consolidation and policy adjustments are required.

D. Bleak fiscal and debt conditions

Average fiscal deficits remain high at an estimated 4.6 per cent of GDP in 2023, slightly higher than the pre-pandemic level of 4.4 per cent in 2019 and projected to widen to 5.2 per cent in 2024 and even higher in 2025 (see figure II), reflecting increased net capital outflows and subdued export revenues, mainly in resource-intensive economies. North Africa is expected to experience the largest fiscal deficits in 2023, owing to erratic economic growth, interest rate hikes, surging food and fuel prices, high subsidies and loss-making State-owned enterprises. It is followed by Southern Africa, where fiscal deficits are mainly driven by

Figure II: Fiscal balances in Africa by subregion, 2020–2025 (Percentage of gross domestic product)

Source: ECA calculations based on IMF (2023c).

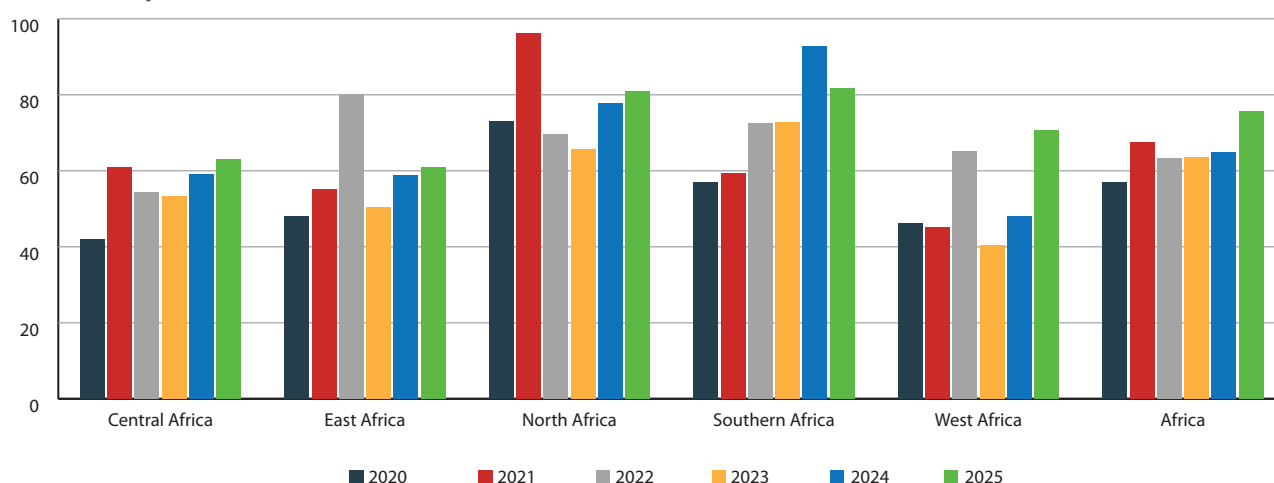
tax revenue shortfalls, cash transfers and subsidies given to vulnerable households, targeted and temporary support to hard-hit economic sectors and increasing interest payments. Central Africa stands out as the only subregion that has recorded a budget surplus since 2022, owing much to higher commodities revenues.

E. Projected continued high public debt, increasing African debt vulnerabilities

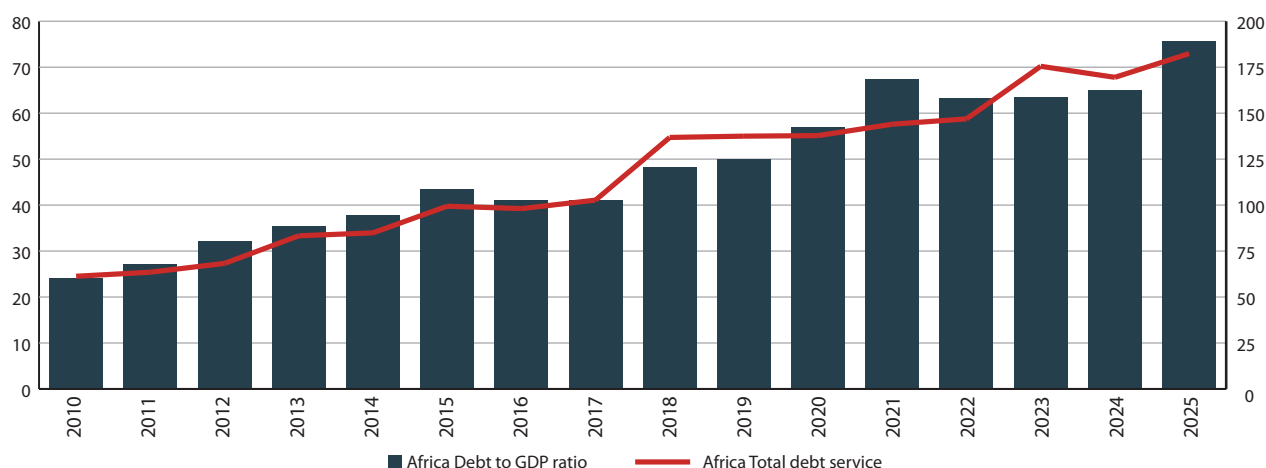
Since 2010, public debt in Africa has increased by 183 per cent, nearly four times faster than the growth of its GDP in dollar terms. In 2022, public debt in Africa reached \$1.8 trillion (United Nations, 2023). Although the average public debt in Africa is estimated to have slightly declined to 65 per

cent of GDP in 2022 from 68 per cent in 2021 as a result of debt relief initiatives in certain countries, it will remain above the pre-pandemic level of 61 per cent of GDP over the three coming years, through 2025. The debt-to-GDP ratio is expected to increase to 64 per cent in 2023, 65 per cent in 2024 and 75 per cent in 2025 (see figure III), owing to growing financing needs resulting from rising food and energy import bills, increased interest rates on public debt, exchange rate depreciations and rollover risks.

Average government gross debt will be the highest in Southern Africa in 2023, followed by North Africa, and will be the lowest in West Africa. Cabo Verde, Egypt, Eritrea, Mauritius, Mozambique, the Sudan, Tunisia and Zimbabwe are among the

Figure III: Government gross debt in Africa by subregion, 2020–2025 (Percentage of gross domestic product)

Source: ECA calculations based on IMF (2023c).

Figure IV: Debt and debt servicing in Africa (Percentage of gross domestic product)

Source: IMF (2023c) & International Debt Statistics (IDS) Database (2023).

countries on the continent with the highest levels of public debt as of 2023 (IMF, 2023a). Furthermore, there has been a significant increase in borrowing costs, and the general appreciation of the dollar has pushed up the debt servicing burden of dollar-denominated debt (see figure IV). Moreover, the share of government revenue allocated to servicing external debt has increased significantly, accompanied by a decline in the availability of development assistance and private finance (ECA, 2023).

Financing constraints will impede the capacity of Governments to allocate resources towards investments in education, health, infrastructure, the energy transition and sustainable development. In addition, this situation puts a greater number of countries at risk of debt default. According to IMF (2023c), as of August 2023, 8 African countries were in debt distress, and 12 African countries were at a high risk of debt distress.

Countries including Ethiopia, Ghana, Malawi and Zambia which face both solvency and external liquidity constraints, are actively pursuing or undergoing public debt restructuring. In contrast, such countries as Egypt and Kenya face a high risk of failing to meet their external financing needs in the coming months (Oxford Economics, 2023).

Climate vulnerabilities and fiscal risks are interconnected, with causation working in both

directions. On the one hand, climate change has the potential to worsen debt vulnerabilities owing to its negative effects on a country's productive capacity and tax base, the costs of post-disaster reconstruction and the increased cost of external borrowing. On the other hand, large debt burdens reduce the fiscal space for climate mitigation and adaptation investments, thereby exacerbating climate change and its negative consequences (ECA, forthcoming). Considering these interactions, debt-for-climate swaps have been proposed as an instrument that can help countries to simultaneously address climate and debt issues.

Since the twentieth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change was held in 2012, both debtors and creditors have shown renewed interest in debt-for-nature swaps. In the light of recent developments, such as the twenty-sixth session of the Conference of the Parties and the global push for a green recovery, analysts and policymakers have been actively exploring novel approaches to financing conservation efforts and climate change adaptation and mitigation in countries that are grappling with significant debt burdens. Many scholars are also advocating the expansion of debt swaps to assist countries in enhancing their climate resilience and bolstering their post-pandemic recoveries (Picolotti and others, 2020; Steele and Patel, 2020; Volz and others, 2021; Chamon and others, 2022).

African interest in climate- and nature-focused debt instruments is also growing. At the High-Level Event on Financing for Development in the Era of COVID-19 and Beyond held in September 2020, the President of Namibia proposed debt-for-climate swaps as a key mechanism. In his speech to the General Assembly in September 2020, the Prime Minister of Cabo Verde called for debt relief for sustainable development, and in April 2021, at the Leaders Dialogue on Adaptation, the President of Gabon called for financial innovations, including debt swaps, to be mainstreamed in addressing climate finance. ECA, the African Union and a group of African ministers of finance are designing a debt swap vehicle for the continent's economies that may be linked to climate and nature outcomes (Patel and others, 2021).

2. Recent trends of debt-for-nature swaps

A. Overview of debt-for-nature swaps

A debt-for-nature (or debt-for-climate) swap is an agreement between a creditor and a debtor in which the repayment obligations for an outstanding debt are suspended, reduced, cancelled or otherwise restructured, and the funds are instead allocated to the achievement of certain nature- or climate-related outcomes, such as preserving natural carbon sinks or biodiversity hotspots. Debt-for-nature swaps first appeared during the 1980s debt crisis, which primarily affected Latin America.¹ They were aimed at both reducing unsustainable external debts and addressing the worsening environmental conditions in developing countries brought on by the exploitation of natural resources, such as deforestation. Debt swaps may also be used to fund climate mitigation and adaptation projects, in which case they are referred to as debt-for-climate swaps. Bilateral or direct swaps and third-party swaps are two of the most common structures.

A swap can be bilateral (direct), where a creditor Government directly cancels the debt owed by the debtor Government in exchange for the debtor Government setting aside an agreed-upon amount of counterpart funds in local currency for a predetermined purpose, such as a nature conservation project. This model has been employed primarily for official (Government-to-Government) debt swaps. Bilateral swaps become multilateral when multiple creditor countries are involved.

A swap can also be characterized as a third-party swap, involving one or more third parties (i.e., non-governmental organizations or other donor institutions) in addition to the debtor and creditor(s). In such a scheme, the third party typically purchases outstanding debt owed by a debtor country to private creditor(s) at a discounted price, well below face value, on the secondary market. The third party can also acquire outstanding debt of the debtor country at a significant discount from an official bilateral creditor. The third party then renegotiates the debt obligation with the debtor (typically a country, but also sometimes private or commercial entities) in exchange for the debtor's commitment to undertake pre-agreed nature- or climate-related policy actions or investments.

Instead of renegotiating the debt obligation, the third party may choose alternative options. One option is to sell the debt back to the debtor at a discounted price, which is still higher than the price the third party initially paid for the debt on the secondary market. This sale would be contingent upon the debtor undertaking nature- or climate-related policy actions and/or investments. Another option is for the third party to provide funds to the debtor at interest rates below prevailing market rates. However, this lending arrangement would be conditional upon the debtor using the funds to repurchase outstanding debt at a discounted rate. In addition, a portion of the resulting debt relief, which represents the difference between the cost of the old debt and the new debt to the third party, would

¹ The concept of debt-for-nature swaps was first introduced by the Vice-President of the World Wildlife Fund, Thomas Lovejoy, in 1984 in response to the deteriorating tropical rain forests and rising debt obligations in developing countries, in particular in Latin America. Bolivia and Conservation International, a non-profit environmental organization based in the United States of America, signed the first debt-for-nature agreement in 1987.

need to be allocated to nature- or climate-related initiatives and investments. In addition to its role as an intermediary, the third party plays a crucial role by contributing expertise and services to facilitate the country's investments in environmental conservation measures (Bove, 2021).

Under both models, once an agreement is reached between the debtor Government and its creditor(s), the debtor Government commits to periodically transfer a pre-agreed amount to a dedicated trust fund, generally in accordance with the original debt repayment schedule. The trust fund often provides grants to local non-governmental organizations for the implementation of agreed environmental projects or programmes. A committee comprised of both government representatives and independent observers, such as representatives of national or international non-governmental organizations, is the most adequate governance structure to facilitate the allocation of funds to pre-agreed projects and to increase accountability (Economic and Social Commission for Asia and the Pacific, 2021).

B. Economic benefits of debt swaps

Debt swaps are a method of debt relief or debt reduction, with an effect equivalent to providing a new source of revenue or savings on expenditures and thus freeing up resources that can be used to fund alternative spending or reduce a country's fiscal deficit. In theory, the amount of fiscal capacity made available is exactly equal to the amount of the debt relief. However, this is only the case if the debt would have been fully repaid in the absence of any relief. The actual savings is equal to the amount that would have gone to debt service in the absence of such relief. In practice, the value of a debt at any given time, pricing in the market's subjective view of a debtor's ability or inability to fully repay its debts, can be most fairly measured by its value on the secondary market, which can be somewhat lower or much lower than the face value of the loan. In other words, the larger the share of debt service that cannot be honoured in a given year, the smaller the amount of additional resources that the debtor country actually frees

as a result of the debt relief (Economic and Social Commission for Western Asia, 2021).

Facing possible default on a debt and the possibility of receiving no repayment at all, a creditor can agree to settle the debt for its prevailing market value. The debt is then generally bought out by the debtor and sold on to an investor at a premium negotiated by the parties, converted from the original foreign currency into the debtor's domestic currency at the market exchange rate on the transaction date (Economic and Social Commission for Western Asia, 2021).

In an official bilateral debt swap, the debtor benefits by replacing loan payments with a new obligation stipulated in the swap's terms, such as environmental or climate actions. Given that the debtor is obligated to repay external debt in the absence of a debt swap, such schemes can reap substantial savings.

C. Potential benefits for Africa

By reducing the debt burdens of developing countries and increasing their fiscal space, debt-for-nature swaps enable Governments to better finance climate-resilient investments. Environmental projects benefit from freed finance that would have otherwise gone towards the creditor's budget, often resulting in economic and social benefits at a local level.

Grants to environmental projects or local non-governmental organizations are typically distributed through a trust fund set up according to the original repayment schedule. This long-term regular funding facilitates investments in climate finance. Since counterpart payments for environmental projects are typically made in local currency, debtor Governments can save scarce hard currency and use it to build foreign exchange reserves. Overall, debt relief can thus bolster economic stability, enhance a debtor's credit rating and attract new investments. Therefore, debt-for-nature swaps can be particularly helpful to countries that are suffering from fiscal stress due to high indebtedness, such as in the African region.

Box 1: Seychelles

Seychelles is an archipelago of 115 islands in the Western Indian Ocean. It is home to rare coral reefs and endangered species, and its economy relies heavily on marine tourism and fishing. Despite some successful reforms and recovery from its 2008 sovereign debt default, Seychelles remained vulnerable to external economic shocks, and its marine ecosystem continued to deteriorate. In 2016, Seychelles signed a debt-for nature swap with The Nature Conservancy, an environmental group based in the United States of America. The deal restructured its sovereign debt of \$21.6 million owed to Paris Club members in exchange for its commitments to protect the ocean.

The Seychelles Conservation and Climate Adaptation Trust was established under the leadership of The Nature Conservancy to purchase the debt from the creditor countries at a discount. Accordingly, the Government of Seychelles agreed to pay back loans to the Trust at a lower interest rate, invest the savings in ocean conservation efforts and designate 30 per cent of the country's marine area as protected, free from unregulated fishing. The debt swap resulted in several significant advantages. First, the Government's debt maturity was extended from 8 to 13 years and its average interest rate was lowered. By making payments in local currency, the Government was able to improve its balance of payments. Furthermore, the debt swap facilitated the allocation of an additional \$5.7 million towards ocean conservation efforts. This financial boost contributed to the preservation and protection of the country's marine resources. The debt swap also diverted over \$11 million from external debt service to domestic investments, boosting economic growth. Lastly, the debt swap resulted in a capital endowment of \$6.6 million for the Trust, which created a long-term opportunity for the further mobilization of funds, fostering future financial resources for conservation and climate adaptation initiatives in Seychelles. The successful execution of a marine spatial plan in the country is contingent upon the active involvement and participation of local stakeholders, thereby ensuring a meaningful implementation process. In addition, the establishment of approximately 400,000 km² of new marine protected areas aligns with the objectives set forth in the Convention on Biological Diversity.

Source: Patel and others (2021) and Mendi and Nedopil Wang (2021).

Debt-for-nature swaps have been implemented in more than 30 countries spanning all continents since their introduction in 1987. A large amount of debt, exceeding \$3.7 billion, has been successfully restructured globally through bilateral and multi-party debt-for-nature swap agreements (African Natural Resources Management and Investment Centre, 2022).² However, the amount actually allocated to environmental projects is less than half of the debt forgiven (approximately \$1.5 billion), which, over 20 years or more, is less than

1.5 per cent of the \$100 billion per year climate finance objective. Of this global figure of \$3.7 billion, the total face value of debt in Africa that was addressed is only \$318 million (African Natural Resources Management and Investment Centre, 2022). Nevertheless, a recent study of the African Development Bank shows that many countries, including Angola, the Democratic Republic of the Congo and Zambia could all be good candidates for debt-for-nature swaps (African Development Bank, 2023).

Box 2: Gabon

In August 2023, the Government of Gabon announced that it had signed a debt-for-nature swap with Bank of America, the United States International Development Finance Corporation (DFC) and The Nature Conservancy to refinance \$500 million in national debt towards marine conservation efforts in the country. In the world's second-largest debt-for-nature swap, the country's debt has been restructured under a so-called blue bond. This is the largest deal of its kind signed by any African State to refinance its debt and preserve marine resources.

This transaction will enable the country to make annual contributions to an independent conservation fund and an endowment that will continue to fund conservation after the bonds are repaid. As part of the agreement, DFC will provide political risk insurance of up to \$500 million for the financing, thereby reducing debt service costs for Gabon.

DFC anticipates that the Gabon blue bond will generate \$163 million in financing. Gabon has agreed to allocate \$5 million per year over the next 15 years from the savings to marine conservation. These funds will be used to advance crucial conservation objectives, protect endangered species and support the country's sustainable "blue economy". This innovative financial transaction marks the launch of a comprehensive, long-term conservation project with a new funding stream to help Gabon finance ocean protection and management for 30 per cent of its ocean.

Source: Savage (2023)

² For further reading on debt-for-nature swaps, see United Nations Development Programme (2023).

D. Advantages and positive outcomes for the creditor country

Debt swaps increase the value of the remaining debt claims of creditor countries, allowing creditors to recover all or a larger portion of their debt. When a portion of the debt has already been forgiven but full repayment remains unlikely, debt swaps are especially advantageous. In addition, creditors need less funding from other sources to meet their international climate commitments and can simultaneously register the instrument as official development assistance. As the nominal value of non-concessional debt can be counted as such assistance, many creditor countries have taken advantage of this tool to increase their official development assistance figures.

Furthermore, creditor countries can enhance their environmental credibility by mobilizing joint financing through international funding institutions. A carefully crafted debt swap can guarantee the proper application of funds and carry more weight than a single donation. Finally, debt-for-climate swaps can help developed countries to reach their goal expressed at the twenty-sixth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change of mobilizing at least \$100 billion per year by 2023, while also providing developing countries with additional resources for mitigating and adapting to climate change (Economic and Social Commission for Asia and the Pacific, 2021).

E. Challenges of implementing debt-for-nature swaps

As described above, a well-structured debt swap has benefits for both creditor and debtor countries. While they may seem like a win-win strategy for all parties, debt swaps are complex in their implementation for a number of reasons. Factors constraining the scaling up of debt swaps include:

- » High transaction costs. Debt swaps require the identification of a suitable project, coordination across multiple parties and time-consuming negotiations of at least two to four years (OECD, 2007), making them less

efficient than other financial instruments. High costs have led to uncoordinated, small-scale project-based operations by single-creditor debt-for-climate swap projects. Their fragmented nature has resulted in project-specific performance measures, which act as an obstacle to increasing the scale and constrain the participation of financial institutions that could potentially mobilize significant financing for debt swaps if there were uniform performance indicators and monitoring standards and a liquid secondary market (Mengdi and Nedopil Wang, 2021).

- » Need for long-term financial commitments. The efficacy of debt-for-nature swaps is contingent upon the fiscal capacity of debtor countries for making long-term and consistent commitments to conservation initiatives. Nevertheless, the ability to accurately plan and maintain these commitments is challenging, in particular when faced with fiscal or liquidity crises, as well as governance concerns such as mismanagement and corruption.
- » Potential inflation or local currency devaluation in the debtor country. As already mentioned, one common aspect of debt-for-nature swaps is that local currency is used to meet the swap obligations. However, a devaluation of the local currency may result in a decrease in the value of conservation commitments expressed in that domestic currency. The potential consequences can also include a reversal effect, whereby the influx of substantial amounts of local currency may lead to inflation within the borrowing country.
- » Challenges in the design and implementation of conservation projects. Given that most debt-for-nature swaps incorporate provisions for the preservation of local resources or biodiversity, potential conflicts may arise with existing conservation initiatives, involving, for example, the relocation of local communities or matters pertaining to land tenure. In addition to financial assistance, conservation programmes require operational support

in the form of the consistent provision of equipment, fuel and skilled personnel. Moreover, assessing or overseeing the impacts of conservation programmes can pose challenges. Performance monitoring indicators attached to swaps impose high administrative burdens, in particular in environments with weak capacity, owing to the need to set up parallel structures for project implementation and monitoring, bypassing the debtor Government's own systems and procedures (Cassimon, Prowse and Essers, 2011).

- » Commitment problems. Debtor commitment problems arise when the swap requires actions or policies that stretch into the future, creating an incentive to renege once debt relief has been granted or an inability to meet the obligations because of fiscal shocks over time. The debtor may also be reluctant to undertake regulatory policies that lead to permanent and costly reallocations if it perceives a risk that the creditor will not provide the relief initially envisioned.

3. Conclusion and policy recommendations

Debt-for-climate swaps have received more attention in recent months as the international community tries to reach the \$100 billion per year climate finance goal set out in Copenhagen in 2009. Swaps would increase climate spending, but may be ineffective due to the limited amount of additional resources generated, undesirable conditionalities, important opportunity costs in terms of forgone grants, and the potential negative impact on the debtor's credit ratings.

Only well-designed and structured debt swaps can provide environmental and fiscal improvements. Debtor countries should only engage in debt swaps when debt volumes are sufficient to justify the lengthy negotiation process and high transaction costs associated with deal structuring and

implementation. Effective debt swap projects need to provide the greatest financial value for the debtor country to build political will and obtain national buy-in. To maximize the financial value and create the most fiscal space, the debtor country should seek the largest difference between the original face value of the debt and its sale price by purchasing the debt title on the secondary market or by reaching an agreement with the creditor to apply a discount rate. It should also invest the interest earned by the funds to provide the mechanism with additional capital. Outstanding debt payments should also be converted into local currency payments to conserve foreign currency. In addition, payments should be scheduled in accordance with the original repayment to ensure a steady and predictable stream of funds. To maximize the financial value of the debt, additionality should be ensured for debtor countries through debt relief. Debt swaps and corresponding debt relief should be in addition to a creditor's official development assistance and not crowd out other ongoing investments in climate mitigation and adaptation. In addition, climate-related projects funded by debt swaps should be in addition to those already funded in debtor countries. While it is beneficial to fund concrete climate objectives and the infrastructure to deliver on them, payments under swap deals should not be used to legitimize cutbacks in governmental spending in other areas (Olshanskaya and others, 2020).

In addition, swap agreements must be aligned with national climate goals, and robust monitoring and reporting frameworks must be in place to ensure that climate impacts are monitored and communicated appropriately. Furthermore, transparent governance arrangements and a well-capacitated operator of the agreement are indispensable for success. Going forward, debt swaps should not be limited to climate and nature, but should be expanded to other areas related to the Sustainable Development Goals, as happened with the thematic bond market, which began with "green bonds" and then developed to include social and other sustainability targets.

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