

EXPLAINERS

Debt-Swaps: Can Sustainability Investments avert total Economic collapses

With \$62 billion annually in debt servicing, many developing countries are dealing with growing debt loads, climate change, and environmental damage. To fulfil their international and domestic responsibilities, governments would immediately require increasing their investments in climate and biodiversity conservation. Last month, an agreement for a "debt-for-nature" swap was inked between Portugal and Cape Verde. The latter owes Portugal approximately 140 million euros (\$152 million), and over 400 million euros to banks and financial organizations.

Cape Verde is vulnerable to sea level rise and coastline erosion. The first 12 million euros of scheduled debt repayments would be transferred to an environmental and climate fund, as part of the debt-for-nature deal struck with Portugal to support Cape Verde's transition to cleaner energy sources and combat climate change. A \$553 million swap for Belize in 2021 reduced the country's debt amount to over 10% of GDP and gave credit to protect the world's second-largest coral reef. Also, a 2015 agreement with the Seychelles saw the government commit to protecting 30% of its waterbodies in transfer for \$22 million in debt restructuring.

- **The Fundamental Learnings from ‘Debt-Swaps’**

They impact a nation's borrowing, whether from bilateral government lenders, development financing organizations, or commercial banks, by allowing states to repay loans over longer periods of time or by lowering interest rates and the total amount owed. Debt swaps, if approved by creditors, can prevent default for low-income nations around the world and allow them to reinvest some of their debt repayments in initiatives like nature protection, improving healthcare, or education. They can also minimize creditors' risk by providing extra guarantees and ensuring that at least a portion of a loan is finally repaid.

During the 1980s, in Latin America, first ever debt-for-nature swaps were achieved, with wealthy nations serving as the primary creditors. Environmental debt swaps were uncommon in the last three decades, with most being relatively small government-to-government deals worth \$10 million to \$20 million. Nonetheless, there have been recent initiatives to scale them up, even though they can be operationally hard and expensive to organize. Private creditors — typically bankers and wealth managers – currently hold 70-80% of a country's obligations.

- **Can ‘Debt-Swaps’ be relied upon in future ?**

Developing countries pressing for these swaps are those who are struggling to repay creditors or are in default on their debt, and hence cannot spend money in making the economy greener or maintaining rich biodiversity. However, many supporters, including the World Wildlife Fund, do not see it as a long-term solution to excessive indebtedness in the poorest nations. They often deal with only a small fraction of total debt and don't address existing lending practices.

More creditors could participate in such projects and assist to boost the number of deals if there was a formal platform or standard that established the requirements for green debt swaps. To monitor whether governments are fulfilling their environmental pledges in return for debt swaps, performance metrics are required. However, skeptics of the swaps contend that poor countries should be given complete debt relief and the freedom to invest the money in a way they see fit.

