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INCLUSIVE RECOVERY PROJECT

Debt-for-Adaptation Swap – Investment in Adaptation and Resilience

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Debt-for-Adaptation Swap – Investment in Adaptation and Resilience

By Mizan R. Khan

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Contents

Abbreviations	3
Abstract	5
Executive Summary	6
1 Introduction	8
2 Review of the ECLAC Proposal on the Debt-for-Climate Adaptation Swap (DCAS)	10
3 Rationale of Selecting the LICs for the DAS	12
4 Potential Areas for Investment under DAS Programmes	15
4.1 Lessons learnt from adaptation projects	15
4.2 Areas for investment under DAS programmes	17
5 Conditions for Success in DAS Programmes – the Debtors and the Creditors	20
Conditions on the creditor side	22
6 Conclusions	24
References	26
Author’s Bio	32

Abbreviations

CAT	Climate Action Tracker
DAS	debt-for-adaptation swap
DCAS	debt-for-climate adaptation swap
DFI	Development Finance International
DFID	Department for International Development
DNS	debt-for-nature swap
DRR	disaster risk reduction
G20	Group of 20
GCF	Green Climate Fund
GEF	Global Environment Facility
IISD	International Institute for Sustainable Development
IUCN	International Union for Conservation of Nature
IMF	International Monetary Fund
IPCC	Intergovernmental Panel on Climate Change
ITFGPG	International Task Force on Global Public Goods
LDC	least-developed country
LIC	low-income country
LLA	locally led adaptation
MEA	Millennium Ecosystem Assessment
NAP	National Adaptation Plan

NbS	nature-based solutions
NDC	Nationally Determined Contribution
ODA	official development assistance
SEI	Stockholm Environment Institute
SIDS	small island developing states
UNEP	United Nations Environment Programme
UNISDR	United Nations International Strategy for Disaster Reduction (now United Nations Office for Disaster Risk Reduction)

Abstract

Low-income countries (LICs) are suffering from triple distresses: the mortal impact of Covid-19, increasing debt burdens, and climate change impacts. Obviously, they are all suffering from a liquidity crunch because of competing national priorities. In the near term, adequate adaptation finance for climate-proofing development and enhancing the resilience of societies is not likely to be available. Therefore, this policy brief brings in the debt-for-adaptation swap as an alternative source that should be included in the global policy discourse. The long-term bilateral debt of the Paris Club members has been proposed as the best possible target for such swaps because of its potential for expedited dispensation through negotiations between the creditors and the debtors. In view of past experiences with small-scale debt-for-nature swaps, which could not make a dent in debt reduction, this proposal is about involving large sums in debt-for-adaptation swaps. Based on a review of past adaptation projects, some areas have been suggested for such investments. However, the success will depend on compliance with many conditions on both sides – the creditors and the debtors – the foremost being an agreed understanding and commitment: Creditors must see their responsibility as a long-term programme of supporting adaptation in LICs with an appreciation that there are genuine global benefits from strengthening their economic and social resilience. The debtor nations must own the scheme, supported by enabling policy-institutional frameworks, including the establishment of an open, transparent, and accountable system of fiduciary management.

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Corresponding author: Mizan R. Khan, mizanrkhan54@gmail.com.

Executive Summary

The global community already lives in a climate-changed world. Covid-19 and the consequent economic shocks have put additional strains on all countries – rich and poor. The low-income countries (LICs) are hit the hardest from these shocks and have the least amount of adaptive capacity. The increasing levels of debt for these countries have reached an unbearable phase, particularly after Covid-19. Adapting to the triple impacts on health, economy, and livelihoods is proving extremely difficult for the LICs. Though the G20 countries have initiated the Debt Service Suspension Initiative for these countries, it excludes more than 60% of their debts. The uptake has not been encouraging, as is evident from the responses of these countries.

But adaptation finance to address particularly the climate impacts, which in many ways are correlated with health effects, is immediate and urgent. During the last decade, the status of adaptation finance has not changed much – hovering below 20% of total climate finance, despite commitments by donors and agencies for a balanced allocation with mitigation. In this globally trying time of a liquidity crunch, where will the resources come from? It is unrealistic to expect new public finance from donors.

This opens a window to look for alternative sources of finance. The debt-for-adaptation swap (DAS) has the potential to respond to this need. It is argued here that with the appropriate design and implementation of such deals, the DAS can be a win-win option, both for the creditors and debtors. Past experiences with debt-for-nature swaps for more than three decades show that relatively little debt reduction has actually occurred in the recipient countries. Experiences in the Caribbean also show that an extremely long time is needed for negotiations alone. Therefore, in order to make the DAS a viable and sustainable option, relatively large amounts of long-term bilateral debt need to be considered while focusing on the LICs with such debts. The investments will have better returns if they are applied to strengthening infrastructure related to health, capacity-building, and in coastal zones, and applied directly to productive sectors such as agriculture, water, forest, fishery, and decentralised renewable energy systems such as solar, wind, and others. These areas at the local community levels are likely to generate income, employment, and economic growth, and also contribute to sustainable livelihoods, debt reduction, and debt sustainability.

However, the success of the deals will depend on compliance with many conditions on both sides, as laid out in this brief. The foremost among them being an understanding and commitment on both sides: Creditors must see their responsibility as a long-term programme of supporting adaptation in LICs with sincerity and an appreciation that there are genuine global benefits from strengthening their economic and social resilience. The debtor nations must own the scheme, supported by enabling policy-institutional frameworks, including the establishment of a transparent and accountable system of fiduciary management. Finally, creditors need to be willing to provide capacity-building support to local and

national institutions under a new paradigm of technical assistance, with local experts leading and foreign consultants facilitating. This process will leave sustainable capacity systems in recipient countries, which in most cases did not happen before.

Parched soil by the White Nile. Khartoum, Sudan.



1 Introduction

Climate disasters are increasing, both in frequency and severity. The frontline victims are low-income countries (LICs) and small island developing states (SIDS) with very little adaptive capacity. The mitigation ambitions so far of major emitters from the Global North and the Global South, particularly from the Umbrella Group (non-EU North), are lacking, compared to the temperature targets set in the Paris Agreement. The Climate Action Trackers «thermometer» projects a temperature rise of 2.2°C to 4.1°C by 2100 (CAT, 2020) unless climate action is scaled-up dramatically. But even if this happens, the last Intergovernmental Panel on Climate Change (IPCC) report (on 1.5°C) made it clear that significant climate damages to livelihoods are to be expected. This makes the need for investments in adaptation immediate and urgent.

On the other hand, the level of adaptation finance is extremely low, despite the pledges by donors. As the private sector is not much interested in adaptation in the LICs because of the inefficacy of market instruments and adaptation being mostly of a public goods nature, international public finance is the best possible source for the LICs. These countries have been accorded preferential treatment for such support in the Paris Agreement. It may be recalled that the provision of climate finance is a legal obligation for the developed countries, both under the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement, and Article 7.4 has recognised adaptation as a global responsibility. But this recognition still falls short of recognising adaptation as a global public good, though adaptation at the national and regional levels is already bringing many direct and indirect global benefits (Khan, 2014a).

Now the Covid-19 pandemic has hit all countries of the world, both rich and poor. But the LICs have been hit the hardest, and half of them are at a high risk of – or already in – debt distress (IMF, 2020). Although the G20 finance ministers endorsed a Debt Service Suspension Initiative in April of this year to grant temporary relief to the poorest countries to help them manage the severe impacts of the pandemic, the uptake to date has been limited.

In view of this unfolding crisis, additional and adequate public money as adaptation finance is unlikely to become available (if past trends are any indication). The debt-for-adaptation swap (DAS) may be a source of alternative finance. Under DAS deals, bilateral and multi-lateral debt relief could enable developing countries, including LICs, to reduce their external debt while investing the funds, thus freed, in national climate adaptation programmes – a growing and unavoidable necessity. But the share of debt relief derived from the debt-for-nature swaps (DNSs) by some creditors was miniscule, just 0.3% of the total (Fenton et al., 2014). Also, there are debates in the UNFCCC process about adaptation finance being new/additional and largely grant-based, and whether DAS deals can be considered as «mobilised» finance. These debates aside, during this global financial crunch, the DAS is an instrument worthy of further exploration by the global climate community.

It is argued here that, with the appropriate design and implementation of such deals, the DAS can be a win-win option, both for the creditors and debtors. However, it depends on many conditions on both sides. Past experiences with DNSs for more than three decades show that relatively little debt reduction has actually occurred in the recipient countries. This policy brief argues that in order to make the DAS a viable and sustainable option, a relatively large amount of public debt needs to be considered, and it will focus on the LICs with large public debts for such deals. The long-term bilateral public debt is likely to be the best target for the DAS because of its potential for expedited negotiations.

This policy brief contains four sections and a conclusion. The next section briefly reviews the experiences in the Caribbean on debt-for-climate adaptation swaps, followed by a discussion on the need for adaptation investments in the LICs and their debt levels relative to what they receive in adaptation finance, etc. The fourth section offers a brief review of what has worked and what has not in adaptation projects so far in order to tease out the potential areas for new investments. The final section reviews the benefits of the DAS, both for the creditors and debtors, and presents the conditions of success to be complied with by both sides. The conclusion summarises the main messages.

2 Review of the ECLAC Proposal on the Debt-for-Climate Adaptation Swap (DCAS)

To understand the efficacy of the DAS in the LICs, it is worth quickly reviewing such initiatives elsewhere. One initiative still in the gestation stage is in the Caribbean, where countries have been suffering from very high levels of debt that often exceed the level of debt sustainability and are compounded by their extreme vulnerability to climate events. In response, the Economic Commission for Latin America and the Caribbean (ECLAC), with supported from the Commonwealth and the World Bank, came up with the idea of a debt-for-climate adaptation swap (DCAS) to grant some relief to the CARICOM (Caribbean Community) countries and also to address the impacts of climate change through better adaptation. Since July 2015, ECLAC has been advocating this idea (ECLAC, 2016).

ECLAC's DCAS proposal calls for donors to use their pledged resources for the Green Climate Fund (GCF) to finance a gradual writedown of 100% of the Caribbean SIDS' multilateral debt stock, which is held by various multilateral institutions, as well as the bilateral debt stock of member states. This would be contingent on debtors agreeing to make annual payments into a Caribbean Resilience Fund in an amount equal to the discounted debt service payments (a «haircut»; ECLAC, 2019). The proposed fund would be expected to provide financing for investment in climate resilience, green growth, and structural transformation in the regional economies. Although this approach may not significantly solve the debt problem, it can serve as a catalyst to enhancing adaptation and debt sustainability.

Finally, a debt-swap task force was established at the meeting held at the Port of Spain on 24 November 2017. Three member states – namely Antigua and Barbuda, Saint Vincent and the Grenadines, and Saint Lucia – were identified to pilot the first phase of the initiative. ECLAC continued to advocate for the initiative at a number of events leading up to the 2019 UN Secretary-General's Climate Action Summit held in New York.

The Caribbean economies have had limited access to concessional external finance because of their status as middle-income developing countries. Evidence also shows that official development assistance (ODA) had been in decline in the region since the early 2000s (ECLAC, 2016). Obviously, the DCAS is theoretically appealing for countries with high levels of debt that face challenges servicing that debt. But the uptake appears to be extremely slow.

This slow uptake can be explained by the following factor: heterogeneity in the debt structures of the Caribbean governments, as the mix of domestic, external multilateral, external bilateral, and private sources varies widely. Therefore the solution cannot be one-size-fits-all. The priorities, design, circumstances, government buy-in and long-term commitment,

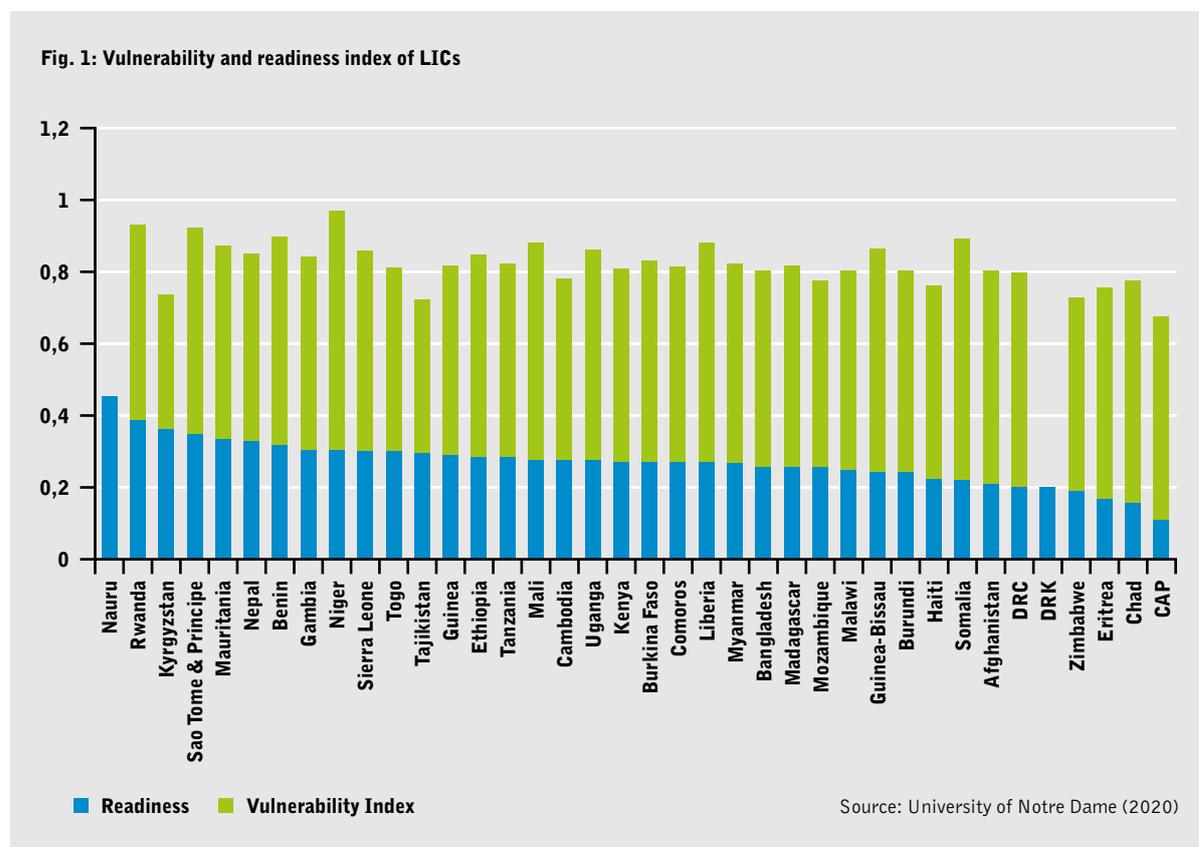
negotiations, partners, and implementation are all differentiating factors, making a singular approach or mechanism difficult to formulate. Although ECLAC's task force has made some progress on this, there is no agreed approach yet. In the meantime, the facilitators of the GCF have indicated that they will not provide funding for debt reduction but will match the debt relief that is provided with financing for climate projects. In response, ECLAC decided to put the focus on resilience-building (of which debt relief is a crucial element) rather than a debt-for-climate swap (ECLAC, 2019).

Although many Caribbean countries have been proponents of debt swaps, particularly for DNSs, since the 1990s with varying levels of success, this has rarely resulted in contributing towards debt sustainability or a significant reduction in debt across the region (Fuller et al., 2018). Furthermore, although negotiating a debt swap frees up a significant amount of funds within the core national budget, it is in no way meant to be a replacement of budgets for national development plans, National Adaptation Plans (NAPs), Nationally Determined Contributions (NDCs), or for securing low-carbon climate-resilient economies. Therefore, competing national priorities may discourage governments from coming on board. Efforts are still ongoing, and different scenarios are being put forward to generate interest in a few of the countries mentioned above (McLean et al., 2020).

The example of the \$27 million Seychelles project – the debt-for-climate and debt-for-nature swaps from three years ago for fishery management, biodiversity conservation, and ecotourism – is widely cited as a success. But Seychelles again has invested quite significantly in oil and gas exploration in its waters (Degnarain, 2020).

3 Rationale of Selecting the LICs for the DAS

Already half of the LICs are in debt distress (IMF, 2020). Covid-19 has exacerbated this situation, rendering them unable to pay for debt services. On the other hand, these countries are extremely vulnerable to climate change impacts. Figure 1 shows that although these countries are very vulnerable, their readiness index is not high, which is not unexpected. However, there are broad differences in their readiness status, ranging from 0.1 to almost 0.5 among the LICs. The ND-GAIN Country Index of Notre Dame calculates this index based on economic, social, and governance readiness. This means that these countries obviously need to strengthen their adaptive capacities, which include social and economic resilience as well.



Lessons from the still exploratory phase of the DCAS – spanning several years in the Caribbean region – tell us that such deals can be more feasible if they focus on homogeneity in the debt profile, whereby the amounts for debt relief should be large enough to lead to a reduction in the debt burden while promoting good adaptation practices. Also, the transaction costs should be lowered as much as possible. External debts come in the form of bilateral or multilateral loans or from the private sector. As private-sector and multilateral agencies do not have direct commitments of climate finance under the UNFCCC, bilateral loans owed to developed-country parties are the option for the alternative forms of financing for adaptation (Fenton et al., 2014), although the DAS does not involve new resources.

Debt relief from this source has several built-in advantages, such as fewer bureaucratic processes, less time needed for negotiations, and historical relations between debtor and creditor countries. This is corroborated by the fact that bilateral DNSs accounted for 93% of these deals during the period 1985–2015 (Steele and Patel, 2020). The highest share of adaptation finance support is also delivered through bilateral channels (Dosji and Garschagen, 2020). The average debt stock to gross national income in this group of countries stands at 37%, but it ranges from 11% in the Democratic Republic of Congo to 118% in Mozambique (Steele and Patel, 2020). In 2018, the LICs had to pay back more than \$11.2 billion as principal and more than \$4.5 billion in interest against receiving just over a billion dollars in adaptation finance (see Figure 4 and Annex 1).

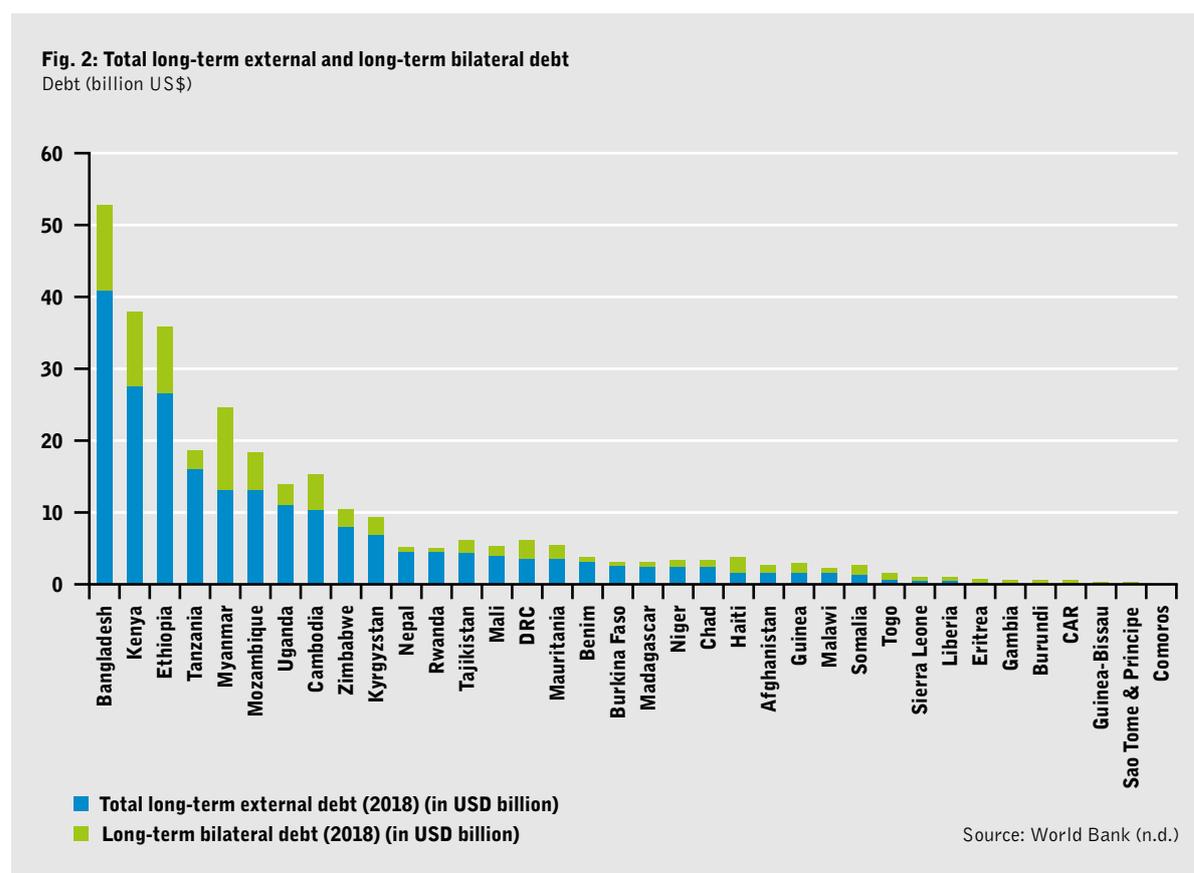
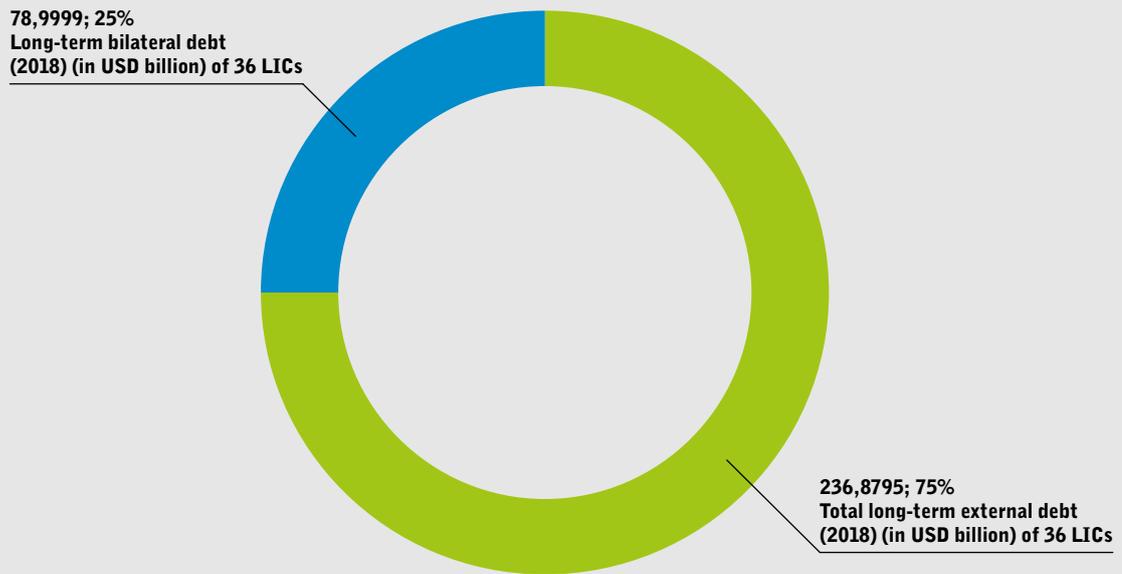


Figure 2 shows that the LICs had substantial amounts of bilateral debt in 2018, ranging from US\$100 million in several countries to more than \$11 billion for Bangladesh. Figure 3 shows that about 25% of the LICs’ debt is from long-term bilateral sources. A number of countries have bilateral debts of more than a billion US dollars. The adaptation support provided by the creditors is many times smaller than the LICs’ debt service payments. For this reason, this policy brief zeroes in on the area of bilateral debt relief. In April of this year, the G20 leaders announced the Debt Service Suspension Initiative for the poorest countries, allowing 77 low-income and ODA-eligible countries to defer interest and debt service payments until the end of 2020. But the level of engagement from these countries so far has not been encouraging.

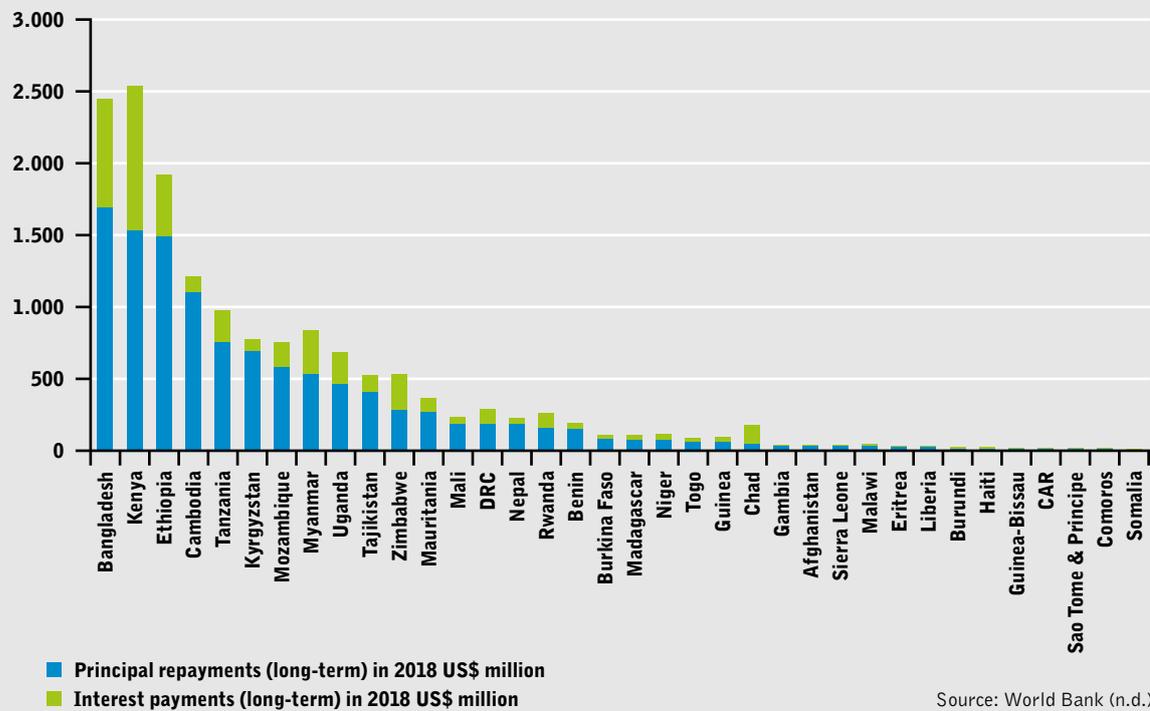
Fig. 3: Share of long-term external debt and total bilateral debt of the LICs



Source: World Bank (n.d.)

Fig. 4: Payments on the principal and interest on debts by the LICs in 2018

Payment in million US\$



Source: World Bank (n.d.)

4 Potential Areas for Investment under DAS Programmes

4.1 Lessons learnt from adaptation projects

To locate the potential areas for adaptation investments, perhaps it is wise to review past experiences with adaptation to see what has worked and what has not so that the lessons can lead to better pathways. Initially, adaptation was not a prominent agenda item in the climate regime. But during the last two decades, extreme events have become the «new normal», hitting the poorest communities and countries the hardest. But they have the least amount of adaptive capacity, with no cushion to fall back upon. Actually, these countries are suffering from both developmental deficits as well as adaptation deficits (Burton, 2009; Fankhauser and McDermott, 2014). This reinforces the poor communities' vulnerability, which is a function of their geophysical locations and the socio-economic conditions that have arisen due to structural inequalities. Thus, it is really difficult from a practice point of view to distinguish adaptation from development. This gives some developed countries the wiggle room to obscure the qualitative difference between climate finance and development assistance. But this distinction has been recognised in the climate regime. In any case, the two forms of funding – adaptation finance and development assistance – are fungible, which means that recipient countries can realign their spending decisions to achieve the adaptation-development mix they desire (Eyckmans et al., 2015). Actually, the development literature now focuses more on climate-resilient development to emphasise the strong link between adaptation and economic development. This link has been studied by Fankhauser and McDermott (2014), who show that economic development affects both the supply and demand for adaptation.

Based on a literature review, the main areas of adaptation actions can be considered as: 1) addressing the drivers of vulnerability, 2) disaster risk reduction (DRR), and 3) building landscape/ecosystem resilience (Eakin and Wehbe, 2009; McGray et al., 2007). These components can be ascribed to three theoretical constructs of adaptation: the sustainable livelihoods framework (DFID, 1999; IISD et al., 2003), the DRR framework (UNISDR, 2005, 2015), and ecosystem services (MEA, 2005). These theories provide the space to consider adaptation decision-making on multiple spatial scales, across multiple environments (from human to natural), and on multiple administrative scales (household to national to international).

During the last two decades, hundreds of stand-alone adaptation and mixed-adaptation development projects covering all the three areas mentioned above have been undertaken in the developing countries. There has been no global assessment of those projects because adaptation is inherently region- and locale-specific. Still, a few overall traits can be observed.

Adaptation projects undertaken, for example, to enhance forest cover, diversify incomes of poor communities, or advance early-warning systems and DRR have had commendable successes (GEF, 2016). The Global Environment Facility study includes a number of case studies from around the world, including one in Bangladesh, where resilience was built with vulnerable coastal communities, transforming barren lands into livelihood-supporting plots through an innovative 3F-based land-use model (fish, farming, and fruits). Research also shows that villages receiving adaptation support or access to extension services or credits attend better to climate risks and build adaptive capacity (Burke et al., 2015; di Falco et al., 2011).

Decentralising climate funds and the associated management down to the local community level works better (Crick et al., 2019). In Bangladesh, for example, the clients of Grameen Bank and BRAC who have little money have built their adaptive capacity quite commendably. In the background paper on locally led adaptation written for the Global Commission on Adaptation, Mfitumukiza et al. (2019) have presented evidence-based findings of the benefits of locally led and community-based adaptation projects. These benefits are: effective and context-specific programmes; higher social, environmental, and economic returns; more equitable results; more holistic approaches; and amplified local knowledge from learning by doing.

However, there are important adaptation gaps, behavioural barriers, and market failures, which hold back effective adaptation (Fankhauser, 2016). There are many instances of insufficient adaptation, or potential limits to adaptation, given that future climate risks may be more severe than the effects of current climate disasters (Adger et al., 2009; Dow et al., 2013; IPCC, 2018). But avoiding loss and damage from climate stressors saves money – as stated in the 2019 flagship report of the Global Commission on Adaptations, *Adapt Now: delay and pay, or plan and prosper* (GCA, 2019).

Considerable research has gone into understanding the adaptation deficit. First and foremost is the gap in adaptation finance. There is particular concern about the ability of LICs and population groups to adapt effectively, their response strategies often being fragile (Burton, 2009; Dercon, 2002). The status of adaptation financing shows a gap in orders of magnitude between the estimated need and the supply (Khan, 2014a; UNEP, 2016). Of the delivered «fast start finance» during the 2010–2012 period, between 7% and 30% has gone to adaptation (Buchner et al., 2014; Ciplet et al., 2013; Nakhooda et al., 2013). What is more disquieting is that an overwhelming share of climate finance (76%–80%) is ODA (Oxfam, 2012; Nakhooda et al., 2013). Soanes et al. (2017) have shown that less than 10% of global climate funds reached the local level during the 2003–2016 period. Even this small amount of money was directed to short-term interventions by distant «experts» who were accountable to donors and aid agencies rather than to communities (Norton and Huq, 2019).

There are also policy, market, and behavioural failures that help explain shortcomings in adaptation performance (Berkhout, 2012; Biesbroek et al., 2011; Cimato and Mullan, 2010; Grothmann and Patt, 2005; Moser and Ekstrom, 2010; Repetto, 2008). Behavioural failures relate to cognitive barriers, inertia, procrastination, high discount rates, and lack of attention by senior management. Market and policy failures affecting adaptation include insecurity over land titles, asymmetric information between buyers and sellers about the risk profiles of assets, moral hazard related to insurance, or at-risk communities looking for government assistance. The presence of these barriers implies that public policy has an important role in overcoming market failures, correcting policy distortions, and incentivising private adaptation. Fankhauser and Soare (2013) suggest three main roles for public policy, such as: 1) ensuring an enabling policy environment; 2) overseeing the provision of climate-resilient public goods, and 3) providing government assistance for the most vulnerable. The presence of adaptation gaps in poor countries and among poorer population groups suggests the need for capacity-building, technical assistance, and help with response plans (Watkiss, 2016). For example, a review of developing-country NDCs indicates that an overwhelming majority of them put capacity-building as a condition for the implementation of their NDCs (Khan et al., 2020; Pauw et al., 2018). The least-developed countries (LDCs) have mostly focused on the need to build adaptive capacity, which includes education and training, research and development, public awareness, etc.

There is also a lack of prioritisation of adaptation needs in longer-term perspectives, many of which can be win-win options. Examples include ecosystem-based adaptation such as mangrove protection (Barbier, 2007; Das and Vincent, 2009; Tri et al., 1998), nature-based solutions (Chausson et al., 2020), and measures dealing with current climate variability and extreme events (di Falco et al., 2011; Paul, 2009).

4.2 Areas for investment under DAS programmes

The review above sheds some light on areas that present themselves as better candidates for investments using debt relief funds. The combined triple effects of climate change, Covid-19, and debt distress will push additional millions of people into poverty in many developing countries. But these countries need to achieve sizeable economic growth to maintain debt sustainability and people's incomes. The unavoidable necessity is to initiate policies that strengthen development infrastructure and address food-, employment-, and income insecurity. This dictates that investments from the DAS should be diverted to early-warning systems; DRR; risk transfer and risk pooling; establishing coastal green-belts; improving infrastructure, including human settlements to avoid loss and damage; and investing in productive sectors such as climate-resilient agriculture, water, forestry, fisheries, and decentralised renewables such as solar and wind, among others. Many of these activities bring in triple benefits for adaptation, mitigation, and development.

Most of the developing countries, including the LICs, are now in the process of preparing their NAPs and the updated NDCs, so the immediate focus should be on integrating adaptation and resilience into the countries' overall development strategies. This will allow for establishing an enabling policy-institutional framework for implementing programmes and projects at the ground level. As investments face competing priorities, the policy process related to climate-proofing development should be based on the short-, medium-, and long-term prioritisation of countries' needs.

As adaptation is inherently region- and locale-specific, adaptation projects cannot have a «one size fits all» approach, even within a country. This leads to examining the potentials of locally led and community-based adaptation models, which are specifically designed to suit the locale. The efficacy of these models is tested on the ground. It should be mentioned that, in developing countries, often adaptation decision-making is centralised and decided largely in the administrative centre of the country. This is one reason why only 10% of adaptation finance so far has reached the local community level. For right reasons, the GCA has locally led adaptation (LLA) as well as nature-based solutions (NbS) listed as two of the eight tracks of its programme. The LLA and NbS are particularly important because the farmers and the poor earn significant shares of their livelihoods from natural resources.

The funds to be created from the debt relief must maintain sustainability. This means that the newly created funds should invest in adaptation actions that strengthen livelihood options, including diversifications that generate employment and income for the poor. This is needed in light of the severe impacts of Covid-19 so that they are not pushed further into the poverty trap. Figure 5 shows the correlation between investments and adaptive capacity of a country. With their 2050 Vision, the LDC Group aims to put their development pathways on a low-carbon and climate-resilient track by 2030 and to deliver net-zero emissions by 2050 (LDC Group, 2019). The group also pledged to deliver at least 70% of climate finance down to the local community level.



Polluted water is bad for the Comoros population which heavily dependent on agriculture and fishing for their livelihood.

5 Conditions for Success in DAS Programmes – the Debtors and the Creditors

Let us first discuss the benefits of the DAS for debtor and creditor countries.

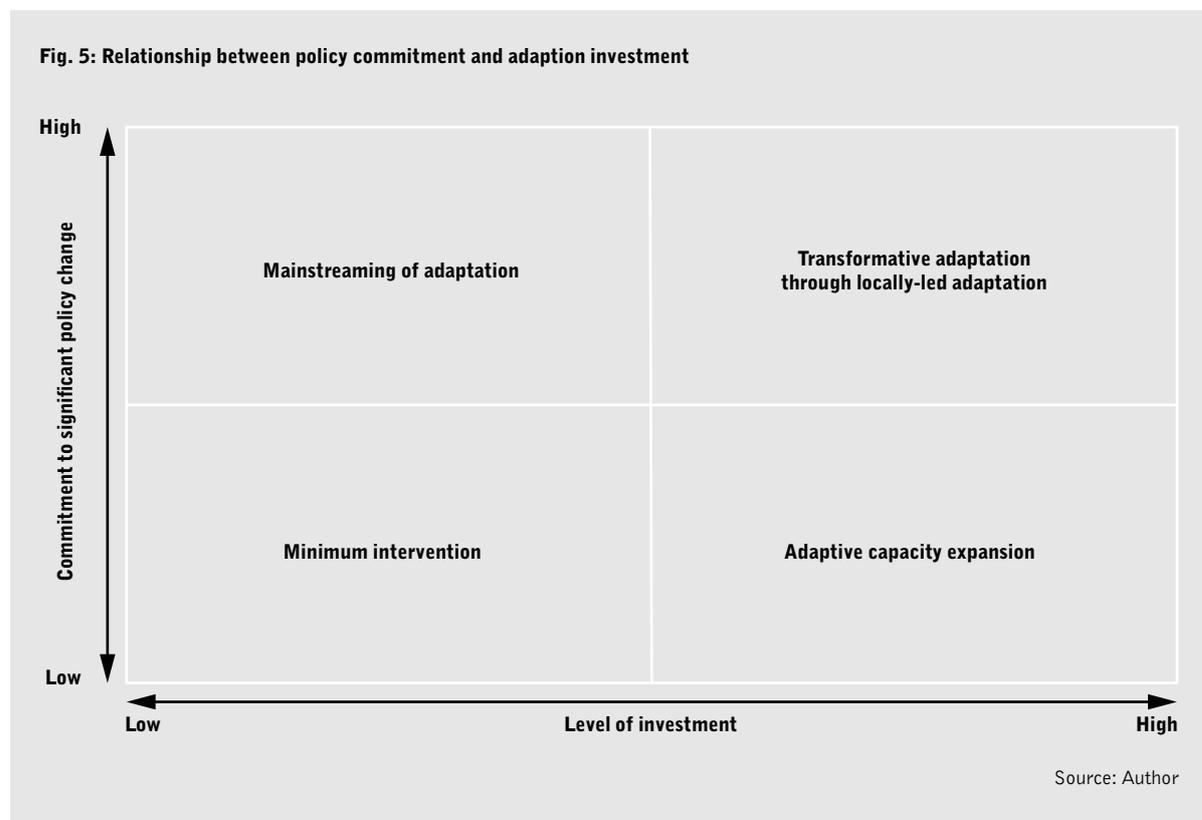
For debtor countries: Many different benefits for the debtors have been discussed in the available literature on these issues (draws on Cassimon et al., 2011; Fenton et al., 2014; Warland and Michaelowa, 2015). First, Additional resources – if it involves large sums – are available for investments in adaptation. Second, it will allow for more fiscal space in the debtor government budget. Instead of having the more painful option of debt servicing in hard currency, local currency can be invested to provide public goods in line with national and local adaptation priorities. Third, if invested wisely in LLA projects and managed properly, it can reduce poverty and generate growth, employment, and income among the marginalised groups. Fourth, the DAS may contribute to a sufficient enough reduction in the debt stock to improve macroeconomic stability. Finally, the DAS provides predictability of funding and the potential to attract additional funding from other sources, both national and international.

Benefits for creditors: First, the DAS will require no new budgetary allocations, as debt relief helps developed countries finance their climate commitments at a time when they are implementing austerity measures and public finance is in short supply in a post-Covid world. Second, it would reduce the difficulty of scaling-up climate finance to meet the collective annual goal of US\$100 billion by 2020. Third, it would fulfil the predictability requirement stipulated in Article 4 of the UNFCCC and Article 9.5 of the Paris Agreement by providing a predictable source of finance over the long term, as developing countries already hold the capital in their national accounts. Finally, DAS deals allow the creditors to apply «soft power» relatively cheaply and earn the good will of the debtor nations. This is a huge foreign policy gain of the Paris Club members.

Conditions for success in the DAS scheme: Based on experiences from DNSs and the long incubation process of the ELCAC proposal in the Caribbean region, we can surmise a number of conditions for success in such a scheme. These conditions relate both to the debtor and creditor nations.

In the debtor nations: First, the debtor nations have to recognise the perceived benefits for the country from the scheme. Based on this perception, the country needs to initiate an enabling policy-institutional framework for effective implementation (Figure 5). Therefore, these schemes need to be aligned with their NDCs, NAPs, and other development-related policies.

Second is country ownership: In order to ensure alignment with national strategies and plans, countries that already have climate change mitigation or adaptation plans in place could be especially attractive for such swaps (Fenton et al., 2014).



Third, as centralised management is not effective in adaptation, the government needs to initiate the decentralisation of adaptation fund management through the creation of local adaptation funds based on agro-ecological zones (Khan, 2014b). This is critical for promoting LLA and community-based adaptation.

Fourth, the debtor nations also have to transparently involve the relevant stakeholders in the oversight and management of the schemes. An open and democratic process will give the programme legitimacy.

Fifth, the debtor nations have to establish a transparent fiduciary management system. There is a widespread perception, including by Transparency International, that governance in many LICs is quite weak. To earn the confidence of creditors that the money is being used efficiently, debtor countries need to have strong governance systems and be willing to implement a monitoring, evaluation, learning, and reporting system with clear indicators to document progress.

Sixth, the debtor country must have the budgetary means to invest the agreed amounts into climate change programmes. For this, it needs to avoid generating the funds by printing money, as this may trigger inflation (Partow, n.d., p. 8; Warland and Michaelowa, 2015).

Finally, there are a number of options for managing the funds. Some countries, including LICs such as Bangladesh, already have climate change funds that are financed by domestic resources. The DAS money can be managed by these funds. The second option could be to deliver the money into the national budgets of the LICs, and the governments can allocate resources for the agreed projects and programmes (Steele and Patel, 2020). Another option could be to initiate a dedicated mechanism to run the programme, like in Seychelles or in the ECLAC proposal in the Caribbean. It all depends perhaps on the size of the pot, its plan for ensuring sustainability, etc. In any case, the operational modalities can be sorted out through negotiations.

Conditions on the creditor side

First, the creditor nations: The Paris Club members need to expand their perspectives on adaptation. The level of adaptation finance continues to be extremely low. This can be attributed: 1) to the inefficacy of market mechanisms for adaptation, and 2) to the problematic framing under the regime that conceptualises adaptation as responses that are bound to national territory. But different types of cross-border climate change impacts – or borderless climate risks (Benzie and Persson, 2019) – are already evident, and the Paris Agreement also frames adaptation as a global responsibility. Many of the adaptation programmes at the national level bring in both direct and indirect global benefits (Khan, 2014a; Persson, 2011). This means that there is a need for an appreciation of adaptation as a global public good. Based on this understanding, there is a future need to mobilise additional resources by taxing the global public «bads».

Second, based on this understanding, creditors need to be willing to sell the maximum possible amount of existing bilateral debt at a price that is significantly lower than face value (Partow, n.d., p. 5). Receiving debt relief while mobilising climate finance could be an attractive proposal during the likely contraction of donor budgets in the wake of Covid-19. Though there is a debate whether the DAS represents additional money or should be considered «mobilised» finance (Warland and Michaelowa, 2015), such schemes can receive quicker approval from the creditor nations' parliaments.

Third, to provide a meaningful critical mass for a debt-for-climate swap, creditor countries could work as a group – for example the Paris Club – to agree on greater amounts of debt relief to a country. If swaps were to reduce funding flows that would otherwise be provided by creditors, this might reduce the interests of debtors for participating in such swaps (DFI, 2009). Therefore, the debt relief should be large enough to make it attractive to debtors, because their interests lie more in economic growth, debt reduction, and adaptation.

Fourth, the scheme must have a programmatic approach of at least six to seven years so that the outcomes and impacts of investments become visible. In order to ensure adaptation benefits, the programmes need to ensure that the sustainability of the measures undertaken

will last a long time. This should be based on a joint understanding of creditors and debtors.

Fifth, allowing flexibility to debtors in the management: This would be done so that they can play a major role in the decision-making for investments. This is crucial to counter arguments of perceived state sovereignty issues, and for ownership. The creditors have agreed that there is a qualitative difference between ODA and adaptation finance. Article 9.3 of the Paris Agreement stipulates that

as part of a global effort, developed country Parties should continue to take the lead in mobilizing climate finance from a wide variety of sources, instruments and channels, noting the significant role of public funds, through a variety of actions, including supporting country-driven strategies, and taking into account the needs and priorities of developing country Parties [...]

Finally, creditors need to be willing to provide capacity-building support to institutions where required (Khan et al., 2020), with the understanding that previous project-based, workshop-focused, foreign consultancy-led initiatives did not work well. Therefore, the GCF and the GEF could provide technical assistance and capacity-building for nature and climate-resilient investments, whereby local expertise lead and experts from developed countries facilitate. A paradigm shift is needed from the conventional technical assistance modality. The International Task Force on Global Public Goods, established in 2003 and led by France and Sweden long ago, has recognised the strengthening of adaptive capacity in developing countries as a global public good (ITFGPG, 2006).

6 Conclusions

This policy brief attempts to analyse debt-for-adaptation swaps as an alternative instrument for boosting the level of adaptation finance, which is extremely low relative to the needs estimated by many different agencies. The picture is not expected to change much because of several factors: first, the inefficacy of market mechanisms for most of the adaptation actions, because they are mostly of a public goods nature; second, the traditional narrow economic conception of adaptation as public goods bound to national territory, which apparently does not bring in global benefits; third, the negative fallout from Covid-19 on all economies, including the rich ones, is likely to constrain additional public finance at the moment from the donors.

Obviously, there is a search for alternative sources of climate finance, which includes both mitigation and adaptation. For LICs, adaptation finance is extremely important because they are hit the hardest by extreme climate events – the «new normal» – and have the least amount of adaptive capacity. Their economies are also being hit the hardest because of Covid-19, and this severely constrains their ability to service debts. This creates an opportunity for turning debts into adaptation investments through swaps in local currency at a discounted value. For this purpose, bilateral debts appear to be the prime candidates for such deals because of some advantages: historical relations between the Paris Club members and the LICs, and the potential for expedited agreements, including the operationalisation of modalities between the creditors and debtors.

However, based on past experiences with adaptation projects, investments should be directed at building such infrastructure and put into productive sectors that contribute to economic growth and enhance resilience to climate shocks. Finally, the success of the deals will depend on the levels of compliance by both sides with the many conditions, as laid out above, as well as their understanding and commitment: Creditors must see their responsibility of supporting adaptations in LICs with sincerity and an appreciation that there are genuine mutual and global benefits. The debtor nations also must own the scheme, supported by an enabling policy-institutional framework, including establishing a transparent and accountable system of fiduciary management.

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Annex 1: Adaptation finance flowing into the LICs/LDCs and debt service payments flowing out (in US\$ millions)

Country	Climate finance in 2019	Principal repayments (long-term) in 2018	Interest payments (long-term) in 2018
Afghanistan	10.6	28.8	9
Bangladesh	58.6	1,693.60	761.6
Benin	20.7	152.7	39.9
Burkina Faso	34.8	78.1	31.6
Burundi	13.8	8.4	3.1
Cambodia	38.4	1,108.80	102.9
Central African Republic	2.8	3.4	1.8
Chad	16.6	42.6	131.3
Comoros	46.3	2	1
Congo, Dem. Rep.	3.0	186	98
Eritrea	6.7	22.8	3.2
Ethiopia	88.1	1,494.20	436.2
Gambia	36.1	30.4	6.6
Guinea	15.1	56.9	28.7
Guinea-Bissau	10.2	3.8	2
Haiti	8.2	8.3	3.6
Kenya	26.5	1,534.00	1,018.40
Kyrgyz Republic	23.6	691.8	87
Liberia	8.5	21.9	8.6
Madagascar	16.4	71.9	30.3
Malawi	24.8	27	16
Mali	60.6	187.1	46
Mauritania	23.3	270.1	92
Mozambique	50.2	582.4	169.7
Myanmar	15.9	533.5	308.8
Nepal	63.0	180.5	45.1
Niger	59.5	70.7	43.7
Rwanda	27.6	155.5	101.2
Sao Tome and Principe	7.4	2.7	1.3
Sierra Leone	10.0	28.5	4.7
Tajikistan	13.7	0	0
Tanzania	131.8	401.8	120.1
Togo	5.4	756.7	218.2
Uganda	62.6	57.9	26.4
Zimbabwe	1.0	463.4	219.8

Source: Heinrich-Böll-Stiftung (n.d.)

Author's Bio

Prof Dr Mizan R. Khan is currently Deputy Director at the International Centre for Climate Change and Development (ICCCAD), Independent University, Bangladesh (IUB), and Programme Director, LDC Universities' Consortium on Climate Change (LUCCC), Dhaka. He served as a Visiting Professor/Fellow at the University of Manitoba, School of Public Policy, the University of Maryland, Universite de Poitiers, and at Brown University. He is a Lead Author of the IPCC and has attended climate negotiations as a member of the Bangladesh delegation since 2001. Dr Khan has authored a wide range of publications, including several books published by Routledge and MIT Press, on climate change economics, politics, and capacity-building. He speaks French and Russian as well.

E-Mail: mizanrkhan54@gmail.com.

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Center for Sustainable Finance, SOAS, University of London, Thornhaugh Street, Russell Square, London WC1H 0XG, UK, www.soas.ac.uk/centre-for-sustainable-finance/
Global Development Policy Center, Boston University, 53 Bay State Road, Boston, MA 02215, USA, www.bu.edu/gdp/

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