Debt-for-Climate Swaps

For Prelims: Debt-for-climate swaps, **Paris Agreement, Small island developing states .**

For Mains: Importance of Climate Finance, Significance debt-for-climate swapsto addressing the climate change

Why in News?

Climate change is a global problem that impacts everyone, but it affects some countries more than others. Unfortunately, the countries most vulnerable to the effects of climate change are often the **least able to afford the investment needed to strengthen their resilience.**

- This puts these countries in **danger of facing prolonged fiscal crises,** forcing them to **rely on aid from the international community.**
- **Debt-for-climate swaps** are an innovative financial instrument that aims to address this issue by creating **fiscal space for climate investments.**

What is Debt-for-Climate Swaps?

- **About:**
    - Debt-for-climate swaps can incentivize debtor countries to take meaningful action on climate while reducing their debt burdens.
    - These swaps involve **reducing debt in exchange for policy commitments or spending by debtor countries.**
        - Both official bilateral and commercial debt can be involved in debt-for-climate swaps.
        - Bilateral debt swaps involve redirecting previously committed debt service payments to official bilateral creditors towards **financing mutually agreed projects in areas such as climate action.**
    - In the past decade, **debt-for-climate swaps have become relatively popular among low- and middle-income countries.**
        - **Multilateral development banks and multilateral organizations such as the** United Nations Development Programme (UNDP) **have been advocating this instrument as a debt-relief measure.**
- **History:**
    - Debt-for-climate swaps are a variation of debt-for-nature swaps, which were first proposed in the 1980s as a way to **conserve biodiversity** and **protect tropical forests in exchange for debt relief.**
    - The first debt-for-nature swap was implemented in 1987 between **Bolivia and Conservation International, a** non-governmental organization (NGO).
    - Debt-for-climate swaps emerged in the 2000s as a broader concept that encompasses **not only nature conservation but also climate mitigation and adaptation.**
    - The **first debt-for-climate swap was implemented in 2006** between **Germany and Indonesia,** with the latter committing to **reduce greenhouse gas emissions from**

        - [deforestation and forest degradation (REDD+)]() in return for debt relief.
- **Benefits:**
    - **For Creditors:**
        - Debt-for-climate swaps can enhance their **development cooperation** and **climate finance objectives,** improve their **debt recovery prospects,** and **strengthen their diplomatic relations** with debtor countries.
    - **For Debtors:**
        - Debt-for-climate swaps can **reduce their external debt stock** and **service, free up fiscal resources** for other development needs, increase their domestic investment in climate action, and improve their environmental and social outcomes.
    - **For Both Parties:**
        - Debt-for-climate swaps can foster **mutual trust and collaboration,** create win-win solutions, and contribute to the global efforts to achieve the **Paris Agreement** and the **Sustainable Development Goals.**
- **Challenges:**
    - Creditor countries are primarily hesitant to go for debt-for-climate swaps unless they are structured to make sure that the **public expenditure commitment towards climate action is superior in value to the remaining debt service.**
        - However, conditional climate grants are designed and structured to make them impossible to divert and are targeted only for climate investment purposes.

Why should Creditor Countries Engage in Debt-for-Climate Swaps?

- Creditor countries should engage in debt-for-climate swaps because signatories to the **Paris Agreement** and the **Glasgow Financial Alliance for Net Zero (GFANZ)**, a **global coalition of financial institutions,** have the commitment to provide financial assistance to developing countries to build clean, climate-resilient futures.
    - Debt-for-climate swaps are one way to fulfill their commitments.

How do Debt-for-Climate Swaps Help Small Island Countries?

- **Small island developing states (SIDS)** are eyeing debt-for-climate swaps to address the two challenges they face: **adapting to increasing climate risk and recovering from financial distress.**
    - Debt-for-climate swaps offer a possible solution for SIDS to address these issues. These involve reducing external debt in exchange for policy commitments or spending by the debtor country.
    - By participating in debt-for-climate swaps, SIDS can **reduce its external debt and free up fiscal resources** for other developmental needs, including **climate action.** This can help them **increase their domestic investment in climate action.**

Source: DTE