

Climate-Just Debt Swaps



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Climate-Just Debt Swaps

Aims

- Climate Mitigation & Adaptation
 - In the Global South

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 - Funded by the Global North

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- Climate Justice
 - True development

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 - High-value jobs, skills & education

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 - Reduction of debt burden

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- Mechanism for Loss & Damage



COP27
SHARM EL-SHEIKH
EGYPT 2022

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 - Reduction of debt burden
- Mechanism for Loss & Damage
- Incentive compatibility
 - Advanced economies



Advanced
Economies

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Banks

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 - Advanced economies
 - Multinationals
 - Banks
 - Developing countries



Advanced
Economies

Multinationals



Banks

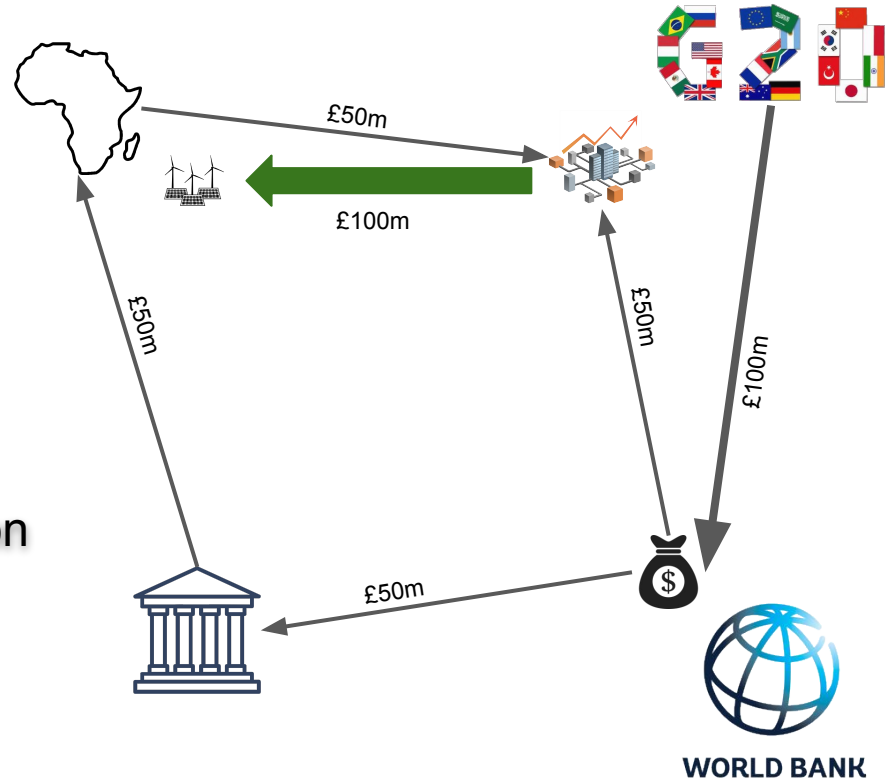
Developing
countries



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Aims

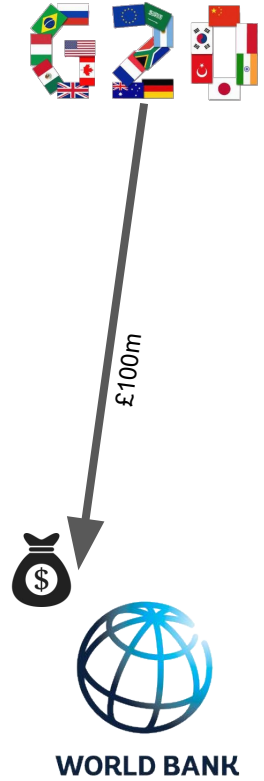
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Climate-Just Debt Swaps

1 → 2 → 3

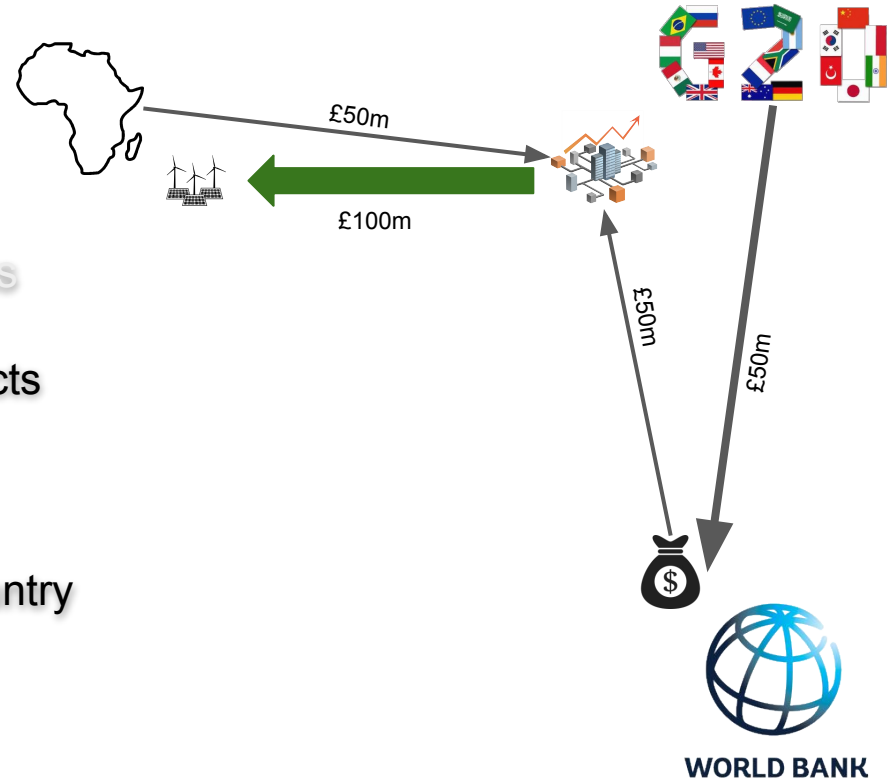
- Contributors make funding commitments



Climate-Just Debt Swaps

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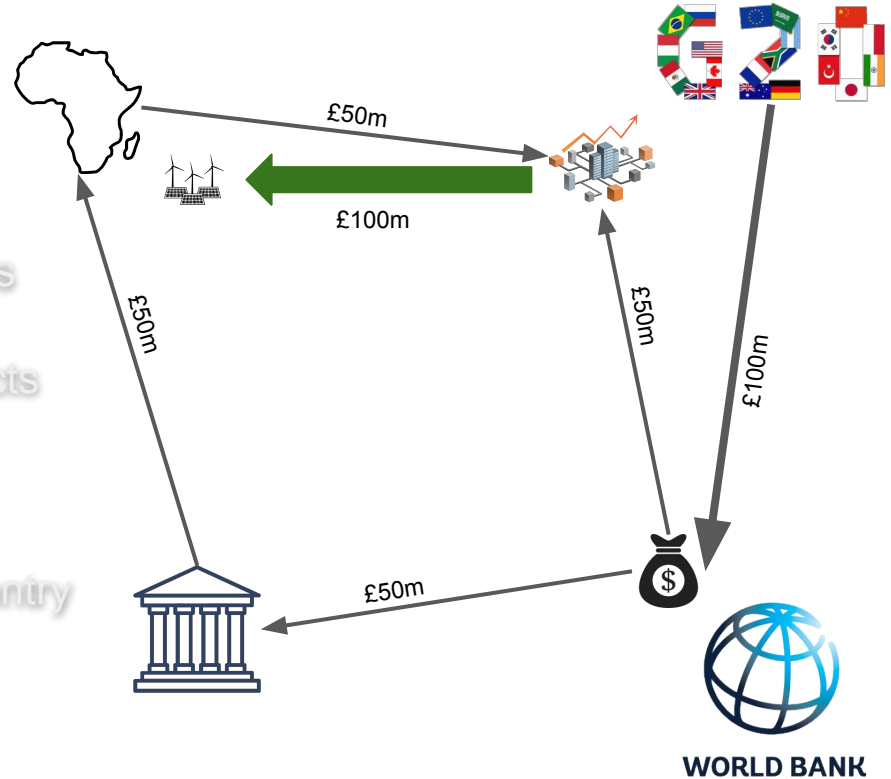
- Contributors make funding commitments
- Countries order green infrastructure projects
- Half the price is paid by the fund
- Conditions apply:
 - Net zero and biodiversity
 - Operational profits → developing country
 - Local labour and supply chains
 - Education provision



Climate-Just Debt Swaps

1 → 2 → 3

- Contributors make funding commitments
- Countries order green infrastructure projects
- Half the price is paid by the fund
- Conditions apply:
 - Net zero and biodiversity
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 - Education provision
- Restructure existing debt:
 - The old debt is cancelled
 - A cheaper (local currency) loan is made



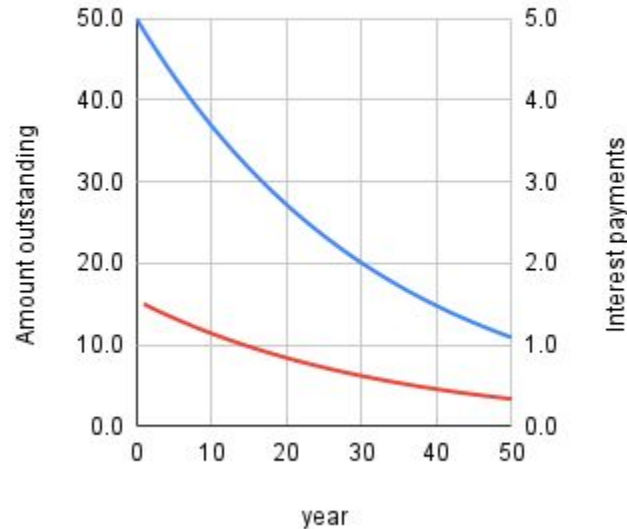
Cross-currency Loans

- Assumptions:
 - The bank uses US dollars
 - The borrower uses shillings (for example)
 - The dollar:shilling exchange rate may fluctuate (currency risk)
 - The bank's country has lower inflation than the borrower's
 - The borrower needs the equivalent of \$US 50m
 - The bank can either lend in US dollars or shillings
 - If dollars, annual interest is 3% of the outstanding balance
 - If pesos, annual interest is 9% of the outstanding balance

Currency Makes a Difference

View from the Bank

Amount outstanding, expressed in USD(2021)



Amount outstanding in blue, values on left hand axis
Interest payments in red, values on right hand axis

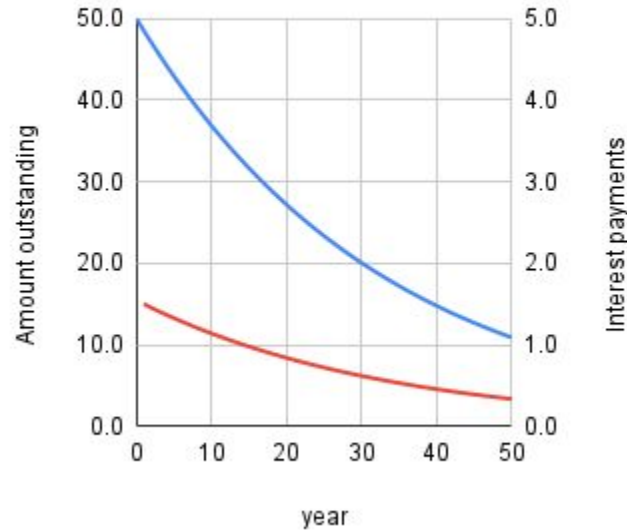
Assume for simplicity:

- loan value: \$50m USD
- repayment schedule:
 - fixed interest rate
 - payable on outstanding balance
 - annual payments
- borrow dollars
- repay dollars
- 3% interest rate

Currency Makes a Difference

View from the Bank

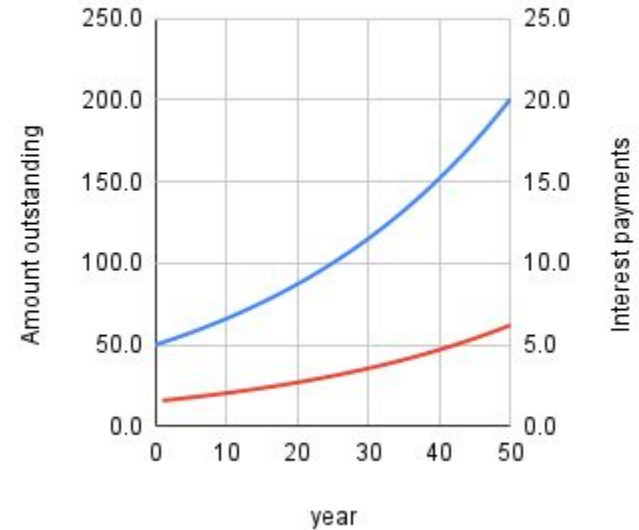
Amount outstanding, expressed in USD(2021)



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View from the Developing Country

Amount outstanding, expressed in real terms



Banks can make loans in any currency

	Loan in hard currency (\$¥€£)	Loan in local currency
Loan capital	\$50m USD	the equivalent
Default risk	x	x
Foreign exchange	-	y
Currency risk	-	z
Bank profit	w	w
Required Interest Payments	3%	9%

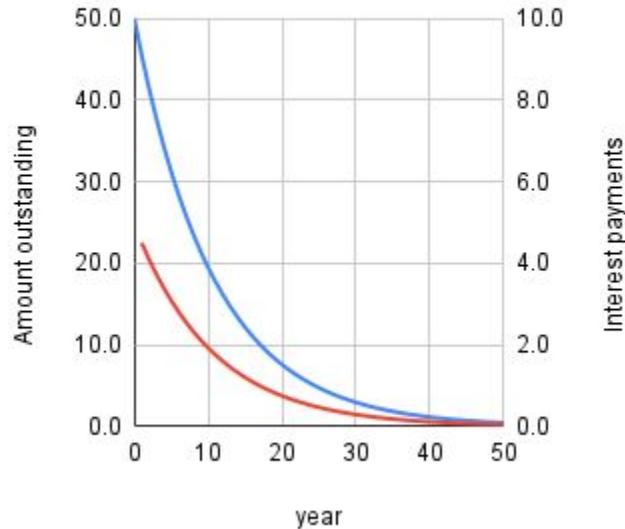
Assumptions (changes in *blue*)

- loan value: \$50m USD
- repayment schedule:
 - fixed interest rate
 - payable on outstanding balance
 - annual payments
- borrow in *local currency*
- repay in *local currency*
- *9%* interest rate

Loans in Local Currency

With Local Currency Repayments

Amount outstanding, if 9% loan in local currency



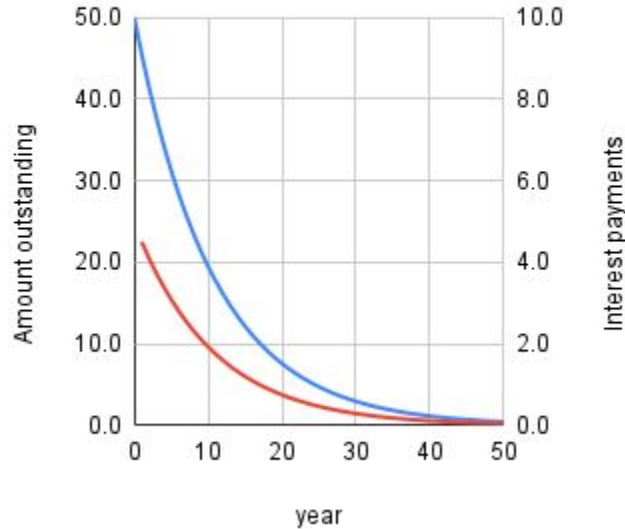
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Interest payments in red, values on right hand axis

- Initial payments higher
 - equivalent to \$4.5m USD instead of \$1.5m USD
- Amount outstanding decreases sharply:
 - repayment rates ARE higher
 - but also values decrease in real terms (because of local inflation)
- Eventually, the debt evaporates
- Bank still happy

Loans in Local Currency

With Local Currency Repayments

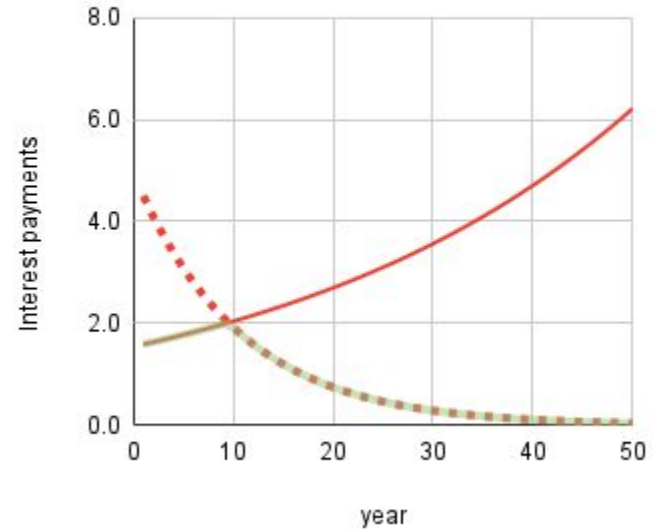
Amount outstanding, if 9% loan in local currency



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Side-by-side Comparison

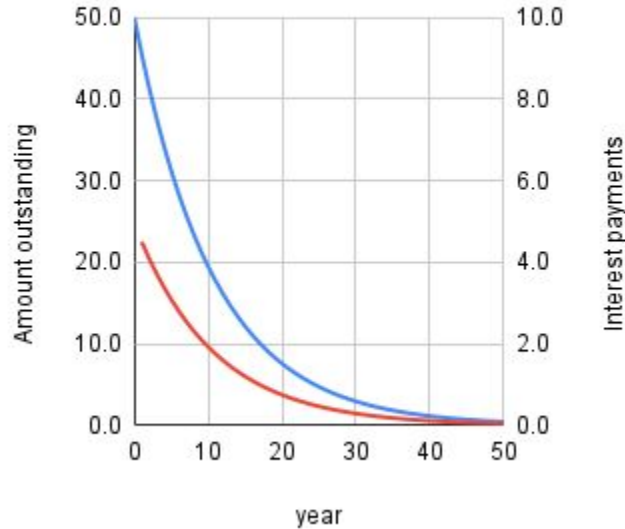
USD loan (red) versus local currency loan (dots)



Loans in Local Currency

With Local Currency Repayments

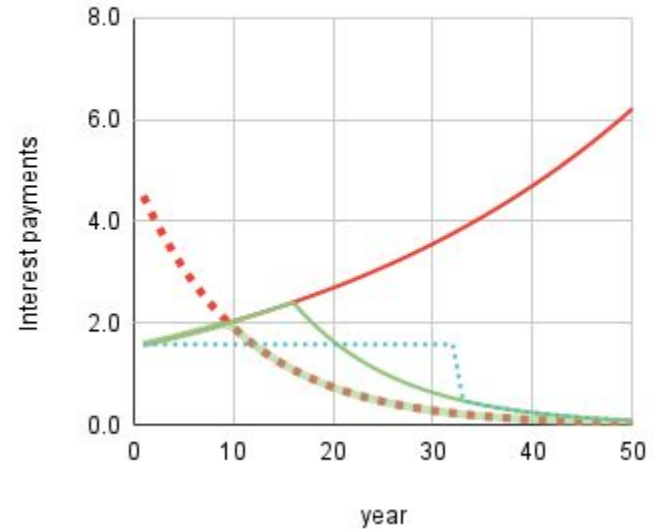
Amount outstanding, if 9% loan in local currency



Amount outstanding in blue, values on left hand axis
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Side-by-side Comparison

Alternative payment schedules in green and teal

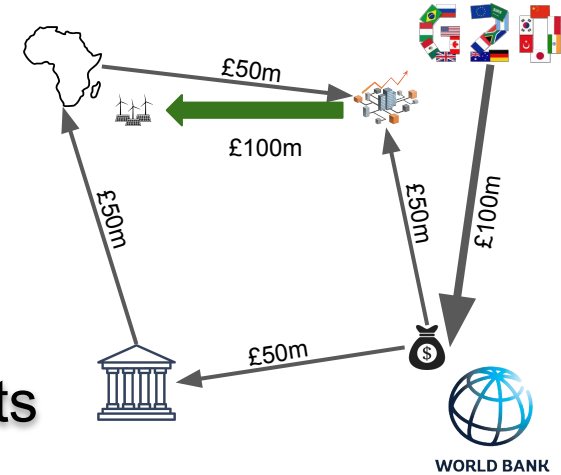


Results - Developing Countries

- Acquire leading edge green infrastructure at half price
- Equivalent amount of hard currency debt written off
- In return, they take out a new, cheaper loan in local currency

Free infrastructure, reduced interest payments

- New profit centre
- High value job creation
- Training and education
- Supply chain knock-ons
- Tax revenues can fund improved institutions
- Reduced reliance on external currencies, skills and resources
- Can take a lead in fighting climate change and biodiversity loss



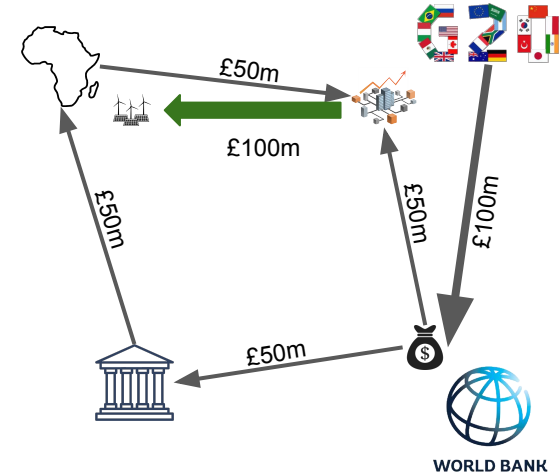
Results - Multinationals

Pros:

- Have a **hugely increased market** for their products
- Are **paid upfront in hard currency**
 - no currency or default risk

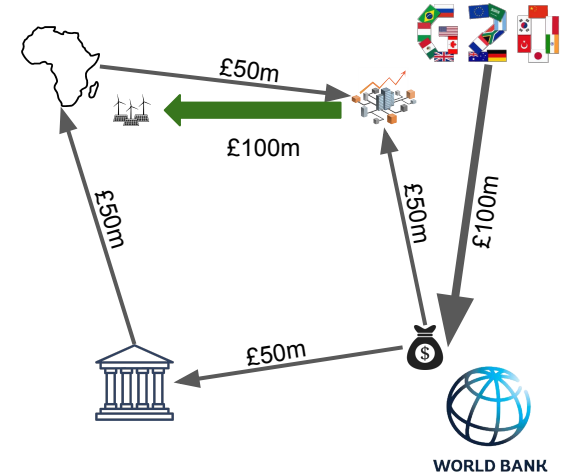
Cons:

- Projects must be net-zero & no net loss to nature
- Can only provide construction, not operation
- Must use local labour and supply chains
- Training and education provisions



Results - Banks

- Improve balance sheet by removing bad and doubtful debt
- Are able to make additional loans with lower default risk

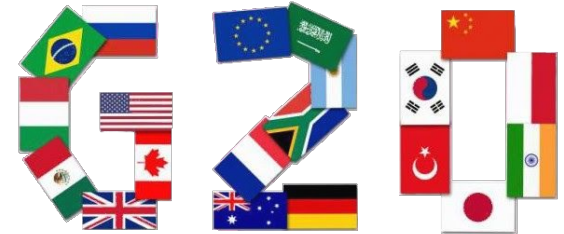
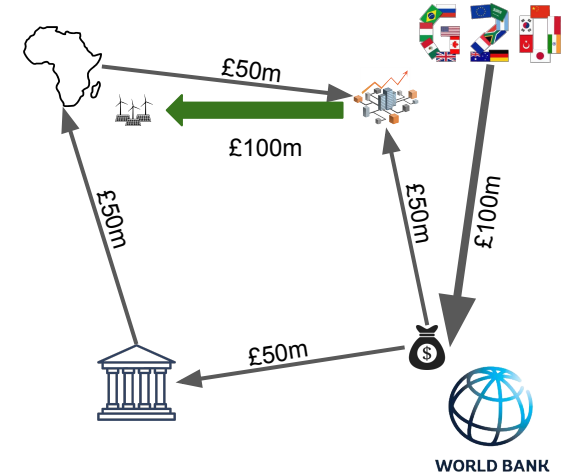


Results - Advanced Economies

- Fund deposits are callable reserves, so they only need to pay out as each project is launched

All funds contributed remain in-country -
direct subsidy of strategic industries

- Funding counts as Foreign Aid, but without the loss
- Funding provides a huge lever for changing company behaviour - for example, by making funding conditional on companies moving from dirty to clean industries
- Can grow their own economy at the same time as reducing global inequality and addressing climate change and biodiversity loss
- The more they contribute, the more their economy (and that of the developing countries) benefits



Summary

Loans can be made in local currencies

→ debt burden will reduce over time

Bad and doubtful debt can be bought cheap

→ can be used to fund debt restructuring

Deals between unequal parties will naturally favour the powerful

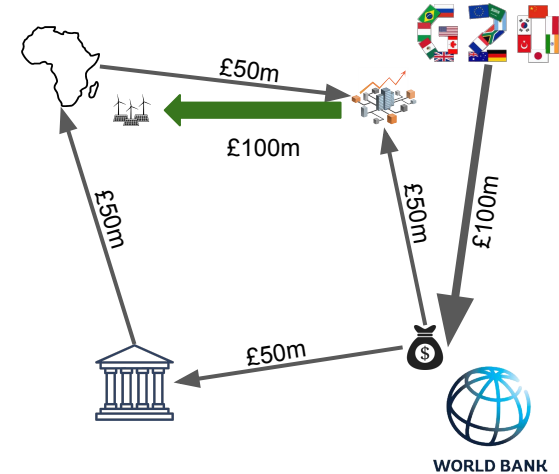
→ so give an MDB the job of setting the terms

If developing countries are exploited their economies will not develop

→ the surplus will create new markets and address inequality

Returning all of the funds to a country's companies keeps money within the economy

→ allowing countries to directly subsidise industries which address climate change



Questions

“And then, one Thursday, nearly two thousand years after one man had been nailed to a tree for saying how great it would be to be nice to people for a change, a girl sitting on her own in a small café in Rickmansworth suddenly realized what it was that had been going wrong all this time, and she finally knew how the world could be made a good and happy place. This time it was right, it would work, and no one would have to get nailed to anything.”

Douglas Adams, Hitchhiker's Guide to the Galaxy

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Photo Credit: Denis Onyodi/KRCS, Climate Visuals

