Sixty Fifth Sovereign Debt News Update: Debt-For-Nature Swap: Portugal Signs Agreement to Trade Cape Verde’s National Debt for Climate Investments

By:

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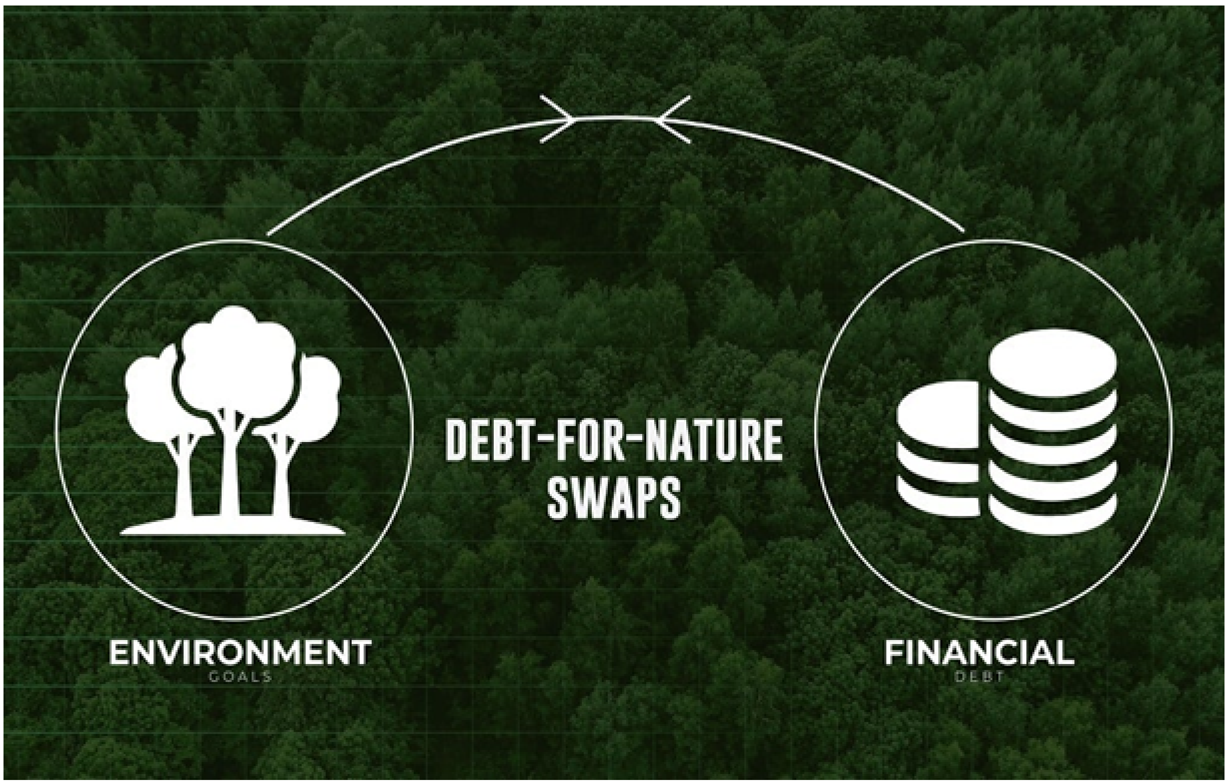
February 6, 2023

In January 2023, Portugal announced it had signed an agreement to swap Cape Verde's debt for investments in an environmental and climate fund that is being established by Cape Verde. The archipelago nation off West Africa's coast, which is already suffering from rising sea levels and significant biodiversity loss due to increasing ocean acidity, owes around €140 million to the Portuguese state and over €400 million to its banks and other entities. Initially, €12 million of debt repayments scheduled until 2025 will be put into an environmental and climate fund established by Cape Verde. Ultimately the entire amount of debt repayments will end up in the fund, allowing Cape Verde to invest in energy transition and the fight against climate change. It is expected that private sector debts owed by Cape Verde to Portuguese companies will, at least in part, be swapped in similar deals to accelerate mitigation and build resilience to climate change in the country.

Climate change is a challenge that takes place on a global scale and no country will be (environmentally) sustainable if all countries are not sustainable. Debt-for-nature deals can help as they can produce green and blue bonds to finance conservation efforts on land and at sea, which appeal to a rapidly growing number of investors seeking to meet net-zero carbon emissions and other environmental goals. Debt-for-nature swaps are financial transactions in which a portion of a developing country's foreign debt is forgiven in exchange for commitments to environmental investments.



Source: News24 While in support of the swap, Cape Verde Prime Minister Ulisses Correia e Silva said in a statement that his country needed to urgently enable mechanisms and financing instruments to support such solutions and deal with natural emergencies. Notably, developed countries have failed to deliver promised climate finance to developing countries. According to research from Overseas Development Institute (ODI), Portugal is one of the countries which in 2020 paid the least percentage of its fair share.The ODI says that –

based on its size, historic emissions and population – it should have paid $688 million towards rich countries' collective $100 billion target. But it paid just $70 million, about one-tenth of its fair share.

Even so, "debt-for-nature" swap deals are emerging in other countries such as Kenya, eSwatini, Pakistan, Colombia, and Argentina, and are part of attempts to resolve a dilemma faced by world leaders on how and who will foot the bill for actions taken to reduce the impact of climate change. According to a recent Reuters report, Zambia is also considering a debt-for-nature swap proposal from the World-Wide Fund for Nature (WWF). If it goes through, it could help the country unhook, at least partially, from a $13 billion debt, currently under re-evaluation. According to Zambian government debt data, the country accumulated $31.74 billion by the end of 2021, out of which $17.27 billion is external debt. While the potential for the swap is not part of the current negotiations under the G20 debt restructuring framework, it could help cut down the country's debt and boost green projects.

But the most notable story of debt-for-nature swaps can be seen in the Seychelles. After defaulting on payment of $230 million in 2008, The Nature Conservancy in 2015 announced a deal that saw approximately $22 million of Seychelles' national debt written off. Consequently, Seychelles has progressed from protecting 0.04% to more than 30% of its national waters, covering 410 000 square kilometres of the ocean after developing 13 new marine protected areas.

Nonetheless, some challenges such as high transaction costs, the need to monitor conservation or climate projects, and the requirement that a debtor country makes a long-term financial commitment, could limit the reliance on debt-for-climate/nature swaps as a long-term solution for Africa. In addition, coordination among existing creditors is a key hurdle to successfully swapping sufficient and large amounts of debt. Further, debt-for-nature swaps are often incompatible with the economic realities of LDCs. This is because most LDCs' economies depend on natural resources. Therefore, inasmuch as debt-for-nature programs fund projects that foreclose access to natural resources and slow down the economic development of the South, they will face strong opposition. For this reason, it has been proposed that pure debt-for-nature programs should be rejected and that debt-for-sustainable development should be implemented. In essence, debt-for-sustainable development calls for strategies that provide incentives to environmentally sound commercial activities and force currently profitable commercial activities to become more environmentally sound. Furthermore, while debt-for-nature swaps are important when debt restructuring is not on the table, these deals do not substitute for comprehensive debt restructuring reform especially for countries with unsustainable debt levels. They also do not obviate the need for climate finance grants and other mainstream debt relief.

Despite the potential challenges, these deals present an opportunity for countries that cannot prioritise environmental actions due to financing constraints and where creditors see the value of possible ecological outcomes. Besides, debt-for-nature programs have promoted a number of valuable conservation projects. However, the magnitude of the environmental crisis will require stronger political commitments and economic resources that are largely incompatible with the complex legal and financial framework that the swaps necessitate.

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