CONCEPT NOTE
The ECLAC Debt for Climate Adaptation Swap and
Caribbean Resilience Fund

Introduction

The ECLAC Debt for Climate Adaptation Initiative is an ongoing Caribbean-wide subregional initiative, which seeks to substantively address the high and unsustainable level of debt of many Caribbean economies, which has compromised the growth trajectory of the subregion. The Initiative actively promotes consideration of a strategy to address the high debt-low growth dilemma of the Caribbean in a sustainable manner while fostering investment in climate adaptation and resilience building. The main beneficiaries are Caribbean economies.

The Initiative will be launched in the first instance with the three Pilot economies of Antigua and Barbuda, Saint Lucia and Saint Vincent and the Grenadines[1].

The recent debt experience in the Caribbean suggests that the debt dynamics in the Caribbean are driven by high interest costs and off-budget liabilities due to both natural disasters and financial sector risks. Thus, country solvency assessment suggests that contingent liabilities are ever-present in the Caribbean, either from macroeconomic imbalances, the lack of competitiveness, or the damage costs (liabilities) caused by natural disasters. Given the Caribbean economy's structural weaknesses and its susceptibility to natural events, fostering macroeconomic integrity, competitive economies and environmental resilience will be critical for building resilient economies. Affordable funding will therefore be crucial. The United Nations Economic Commission for Latin America and the Caribbean (ECLAC) has therefore proposed the establishment of a Caribbean Resilience Fund (CRF).

Anatomy of the Caribbean Resilience Fund

The CRF would essentially be a special purpose financing vehicle intended to leverage long-term low-cost development financing for the Caribbean. The CRF would also ensure the availability of resources to the Caribbean for investment in adaptation and mitigation initiatives, in the development of green industries, thereby promoting both resilience building and the structural transformation of Caribbean economies. Given the constraints that multilateral facilities, such as the GCF, have with financing debt restructuring, it is proposed that the Caribbean Resilience Fund be comprised of distinct financing windows for supporting growth and competitiveness;

[1] In furtherance of this initiative ECLAC has been engaging in discussions and collaborating to varying degrees with several key stakeholders including, Ministries of Finance of member states of the Caribbean Community, Debt Managers of Antigua and Barbuda, Saint Lucia and Saint Vincent and the Grenadines, the Department of Environment, Antigua and Barbuda, the Caribbean Development Bank (CDB), the Caribbean Community Secretariat, the Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (OHRLLS), the OECS Commission, the Green Climate Fund (GCF), the CARICOM Development Fund (CDF), and UN ESCAP (Economic and Social Commission for Asia and the Pacific).

resilience building; and debt restructuring or reprofiling, respectively. In so doing, the CRF would explicitly target remedying the leading existential challenges facing the Caribbean through three (3) broad thematic windows focusing on – (1) Resilience Building; (2) Growth and Competitiveness; (3) Liquidity and Debt (unsustainability), the major areas of focus of which are summarized below.

Theme 1: Resilience Building

A Resilience Building Fund would provide financing to public and private sector activities that focus on resilience building. This theme would primarily be focused on climate and environment resilience-building activities and have different sub-windows such as: improving physical infrastructure; policy reform; deepening capital markets, including insurance markets; identifying and developing the skills required to build climate resilience.

Theme 2: Growth and Competitiveness

A Growth Fund that would finance both public and private sector activities focused on growth projects (especially through investment in blue and green industries) and reforms that support growth. The Fund would collaborate with member countries, focusing on economic reform activities, and use the World Bank Doing Business Reforms index as a benchmark. Sub-windows could focus on: modernizing physical infrastructure - boosting infrastructure should boost GDP; incentivizing investment in green industries for restructuring; business reforms; and MSME support.

Theme 3: Liquidity and Debt Facility

In its original conception, the Liquidity and Debt Facility would provide debt relief and liquidity support to participating CARICOM governments with high debt to GDP, and debt affordability ratios. ECLAC proposes that this Facility have a built-in credit enhancement mechanism geared towards making the subregion's public debt more attractive to private investors and while achieving the following: lowering overall effective interest rates; increasing fiscal space; and providing governments with more time to repay the amortization part on their debt by increasing the debt tenor; and stimulating capital markets where debt could be resold on the secondary market. Within this thematic window, the CRF could also pursue different sub-windows associated with debt reprofiling, such as: debt buy-backs; debt swaps such as the ECLAC Debt for Climate Adaptation initiative; swap initiatives based on creditors' support to help Caribbean countries address debt reduction; and liquidity enhancement mechanisms.

It is important to recall that the notion, structure and modality of functioning of a Caribbean Resilience Fund has evolved considerably since its initial conceptualization. Recently, following discussions with the President of the CDB and his team the institution has expressed an interest in housing the CRF, and more particularly the resilience building; and growth and competitiveness windows. The discussions are still at a delicate stage as we seek to determine how best the Fund might be seamlessly integrated into the framework of the Bank, while at once playing a significant role in the CDB's effort to significantly expand its capitalization towards financing structural transformation and climate resilience building in the Caribbean. In addition, with funding support from the OHRLLS, ECLAC has engaged a consultant to outline options, including but not limited to private equity, with attendant strategies, for capitalizing the first two (2) windows of the CRF.

In light of the CDB's reluctance to participate in the proposed window three, ECLAC is exploring instead a strategy that would provide an opportunity to operationalize the debt swap component of the CRF through a special purpose vehicle, the architecture of which would facilitate a regional approach to instituting a broad range of debt for climate swaps, nuanced by individual country priorities and needs, beginning with the pilot countries with a view to scaling-up subregionally.

Debt for Climate Adaptation Swaps

ECLAC is cognizant of the constraints imposed on concessional resources for middle income countries of the subregion and the need to address the specific preferences of various creditors. This is crucial given that the total initial targeted capitalization of CRF amounts to US$10.6 billion with US$3.7 billion earmarked for windows 1 and 2; and US$6.9 billion for implementing region-wide debt for climate swaps. Unsustainably high debt levels, further fueled by COVID-19 related spending, have placed additional upward pressures on borrowing requirements, leaving the subregion's debt burden averaging just under 85% of GDP, debt services costs at approximately 25% of government revenue (and as high as 77% for Antigua and Barbuda) and average fiscal balance at -3.9% of GDP at the end of 2021.

The Caribbean's debt and liquidity challenges are now at a tipping point and require an urgent solution. Accordingly, ECLAC in collaboration with the OHRLLS has engaged a consultant to design debt conversions and structure debt for climate swaps for the three pilot countries. In addition, an ECLAC team recently conducted missions to the pilot countries and Belize, to discuss and to receive support for debt reprofiling and debt reduction to increase fiscal space in the framework of the ECLAC debt for climate adaptation swap initiative; and gain some insights into Belize's experience with debt for environmental swaps given the success of their recent superbond swap initiative with The Nature Conservancy (TNC) and the Development Finance Corporation (DFC).

The reality on the ground is that there is very little appetite for broad-based engagement of the Caribbean in classical debt for climate swaps on the part of investors, DFIs and the international community. The ECLAC mission therefore engaged the pilot countries on the possible roll out of a series of liability management operations (LMO) that would help to reprofile their debt, since the burden of debt servicing was a major issue, especially in light of the fiscal and economic impact of COVID-19. For ECLAC, there exists a distinct opportunity to action the Liquidity and Debt Reduction component of the CRF utilizing Liability Management Operations which seek to buy-out high-interest short-term debt and replace with a lower interest, longer-term (12-20 year) green bond, targeting a block of Caribbean countries as part of a regional strategy. This is to be implemented in collaboration with other partners such as the IDB, CDB, the Development Finance Corporation (DFC) of the United States, The Nature Conservancy (TNC) and Credit Suisse, among others.

The liability management operation ECLAC has prescribed will target in the order of US$200 million of beneficiary country public debt i.e. Bonds, Loans, and/or Overdraft Lines of Credit, through the issuance of green bonds facilitated by a private entity such as Credit Suisse and backed by a Development Finance Institute ("**DFI**") such as the InterAmerican Development Bank. For example, the maturity of the restructured debt could be extended over 20 years, with a 5-year grace period, with the interest rate coming in at around 7% or maintained at or near the same current rate. This arrangement would create considerable fiscal space (upward of US$170 million for one pilot country) for investments and/or debt relief and annual fiscal space of approximately US$34 million, over the first five years. The arrangement would also be conditioned by parametric insurance in the order of US$7.25 million for the first five years and US$11.15 million for the last 15 years (equal to one semi-annual payment by the Government on the restructured debt). This will be payable in the event of a hurricane.

The example outlined above represents just one of myriad possible options and country-specific scenarios that can be designed using the LMO. ECLAC believes that an LMO for the three pilot countries in the first instance, will provide the necessary critical mass to drive interest rates and administrative costs down, while generating interest from the major participating principals in crowding-in the rest of the subregional economies, which may have an interest.

Planned Meeting of Experts

All outstanding issues necessary for the establishment of the CRF will be considered at ECLAC's upcoming High-Level Meeting on the Caribbean Resilience Fund and Debt for Climate Swap Initiative, scheduled to be held in Antigua and Barbuda, 26-29 July 2022. In-depth discussion will address the main elements of the CRF; its structure, participation and governance. This will include reflection on optimal housing of the CRF and scope for capitalization of the Fund. The meeting will also explore important next steps for initiating debt swap negotiations.

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