

Miracle or mirage?

Are debt swaps really a silver bullet?

By Iolanda Fresnillo • November 2023



Contents

Executive summary	3
Introduction	6
1. What are debt swaps and how do they work?	7
1.1. Bilateral debt swaps	8
1.2. Third party involvement debt swap	10
1.3. Private intermediation debt swaps via debt buy-backs	12
2. A new push for debt swaps	17
2.1. From Seychelles to Gabon: the future of debt swaps?	18
3. Questions, concerns and challenges around debt swaps	20
3.1. Are debt swaps fit to deal with unsustainable debts?	20
3.2. Are debt swaps an opportunity to provide development and climate finance?	21
3.3. Is it all about scaling up debt swaps?	22
3.4. Details matter: disbursement schedule and local vs foreign currency	22
3.5. Are debt swaps another open door to donor conditionality?	23
3.6. Slow, complex and costly	25
3.7. Transparency, accountability and civil society participation	25
3.8. The risk of greenwashing and legitimising illegitimate debts	27
4. Conclusions: to swap or not to swap?	28

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Brot
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Executive summary

As the end of 2023 approaches, 136 countries are considered to be in a critical debt situation. At the same time, fiscal space has been reduced, leading many, including governments, UN agencies and some international NGOs, to point to debt swaps as an innovative solution for tackling sovereign debt problems, while also generating resources for the Sustainable Development Goals (SDGs) or climate action. Therefore, debt swaps, while not new, are gaining increasing attention in international development and climate forums, particularly due to the proliferation of so-called “debt-for-nature swaps”.

However, as we detail in this briefing, debt swaps will not provide substantial debt reduction, nor will they create sufficient fiscal space for global south countries to tackle the development and climate challenges. Debt swaps will not cover up the shame of the lack of political will and commitment amongst countries in the global north to support the global south. Instead, countries in the global north should recognise their historical responsibilities in perpetuating neo-colonial economic governance and dynamics that keep countries in the global south tied to debt dependency. As such, progress on debt swaps must not be an excuse to detract attention from the urgent need to move forward fundamental reform of the international debt architecture.

The evolution of debt swaps

A debt swap is a financial instrument that provides conditional debt reduction in exchange for agreements by the debtor to invest the freed-up resources in specific areas, such as education, health, climate or the environment. Over the last 30 years, the types of debt swaps have evolved in different ways, depending on the origin of the debt (whether private or bilateral), the debt conditions (whether commercial or concessional), the agreed purpose of the swap or the type and number of actors involved, as well as the conditions and mechanisms used to implement the swap and/or the resulting projects. With regards to this briefing, Eurodad has identified three types of debt swaps, which are defined by the main actors involved (see Table 1).

While for many years bilateral debt swaps have been the most prominent form, the focus has switched lately to private intermediation debt swaps, which involve a debt buy-back from bondholders. The recent debt-for-nature swaps focused on marine conservation in Barbados, Belize, Ecuador and Gabon, have been presented as the future of debt swaps, attracting a lot of attention. However, these cases have also raised concerns, mainly due to the lack of transparency, the high transaction costs, and doubts about country ownership and participation from communities and civil society.

Table 1: Types of debt swaps

Debt swap types	Agents involved	Other characteristics
Bilateral debt swaps	A bilateral creditor and a sovereign debtor	<ul style="list-style-type: none"> • Treating bilateral debt • Disbursements are usually in local currency • Can be reported as official development assistance (ODA). • Australia, Belgium, France, Italy, Germany, Norway, Portugal, Spain and the US are among the countries with bilateral debt swap programmes.
Third party involvement debt swaps	A bilateral creditor, a sovereign debtor and a multilateral or multi-stakeholder fund (public or private)	<ul style="list-style-type: none"> • Treating bilateral debt • Disbursement to the multilateral fund in local currency • Can be reported as official development assistance (ODA). • Active programmes with the World Food Programme (WFP) and the Global Fund to Fight AIDS, Tuberculosis and Malaria (Global Fund).
Private intermediated debt swaps via debt buy-back	Bilateral or private creditors (bondholders), a sovereign debtor and a non-for-profit private agent	<ul style="list-style-type: none"> • Treating bilateral or, most recently, bondholder debt. • Involves a debt buy-back operation and a new debt issuance/new loan. • Mostly used for debt-for-nature swaps. • Usually involves commercial banks, multilateral development banks, development finance institutions, insurance companies, legal and financial advisors and other private financial institutions.

Source: Eurodad

Taking both these recent cases into consideration, along with debt swap experiences throughout the last three decades, this report has identified a number of questions, concerns and challenges:

- **Debt swaps are not an effective instrument for significantly reducing debt levels.** The history of debt swaps shows that the overall impact on debt levels has been rather limited, mainly due to the reduced scale of the operations. Over three decades of debt swaps have led to roughly US\$8.4 billion of debt treated, 0.11 per cent of total debt payments by low- and middle-income countries during the same period. Debt swaps are not a means to restore debt sustainability, and cannot be a substitute or a way to avoid a comprehensive debt restructuring, including debt cancellation.
- **Debt swaps should be seen as tools to free up funds for governments with fiscal space constraints** and with limited access to grants or concessional finance. However, it is improbable that debt swaps will be able to substantially contribute to the SDGs, climate and conservation financing needs. According to research from the International Monetary Fund (IMF), climate conditional grants (grants addressed to climate projects or goals) are more efficient than debt-for-climate swaps, due to the length, complexity and high transaction costs that these operations entail and the fact that grants are normally more targeted and therefore lead to a higher net fiscal transfer.
- **The impact of debt swaps does not only depend on the ability to scale them up.** As is shown in this briefing, potential for such scaling up is limited and should be additional to existing official development assistance (ODA) and climate finance commitments. Instead, the potential impact of debt swaps will also depend on elements such as the disbursement schedule and the currency in which the debtor agrees to mobilise the freed-up resources. It is vital that the calendar for the debtor to disburse the freed-up resources is sustainable and realistic, not adding additional fiscal pressure, and that such disbursements are made in local currency.
- **Debt swaps inherently bear conditionality.** The debt swap will not happen if the debtor country does not agree to invest the freed-up resources in the area or project to be approved by the creditor. This entails a risk that they will be used by creditors to impose their own interests and priorities over those of the borrowing country. Particularly concerning is the use of 'tied aid' methods to promote creditor country commercial interests or coupling debt swaps with carbon credit exchanges. In this sense, if ownership by the debtor country is not ensured, a debt swap can lead to a loss of sovereignty. These exact concerns have been raised in recent debt-for-nature swaps, where international conservation foundations or foreign corporations played a prominent role in setting up the deal.
- **Debt swaps tend to be slow, complex and costly instruments.** Debt swaps tend to have high transaction costs, particularly in relation to the amounts involved, due to complexity of the process, the number of agents involved, the lengthiness of the negotiation and implementation periods, and the multiplication of transaction and management costs. Even when the amounts dealt with have been scaled up, as with the recent debt-for-nature swaps, these transaction costs have not been reduced.
- **Lack of transparency and accountability has been a constant.** In most recent debt-for-nature swaps, the amount, quality and comprehensiveness of available information is not sufficient, which can lead to misunderstandings. Debt swaps are mechanisms to deal with sovereign debt, as such transparency and accountability should be a given.
- **Insufficient community and civil society participation.** While debt swaps have occasionally incorporated the participation of citizens, civil society or other local entities of both the lender and borrowing country, this has not always been the case. Additionally, the quality of this participation has been questionable, with many cases barely going beyond a tick box exercise. Another area of concern is the lack of systematic monitoring, accountability and evaluation of the impacts of debt swaps. Reports of the exclusion of indigenous peoples and local communities in the definition and implementation of debt-for-nature swaps in the past, has even led to the violation of their rights. Debt swaps have occasionally led to communities experiencing exclusion, denial of access to traditional lands and resources, displacement, knowledge extraction and biopiracy, and human rights violations.

- **The risk of greenwashing.** Debt-for-nature and debt-for-climate swaps can open the door to greenwashing, as in the wrongdoing case where new bonds in debt-for-nature swap schemes were labelled as “blue bonds”. However, the bigger greenwashing risk is that creditors and the international community, including international conservation NGOs, appear to be delivering on their climate finance and environmental conservation commitments, while actual results are still to be seen and concerns remain unaddressed.
- **Debt swaps are used as a means of legitimising and erasing responsibilities on illegitimate debt.** The unconditional cancellation of illegitimate debts has long been a key demand from many debt justice organisations. While debt swaps are conditional debt relief instruments, they should not be used in the case of illegitimate debts that should not have been acquired in the first place.

In conclusion, for countries without access to grants or concessional finance, well-designed debt swaps can play a role in mobilising extra resources for the SDGs or climate projects. However, experience shows that their impact on the fiscal outlook and debt situation of the country will not be particularly meaningful. Furthermore, the recent debt-for-nature swaps via debt-buy-back operations, involving new bond issuances to refinance existing distressed debt, are perpetuating the debt dependency and the dependency on financial markets. This is, in turn, enhancing the financialisation of development and climate finance. Moreover, for debt swaps to work for economic, climate, gender and social justice, the quality and governance failures should be actively tackled prior to any further promotion. Finally, the increasing focus on debt swaps should not become an excuse to detract from the urgent need for debt cancellation and delivery of debt-free climate finance, nor to avoid the necessary reforms in the international debt architecture.

Introduction

Countries in the global south are facing a multiplicity of crises. The Covid-19 pandemic, the climate emergency, inflationary trends and increasing borrowing costs, together with volatile and grim economic forecasts, are some of the elements of the polycrisis generating terrible human, social and political consequences in the global south. Governments in countries across the global south – many of which went into 2020 with high public debt levels¹ – have been taking out more loans to fight the pandemic, invest in the recovery and tackle the climate emergency. Total public debt in the global south increased from 35 per cent of Gross Domestic Product (GDP) in 2010 to 60 per cent in 2021,² leading to 136 countries in the global south being in a more or less critical debt situation.³

As several United Nations (UN) agencies have been warning, debt service is already crowding out spending on public services that are essential in order to reduce poverty and inequalities and to tackle the climate crisis.⁴ On average, domestic and external debt service is absorbing 38 per cent of budget revenue and 30 per cent of spending across the global south. More crucially, debt service equals combined total spending on education, health, social protection and climate.⁵ Increasing debt levels, rising borrowing costs and bleak economic prospects will only exacerbate the difficulties that many countries are facing today when it comes to making their debt payments.

In this context, the international community responses to the debt crisis have fallen way short of what is needed. The lack of a comprehensive and fair debt resolution framework, with the G20 Debt Service Suspension Initiative (DSSI) and Common Framework failing to deliver on sufficient debt relief, leaves countries in the global south facing debt distress in a very complex situation. Either they keep borrowing at escalating onerous costs in order to refinance their existing debts – a path that is not available for all countries; or they seek debt restructuring, most probably in a messy, lengthy and costly process, facing credit rating downgrades, with bilateral creditors barely offering any debt cancellation, with private creditors resisting participation and with multilateral creditors totally refusing to participate in debt relief.

On top of this, fiscal consolidation (reducing fiscal deficit by cutting expenses and/or increasing revenue) and other austerity measures (i.e. privatisation, promoting public-private partnerships (PPPs), liberalisation, etc.) will likely be implemented so they can keep up with the payments, by the government's own will or through an International Monetary Fund (IMF) programme that will be needed before even starting any debt restructuring.⁶

To tackle the sovereign debt crisis and at the same time generate the resources needed to invest in sustainable development, including climate resilience, numerous voices have been pointing to "debt swaps" as a possible innovative solution. Debt swaps are not new, but they are gaining increasing attention, particularly due to the proliferation of so-called "debt-for-nature swaps". However, debt swaps are not regarded by everyone with the same level of enthusiasm.

This briefing aims to inform the discussions on debt swaps among civil society, academics and policy makers. It has been compiled with information from ten interviews with policy makers, academics and other experts,⁷ as well as by online surveys with civil society representatives and a literature review of analyses, proposals and positions by civil society organisations (CSOs) and international organisations. This text has been reviewed by Eurodad members and allies (see acknowledgements on page 2). The first section of the report describes different types and experiences of debt swaps; the second section explores the history of debt swaps, particularly focusing on recent cases; and the third and final section outlines different limitations, risks and opportunities that different actors have highlighted around the implementation and results of debt swaps.

1. What are debt swaps and how do they work?

A debt swap⁸ is a financial instrument that provides conditional debt reduction in exchange for the debtor agreeing to invest the freed-up resources (usually in local currency) in specific areas, such as education, health, climate or the environment. A debt swap involves both the sovereign debtor country and also either a creditor (usually a bilateral creditor) or a group of creditors (for example, a group of bondholders or several bilateral creditors). The agreement can establish that the full amount treated by the debt swap should be invested by the creditor, but it can also establish that some of the resources included in the swap will be unconditionally cancelled, and the rest is to be invested in the agreed area.

The mechanics of debt swaps can vary substantially. Throughout the last four decades the types of debt swaps have evolved in different ways, depending on the origin of the debt (whether private or bilateral), the debt conditions (whether commercial or concessional), the agreed purpose of the swap (see Table 1) or the type and number of actors involved, as well as depending on the conditions and mechanisms used to implement the swap and/or the resulting projects.

While most of the attention and discussions today are focused on debt-for-climate and debt-for-nature swaps, over the years debt swaps have been developed and implemented in a wide range of areas, depending on the use of the freed-up resources.

While debt swaps are gaining attention, particularly through the promotion of debt-for-nature and debt-for-climate swaps, they are not so new. Debt swaps have been in place since the 1980s, when there was a proliferation of debt-for-equity swaps and debt-for-nature swaps treating debt with private creditors.⁹ In debt-for-equity swaps, sovereign debt was exchanged for public assets (i.e. privatisation of public enterprises),¹⁰ with experiences in “Chile – swapping 70 per cent of its commercial debt in 1985 – as well as Argentina, Mexico, and the Philippines during the 1980s and 1990s”.¹¹

These debt-for-equity swaps were controversial as they facilitated the acceleration of the privatisation of public assets in the global south. As we will see, there were numerous experiences of debt-for-nature swaps in the 1980s and 1990s, and debt-for-development swaps in the 1990s and 2000s. The present push for debt swaps builds on those experiences.

The following sections explain the different debt swap dynamics, depending on which actors are involved, although the debt swap’s final mechanics and details can vary from case to case.¹²

Table 2:
Purposes of debt swaps

Debt for development swaps	
Debt for Sustainable Development Goals (SDGs)/development	Freeing up resources from debt service payments in exchange for the debtor government’s commitment to fund local development investments, policies, programmes or projects in the debtor country. Some debt swaps have also been focused on economic development, including partnerships with the local and creditor country private sector.
Debt for education	Focused on education projects, normally including investment in education infrastructure (building schools, providing furniture or equipment ...), training and other related public investments in education.
Debt for health	Focused on financing healthcare policies or fighting specific diseases like the Debt2Health programme run by the Global Fund to Fight AIDS, Tuberculosis and Malaria.
Debt for food	Focused on financing projects, programmes and policies to fight undernourishment and promote food security, like those sponsored by the World Food Programme under their debt-for-food programme.
Debt for environment swaps	
Debt for nature	Focused on the debtor government commitment to invest in nature or biodiversity conservation projects. These types of debt swaps have usually involved the participation of a conservation non-governmental organisation (NGO) that facilitates the operation and oversees the conservation projects attached to it.
Debt for climate	Broader than debt for nature swaps, focused mainly on climate adaptation policies and projects, although they can also be addressed to mitigation.
Other debt swaps	
Debt for equity or private investment	Conversion of debt into equity shares of public companies or into private investments, in order to attract foreign investment in the debtor country, normally from companies from the creditor country.

Source: Eurodad

1.1. Bilateral debt swaps

A classic **bilateral swap** involves a sovereign creditor and a sovereign debtor, in an operation between two governments agreeing over bilateral debt. According to the International Institute for Environment and Development (IIED), debt swaps on bilateral debt have been the most prominent form of debt swaps.¹³ A bilateral debt swap can be triggered by a petition from the debtor government, but on occasions it is the creditor government that offers – sometimes as a top up of a debt restructuring process or debt relief commitment – the possibility of the swap. Regardless of who initiates the process, the two governments need to agree on the purpose of the swap. This is the development area or type of infrastructure in which the creditor country is going to invest the proceeds of the debt reduction and on the terms of the operation. According to Aldo Caliarì from Jubilee USA, there are three elements within the terms of the operation that will mark the potential impact of the debt swap:¹⁴

- i. **The nominal value of the debt to be reduced:** How much debt is included in the swap.
- ii. **The conversion or discount rate:** This is the percentage of the nominal value of the debt treated that is to be mobilised by the donor as counterpart funds. If, for example, US\$100 million will be included in the swap, the deal can determine that US\$50 million is cancelled unconditionally and that the borrower country will invest US\$50 million in the agreed development area or investment. In some cases, the amount

to be disbursed by the borrower is 100 per cent of the debt treated; in others, there is a part of outright debt cancellation.

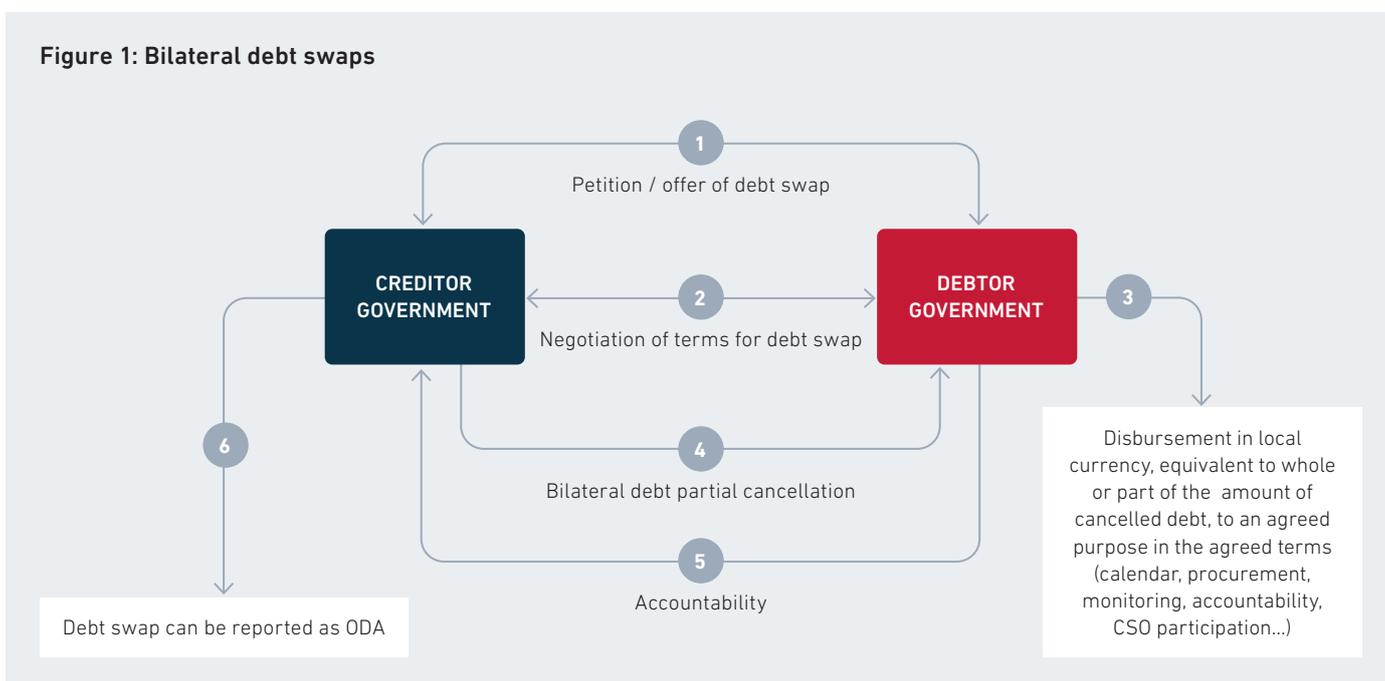
- iii. **The disbursement modalities:** These can include a schedule and currency in which the debtor agrees to mobilise the freed-up resources. In most bilateral debt swaps, disbursements by the debtor country are to be made in the local currency.

Other terms, including procurement policies for the implementation of the project, monitoring and accountability, or CSO participation, must also be agreed between the parties. While the main agreement is between two governments (therefore, a bilateral operation), the possibility for other stakeholders (CSOs, local institutions or corporations) to participate in the definition, implementation or overseeing of the process also exists.

For Paris Club lenders, when the debt swap is proposed as part or on top of a debt restructuring agreement regarding non-Official Development Assistance (ODA) claims (debt generated by loans under commercial terms and/or non-reported as ODA), such a deal can include a limit on the percentage of debt that can be treated in the swap operation. There are no restrictions, however, regarding debt swaps on ODA claims – debt resulting from concessional lending reported as ODA in the first place.¹⁵ For Organisation for Economic Co-operation and Development (OECD) countries, debt swaps can be reported as ODA following the same rules as other debt relief initiatives.¹⁶

The following scheme is an attempt to simplify the mechanics within a bilateral debt swap, but as mentioned before, the details may vary from case to case.

Figure 1: Bilateral debt swaps



In 1990, debt swaps were integrated as an option in Paris Club provisions, which gave an impetus to the bilateral debt swaps.¹⁷ According to Aldo Caliarì, “after a first wave of debt swaps, at the end of the 1990s their relevance declined in the context of adoption of the much more comprehensive Heavily Indebted Poor Countries initiative (HIPC), which would later be expanded in the [Multilateral Debt Relief Initiative] MDRI”. In the 2000s, there was a second wave of bilateral debt swaps for development, particularly targeting countries excluded from HIPC and MDRI, such as lower middle-income countries (like Indonesia and El Salvador), or non-HIPC low-income countries (like Pakistan), or targeting debt remaining after HIPC debt relief (as a top up of this initiative).¹⁸

In the last two decades, several creditor countries have developed their own debt swap programmes, offering similar schemes to various debtor countries. For instance, this is the case of the French government programme Debt Reduction-Development Contract (C2D), which channelled additional debt relief to HIPC eligible countries through “a unique debt-swap mechanism”.¹⁹ The French C2D scheme consisted of eligible debtor countries repaying the debt and then France granting back an equivalent amount in the form

of grants for poverty reduction programmes determined by the two parties. France, Germany, Italy and Spain have active bilateral debt swap programmes, while Australia, Belgium, Norway, Portugal, Russia and the US either had programmes in the past or have occasionally agreed on ad hoc bilateral debt swaps.

There has not been a systematic monitoring or evaluation of debt swaps, but researchers Diego Filmus and Esteban Serrani produced one of the most extensive compilations of bilateral debt swaps, covering 1988 to 2008.²⁰ Serrani and Filmus identified 128 debt swap operations in 38 countries, with a nominal value of US\$6.13 billion, converted into US\$3.32 billion invested in social projects.²¹ In comparison, HIPC and MDRI provided 37 countries up to US\$76.2 billion and US\$43.3 billion of debt relief, respectively.²² Canada, Germany, Spain, Switzerland and the US appear in the study as the bilateral creditors that are most involved in bilateral debt swap operations, with 72 per cent of all the debt treated by bilateral debt swaps during those 20 years. Geographically speaking, 58 per cent of the operations reviewed took place in Latin American debtor countries (74 cases), 23 per cent in African countries (29 cases) and 19 per cent in Asian countries.

Box 1: Debt swaps the French way

In 1999, France committed to topping up the debt cancellation that they were to provide via the HIPC initiative with a particular debt swap scheme to cancel the ODA debt obligations. Under the programme Debt reduction and development contract (C2D), the eligible countries continued with the debt payments, but after payment the French government would return to the debtor country “an equivalent sum in the form of a grant to finance programmes previously determined in a contract signed by both parties”. The programme mobilised around €5.4 billion – including arrears – over two decades in 18 countries.

However, as the French Platform on Debt and Development (PFDD) highlighted, this mechanism “differs from other debt-swap tools in that it maintains a financial flow in currency from the beneficiary to the creditor. Debt servicing thus weighs all the more heavily on the country’s balance of payments because the mechanism calls for interest payments”. The grants from the donor side are discontinued when the debtor is unable to continue with the debt payments, even during debt payment moratoria within a broader scheme like the G20 Debt Service Suspension Initiative (DSSI) in 2020. Since the debtor has

to make the debt payments in order to benefit from a refinancing of an equivalent amount in the form of grants, if those payments are postponed, the refinancing in grants is also interrupted.

Right before C2D was announced in 1999, the French authorities promised an additional cancellation of all of the HIPC initiative eligible countries’ ODA debt. An extensive evaluation undertaken by PFDD on two decades of C2D programmes showed that delays in the implementation of the HIPC initiative led to countries like Burundi and Rwanda repaying most of their debt obligations before they could sign their first C2D contract. “From this point of view, France has not respected its initial commitment to total cancellation”.²³ The evaluation also concluded that, despite the promise of civil society participation, this was only the case in five of the 18 countries. In the cases where CSO participation was allowed, this was limited to monitoring of certain projects financed by the proceeds of the swap, but never on the decision making of the allocation of the funds. Only very late in the process and only in four countries, the CSOs involved received support to ensure independent and quality monitoring of the projects.

1.2 Third party involvement debt swap

Another modality of debt swaps on official debt is what we could call **third party involvement debt swap**, also referred to as triangular or trilateral debt swap. In this type of debt swap, a third party is added to the operation, normally a public or private multilateral or multi-stakeholder fund that plays an intermediary role in the operation. This is the case of debt swaps operated through the World Food Programme (WFP) or the Global Fund to Fight AIDS, Tuberculosis and Malaria (Global Fund).

The WFP has enabled debt swaps involving creditors such as France, Germany, Italy, Russia and Spain, with countries like Egypt, Guinea-Bissau, Mozambique and others in the Sahel and southern Africa region, with the resources freed-up by the debt swap invested in an already existing national WFP food programme in the country, in partnership with the debtor.²⁴

The Global Fund started its Debt2Health programme in 2007 and has developed 12 operations since then in ten countries (Cameroon, Côte d'Ivoire, Democratic Republic of the Congo, Egypt, El Salvador, Ethiopia, Indonesia, Jordan, Pakistan and Sri Lanka) involving three creditor countries (Australia, Germany and Spain). The Global Fund facilitates individually negotiated debt swap agreements between a creditor and debtor country, and part or all of the debt cancelled in the operation is invested in programmes to fight AIDS, tuberculosis or malaria or to strengthen public health systems through

Global Fund projects. As with the WFP, the resources released by the swap operation are invested in local currency in existing Global Fund programmes in the country or used to start new programmes. In the 16 years of implementation, the Global Fund has mediated in debt cancellation totalling slightly over €336 million, of which almost €226 million was invested in health programmes (see Table 3).

In this type of debt swap, the creditor – usually a bilateral one – cancels part of the debt owed by a country in the global south that commits to disburse, in local currency, an equivalent amount to the whole or part of the cancelled debt to an existing multilateral fund – the third party. These resources are used to implement existing or new projects by the multilateral fund in the debtor country. The negotiation of the terms for the debt swap, including the quantity of debt that is to be cancelled and the percentage that it is to be disbursed by the debtor country in the existing fund, happen between debtor and creditor country, but with the mediation or facilitation of the multilateral fund.

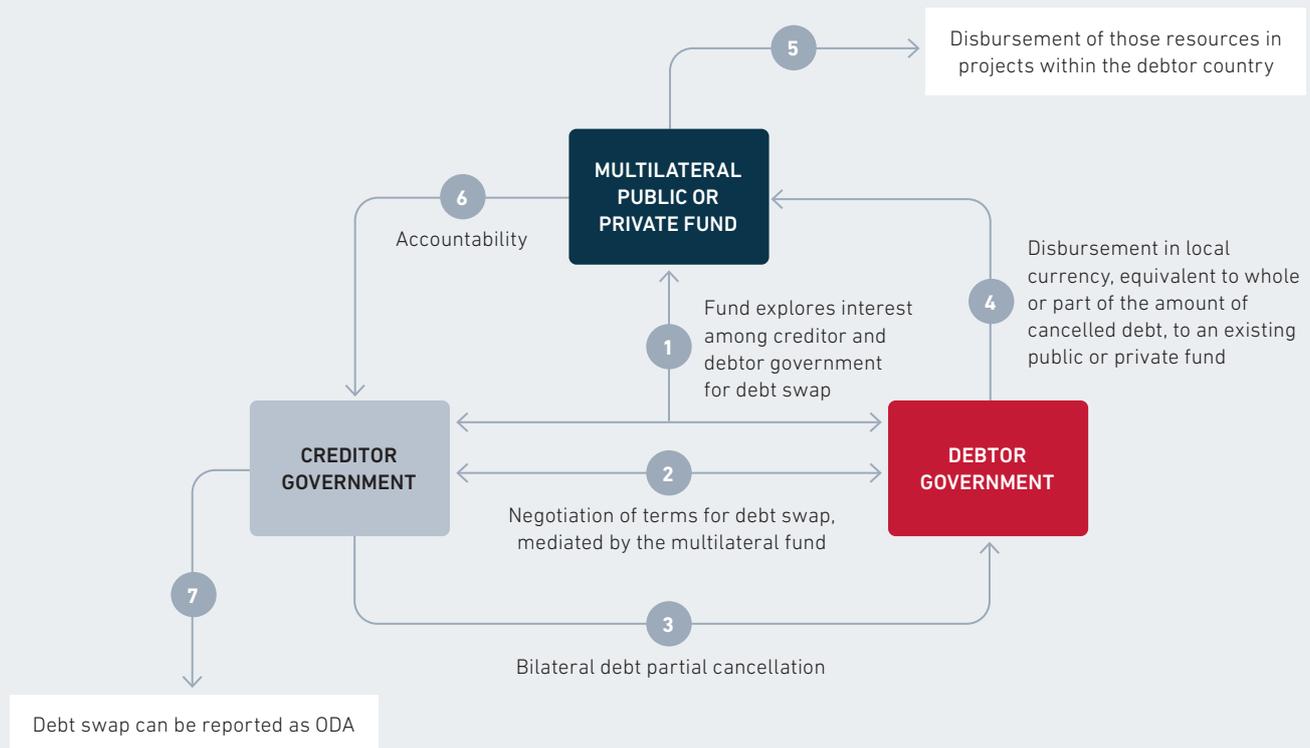
According to the Global Fund, the main benefit for using this modality is that transaction costs can be reduced. There is no need to set up a new mechanism or procedures to implement, monitor or evaluate the project in which the freed resources are invested. According to the Global Fund, they assume the role (at no cost to the debtor or the creditor) of identified programmes aligned with national strategies and priorities, ensuring transparency, accountability, country ownership and measurable impact.

Table 3:
Debt2Health
swaps
agreements
2007-2021

Debt2Health Agreement	Signed	Health investments	Debt swap amount	Benefiting programme
Germany – Indonesia	Sept 2007	US\$35m	US\$70m	HIV/AIDS
Germany – Pakistan	Nov 2007	US\$26m	US\$53m	Tuberculosis
Australia – Indonesia	July 2010	US\$35m	US\$71m	Tuberculosis
Germany – Côte d'Ivoire	Sept 2010	US\$13m	US\$25m	HIV/AIDS
Germany – Egypt	June 2011	US\$5m	US\$10m	Malaria
Spain – Cameroon	Nov 2017	US\$10m	US\$27m	HIV/AIDS
Spain – DR Congo	Nov 2017	US\$3m	US\$8m	Malaria
Spain – Ethiopia	Nov 2017	US\$4m	US\$9m	Resilient and Sustainable Systems for Health (RSSH)
Germany – El Salvador	Feb 2019	US\$11m	US\$11m	RSSH
Germany – Jordan	Dec 2020	US\$11m	US\$11m	Middle East Response (MER)
Germany – Indonesia	Apr 2021	US\$56m	US\$56m	Tuberculosis
Germany – Sri Lanka	Jun 2021	US\$16m	US\$ 16m	RSSH
Additional debt swaps worth up to US\$100m currently in negotiation phase (undisclosed sovereign creditor)				

Source:
The Global Fund²⁵

Figure 2: Third party involvement debt swap



Box 2: Multilateral debt swaps

Since multilateral creditors claim to have preferred creditor status in any debt treatment, there have never been experiences of debt swaps involving obligations to multilateral development banks. However, in 2016, the Commonwealth Secretariat defined a proposal for "Multilateral Debt Swap for Climate Change Adaptation and Mitigation".²⁶ This proposal, besides the debtor government and a multilateral creditor, also requires the participation of a "climate finance" provider, particularly mentioning bilateral donors. The proposal mechanics would require the climate finance provider (or pool of providers) to write down the debt held at multilateral creditors, by making a donation to cover losses caused by the debt cancellation for the multilateral institution (similar to the way the Multilateral Debt Relief Initiative was financed).²⁷

A trust fund would be set up to manage, invest and disburse resources for climate adaptation or mitigation projects, and the fund would be financed by the debtor government's payments of debt service, which would be diverted away from multilateral institutions through the swap arrangement. Whether the swap mechanism would entail a discount (partial unconditional debt cancellation) would be up to the climate finance providers participating in the scheme. If there is no debt cancellation, then the full amount owed to the multilateral creditor would need to be disbursed to the trust fund. In this case, the only savings from the debt swap would be those "derived through foreign currency savings (assuming multilateral debt in \$US), increased employment, growth and climate change adaptation progress".²⁸ In any case, the Commonwealth proposal is a theoretical one.

1.3 Private intermediation debt swaps via debt buy-backs

What we call private intermediation debt swaps also involves third parties, usually a not-for-profit entity – a non-governmental organisation (NGO) or private foundation – offering a debtor government to facilitate a debt swap involving a debt buy-back. A debt buy-back is simply buying debt titles – this can be private but also bilateral – from the creditor, usually at a discount. When it involves bondholders (so debt issued in the form of bonds), this buy-back is made through debt secondary markets. In the case of bilateral debt, it involves just an agreement with the bilateral creditors. The operation usually involves other agents including commercial banks, multilateral development banks, development finance institutions, insurance companies, legal and financial advisors and other private financial institutions.

This kind of scheme was particularly relevant for **debt-for-nature swaps** in the late 1980s and 1990s, led basically by three non-governmental conservation organisations: Conservation International (CI), World Wildlife Fund (WWF) and The Nature Conservancy (TNC). The first debt-for-nature swap was done in Bolivia in 1987, orchestrated by the NGO Conservation International, involving debt to commercial banks.²⁹ This was in exchange for Bolivia's commitments to protect a biosphere reserve and establish a supporting fund in local currency.³⁰ From 1987 to 2008, there were at least 48 debt-for-nature swap operations in 15 countries treating around US\$170 million of bilateral and commercial debt, and generating approximately US\$150 million in local currency for conservation purposes.³¹ At the end of the 1980s, UNICEF also promoted commercial debt swaps, using a similar scheme but for children's aid programmes instead of for conservation programmes. Between 1989 and the end of the 1990s, UNICEF facilitated 21 swaps worth US\$52 million out of a total of US\$199 million of cancelled debt.³²

Until 2008, these operations would generally entail the private entity either soliciting a debt claim donation (total or partial) from a bilateral creditor, buying the debt from the bilateral creditor or purchasing commercial debt from a private creditor at a discount. The debt claims could be transferred to a trust fund to which the debtor country then owed the debt. The operation could involve a partial write off of the debt that this third party has bought or received in donations. The debtor country would then commit to disburse, generally in local currency, the equivalent to whole or part of the debt involved in the operation to the trust fund, to be invested in the agreed purpose of the fund. In the cases mentioned above, this was nature conservation.

These first experiences with debt swaps did not remain uncontested. According to researcher Andre Standing, "in the run up to the first Earth Summit in 1992, large numbers of organisations, including those representing indigenous peoples and small-scale farmers, denounced debt swaps categorically".³³ Another criticism, particularly on early experiences of debt-for-nature swaps, is that they did not bring indigenous voices into discussions. In fact, they even threatened indigenous peoples' rights³⁴ (see Box 10).

In 2015, the debt swap that TNC managed in Seychelles brought some innovation to the above scheme, in what has been considered as the basis for the more recent cases of debt-for-nature swaps in Barbados, Belize, Ecuador and Gabon. In that case, TNC set up a trust fund, the Seychelles Conservation and Climate Adaptation Trust (SeyCCAT), through which they issued a blue bond (US\$15.2 million) and received grant money from private philanthropic foundations (US\$5 million). These resources were used to lend to the Seychelles government, which in turn used that money to buy back bilateral debt worth US\$21.6 million from Paris Club creditors at a discount of 6.5 per cent. The direct debt reduction totalled US\$1.4 million, but Seychelles committed to invest US\$5.6 million in marine conservation plus US\$3 million for the endowment trust. According to TNC, "the debt conversion effectively redirects the Seychelles' debt payments from official creditors to the newly created local trust, and restructures debt payments to more favourable terms (i.e. longer term and partial conversion to local currency)".³⁵ In exchange for the savings that these more favourable terms provided, the government committed to protect 30 per cent of its waters and 15 per cent of its high-biodiversity areas, and adopted a marine spatial plan to guide the update of coastal zone management, fisheries and marine policies. Through SeyCCAT, TNC used the debt payments made by the Seychelles government to repay the blue bond and to fund other marine conservation and climate adaptation programmes.

The recent debt-for-nature swaps in Barbados, Belize, Ecuador and Gabon are slight evolutions of the Seychelles model, involving private creditors (bondholders) instead of Paris Club creditors. The main element of these recent cases is the issuance of a debt bond by a special purpose vehicle (SPV) (see more detail under 'Creation of a Special Purpose Vehicle (SPV)' on page 14) to finance a debt buy-back by the debtor country in debt secondary markets. The savings of the operation, which will be disbursed in a trust fund to finance conservation projects, come from either buying the debt at a discount from bondholders or issuing a new bond in better conditions (lower interest rates and longer maturity periods), or a combination of both.

Figure 3. Private intermediation debt swaps via debt buy-backs

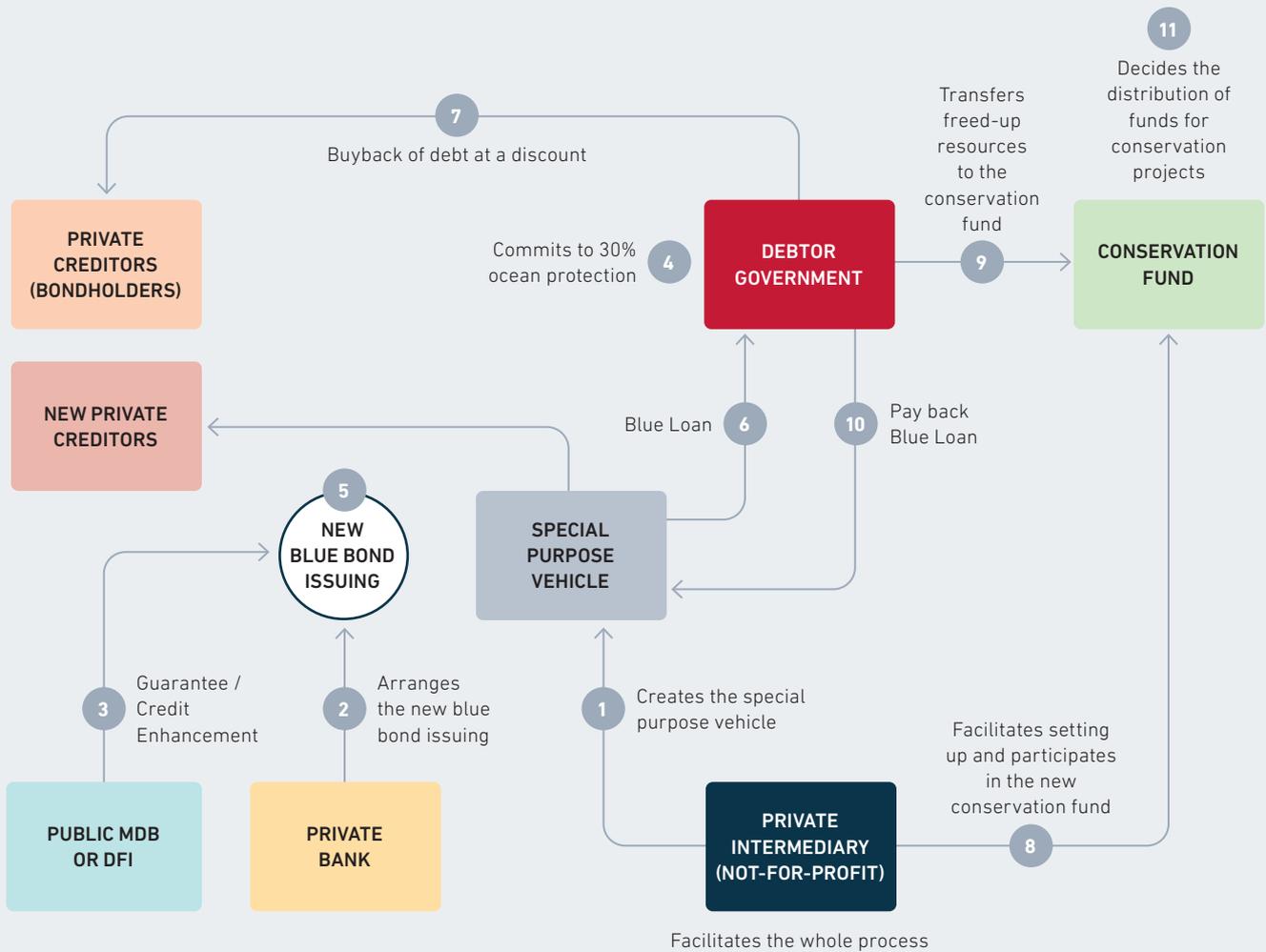


Table 4:
Key agents
involved in
recent private
intermediation
swaps

Country	Intermediary (deal arranger)	Bond issuance arranger	Credit enhancement /Guarantees	Other institutions involved
Barbados	TNC	Credit Suisse International and CIBC FirstCaribbean	Inter-American Development Bank (IADB)	Bank of New York Mellon (BNYM) (endowment trustee); Shearman & Sterling; Dentons; DLA Piper; Gilbert LLP; White Oak Advisory; Cleary Gottlieb Steen and Hamilton; Norton Rose Fulbright; Clifford Chance (legal and financial advisors)
Belize	TNC (through NatureVest)	Credit Suisse International	US International Development Finance Corporation (DFC)	Potomac Group (advisors) Shearman & Sterling; Ropes & Gray; DLA Piper; and Barrow & Co. (legal and financial advisors)
Ecuador	Climate Fund Managers/Oceans Finance Company and Pew Bertarelli Ocean Legacy	Credit Suisse	DFC (political risk) and IADB (guarantee)	Aqua Blue Investments (technical support) Bank of New York Mellon (BNYM) (facility lender of the loan to Ecuador)
Gabon	TNC	Bank of America	DFC	Lazard Frères; White & Case (advisors)

Sources:
TNC,³⁶
D. Ortega-Pacheco,³⁷
White & Case³⁸

The different deals in Barbados, Belize, Ecuador and Gabon have different characteristics, but they all share certain elements, similar to the Seychelles scheme:

- **Marine protection focus:** All of the cases have focused on marine and coastal protection, framed within the global commitment to effectively conserve and manage at least 30 per cent of marine and coastal areas by 2030, as agreed in the Kunming-Montreal UN Global Biodiversity Framework.³⁹
- **Third party intermediation:** One of the main elements is the leading role of international foundations, mainly TNC or, in the case of Ecuador, a consortium of private investment agents focusing on the blue economy.⁴⁰ All of the above cases have been initiated by these international organisations that have been exploring which countries could be the best placed to develop their schemes for debt swaps. The level of economic gains for these organisations for their participation in the debt-for-nature deals remains unknown.
- **Distressed bond debt:** In most cases, sovereign bonds were being traded in financial markets at a discount before the debt swap. This is a key element for this kind of debt-for-nature swaps/debt buy-back, as such distress is the main element that determines how much debt reduction will be secured. The participation of bondholders in the exchange or debt buy-back (see 'Debt buy-back' below) depends on whether they expect to be paid at all or get a better price than the one offered in the operation.

- **Creation of a Special Purpose Vehicle (SPV):** The intermediary sets up an SPV, which is a subsidiary company that is created to undertake a specific business or purpose. The SPV is the one that issues the new bond to finance the debt buy-back, usually with the support of an international commercial bank as a global lead arranger for the new bond. In the four recent cases, the SPV is domiciled in a tax haven rather than in the borrowing country.

Table 5. Special Purpose Vehicle and domicile in recent private intermediation swaps

Country	Special Purpose Vehicle	Domicile
Barbados	BB Blue Financing DAC	Ireland
Belize	Belize Blue Investment Company (BBIC) LLC	Delaware
Ecuador	GPS Blue Financing DAC	Ireland
Gabon	Gabon Blue Bond Master Trust	Delaware

Source: Eurodad, from different sources

- **New "blue" bond:** The SPV issues a new bond, usually on better terms than the existing bonds and lends the proceeds of the new bond to the debtor country through a so-called "blue loan". In the recent cases, the new bond has been labelled as "blue" bond by the issuer, but this has raised concerns from several agents in the financial markets (see Box 3). The proceeds of the new bond will

be used for: buying back existing bondholder debt from secondary markets; establishing an endowment fund for the conservation objectives of the deal; and covering transaction costs, including closing costs and fees.

- **Credit enhancement:** International financial institutions, such as the Inter-American Development Bank or the US International Development Finance Corporation (DFC), provide credit enhancements (through guarantees) to secure more favourable terms for the blue loan than those that the country would get by themselves (lower interest rates and/or longer grace period and maturity). “The DFC provided political risk insurance of non-payment of arbitral award and denial of justice for Belize and Ecuador, the IDB provided credit guarantees for Barbados and Ecuador, and TNC for Barbados”.⁴¹
 - **Debt buy-back:** As mentioned above, the proceeds of the new bond issuance will be used to buy back part (Barbados and Ecuador) or all (Belize) of existing external bonds on the secondary market at a discount (below par market prices) or existing domestic loans with high coupon rates (Barbados).
 - **“Blue” loan:** The SPV lends part of the proceeds from the blue bond issuance to the borrowing country through a new loan, which is conditional to the investment in marine conservation.
 - **Marine conservation fund:** All of the cases included the creation of a conservation fund to manage the endowment funds and finance marine conservation projects. This body is governed by a board including international partners (usually the deal arrangers) and local agents – government, private sector and in some cases civil society. This fund receives the payments committed by the government (including savings from the debt buy-back operation and additional commitments), usually in local currency, and chooses which projects to fund (if not agreed ex ante). The fund also “assists the government advance on its other conservation commitments”. If it is established in the deal, the fund also collects penalties when key conservation milestones are missed. Such penalties, instead of going to the blue bond holders, are held by the conservation fund and can be refundable if the government complies with the commitments.
- Lack of transparency during the process and even at the announcement of the deal. Some of the transparency concerns have been addressed ex post, mainly due to concerns raised by civil society; in the case of Ecuador, this was through freedom of information demands.
 - High transaction costs, given the involvement of multiple agents along with the intermediary. For instance, in the case of Barbados, besides TNC (intermediaries) and the bond issuance arrangers – Credit Suisse and CIBC First Caribbean – up to four legal advisors for TNC were involved, one financial and one legal advisor to Barbados, one legal advisor to the IDB, one legal advisor to the arrangers and one endowment trustee. The potential high payouts for a large number of intermediaries in these privately led operations undermine savings that could otherwise (i.e. if the operation was publicly managed) go towards conservation.
 - Linked to the high transaction costs, CSOs have raised concerns about the different interest rates of the blue bond and the blue loan. For instance, the loan to Ecuador carries a 6.98 per cent rate whereas the blue bond was issued at 5.4 per cent.⁴² In the case of Barbados, the pre-existing debt carried a 7.2 per cent interest rate, while the new blue bond achieved a very low 3.8 per cent interest rate. However, the loan to Barbados carried a 4.9 per cent interest rate. In the case of Gabon, it seems that the blue loan carried an interest rate about 2 per cent higher than one attached to the blue bond.⁴³ The difference between both is what covers transaction costs, including the guarantee fees or the intermediaries (TNC or other), as well as advisory, monitoring and reporting cost recovery. However, CSOs have argued that there is usually lack of transparency around these costs and how much will be raised through this difference in interest rates between the bond and the loan.
 - A key element in assessing the viability of the conditional debt buy-back model is the element of the distressed debt. In order for these operations to free up substantial resources for conservation, the buy-back operation needs to provide a substantial discount. For the investment bank Lazard, this model is hardly replicable at scale because “the transaction is only possible in case of distressed debt over a long period – as it takes time for an investor to raise funds and reach an agreement with the debtor country over this type of instrument”. For Lazard, the type of buy-backs that have recently characterised the debt-for-nature swaps “are inherently country-specific and situation-specific transactions”. It is worth noting that the Lazard assessment was made in 2021, when sovereign debt was not seeing as many distressed levels in secondary markets as today.⁴⁴

The deals in Barbados, Belize, Ecuador and Gabon also share some challenges and elements of concern:

- Long preparatory and negotiation process, led by the foreign lead arranger.

- Some have also raised concerns around the possibility that debt-for-nature may trigger a downgrade of the country's credit rating, leading to increasing borrowing costs. In the recent debt-for-nature swaps, the debt buy-back was assessed by Moody's as "distressed exchange" for Ecuador and Belize, but not for Gabon and Barbados. While Belize had already missed payments before the swap and Ecuador lacked market access, and both countries' bond yields were at highly distressed levels, that was not the case for Gabon and Barbados. In Gabon and Barbados, their bond yields were at around 11 per cent and 8 per cent respectively; in the case of Belize and Ecuador, bond yields were above 20 per cent.⁴⁵
- Lack of or unclear participation of local communities and civil society. While TNC argues that, at the government's request, they help "design participatory and transparent processes with active stakeholder engagement to expand marine protections and identify areas for sustainable economic activity".⁴⁶ There is no detailed information about how this participation is unfolding in the different processes, and consultation or participation, even by national parliaments, is non-existent in the definition process, for instance to decide whether the focus should be on marine conservation or another social or environmental priority.

Despite being presented as breakthrough proposals and success stories, according to the International Monetary Fund (IMF), "these operations⁴⁷ have been small and did not provide a universal solution for countries struggling with debt sustainability and nature loss".⁴⁸

Box 3: Not so "blue"

In September 2023, the International Capital Markets Association (ICMA) published a guide for bonds to finance the sustainable blue economy, including the so-called "Blue Bonds". In parallel to this launching, Nicholas Pfaff, deputy chief executive and head of sustainable finance at ICMA, stated that the debt-for-nature swaps using the combination of "blue bonds" issuance by Credit Suisse and BOA in the cases of Belize, Barbados and Gabon and debt buy-back, was something "completely different" to what the blue bond terminology referred to, leading to "regrettable confusion". The main reason was that most of the funds raised, if not all, were actually used for the debt buy-back, and not for the marine conservation policies.

TNC responded with a sort of "rebranding" from blue to "nature bonds", as "an expansion of TNC's successful Blue Bonds model".⁴⁹ Before the ICMA guidance, Barclays had already raised concerns about "greenwashing", as the proceeds of the bonds were used mostly to finance the purchase of bonds, and only a small subset was being devoted to nature projects. For Barclays analysts, the misuse of the "blue bond" label in these debt-for-nature swap operations was not only misleading, but also "exacerbating concerns over the quality of the ESG-labelled market".⁵⁰

Table 6:
Key indicators
of recent
debt-for-
nature swaps

Country	New "Blue" Loan US\$ millions	Debt bought-back US\$ millions	Debt reduction			Average repurchase price Cents per dollar	Funds for marine conservation US\$ millions
			US\$ millions	Per cent of GDP	Per cent of external public debt		
Barbados	146	150	4	0.1 %	0.15%	92.2	50
Belize	364	580	216	8.7 %	16.78%	55.0	178
Ecuador	665	1,628	972	0.8 %	1.68%	41.0	450
Gabon	500	455	–	–	–	85 to 96.7551	75 to 12552

Sources:
Eurodad,
data from IMF,⁵³
White & Case⁵⁴
and World Bank
International Debt
Statistics

2. A new push for debt swaps

Over the last years, debt swaps have started gaining attention again. After the financial crisis in 2008, TNC revived the proposal of debt-for-nature swaps, recognising that the devaluation of sovereign debt bonds from developing countries in financial markets posed an opportunity to revitalise them.⁵⁵ More recently, the exacerbation of debt problems across the global south, together with the decline in ODA flows and the lack of conservation and climate finance, have opened the door for a renewed interest in debt swaps, particularly, debt-for-climate and debt-for-nature swaps. As a report by the Potomac Group⁵⁶ for the African Development Bank states, “debt-for-climate/nature swaps are seen as a proven and effective method” to address debt, climate and nature challenges “with a comprehensive and holistic strategy”.⁵⁷

Other institutions that have been discussing, developing proposals or promoting debt-for-climate swaps and debt-for-SDG swaps include the Commonwealth Secretariat,⁵⁸ the UN Economic Commission for Latin America and the Caribbean (ECLAC),⁵⁹ the UN Economic and Social Commission for Asia and the Pacific (ESCAP)⁶⁰ and the UN Economic and Social Commission for Western Asia (ESCWA). In the case of ESCWA, their proposal is that multiple bilateral creditors write off debt service payments (or part of it) until 2030, and these resources are devoted by the debtor country to a “Debt Conversion Account” to fund projects selected through the ESCWA Debt Swap Mechanism, using a Key Performance Indicator (KPI) framework to select and monitor those projects aligned with existing national development plans and climate commitments. ESCWA would also liaise with donors to scale up the fund for investments.⁶¹ The Global Fund and WFP have been promoting debt swaps in their areas of expertise, health and food security respectively. The Global Partnership for Education, also a multi-stakeholder global fund promoting investment in education in lower income countries, has launched the Debt2Ed programme, a third party involvement debt swap scheme to mobilise more resources for education.⁶²

From the creditors’ side, the European Commission (EC), the World Bank and the IMF have also shown interest and discussed the possibility of promoting debt swaps further. In the case of the European Commission (EC), the Directorate General for International Partnerships (DG INTPA) commissioned a report from Lazard consultants to explore further actions of the European Union institutions and member states in promoting debt swaps.⁶³ In 2022, the IMF published a working paper comparing debt-for-climate swaps to alternative fiscal support instruments, concluding that “debt-for-climate” swaps are generally a less efficient form of fiscal support than conditional grants and/or broad debt

restructuring. They argued in favour of climate conditionality in comprehensive debt restructurings as an alternative to debt swaps. In debt restructurings, in contrast to debt swaps, both bilateral and private creditors participate and the perimeter of the debt treated is usually bigger.

The discussion around debt-for-climate swaps has also been part of the climate discussions at the UN Framework Convention on Climate Change (UNFCCC). At COP27 in Sharm El Sheikh, Egypt’s Ministry of Finance, with the support of the UN Economic Commission for Africa (UNECA), convened the “Sustainable debt coalition initiative”, supported by 16 countries,⁶⁴ which called for debt swaps, amongst other mechanisms, “to address issues related to both climate change and financial stability”.⁶⁵

The UN Secretary-General Antonio Guterres also endorsed the push for debt-for-climate and debt-for-SDGs swaps in his SDG Stimulus proposal. For Guterres, debt swaps “can be helpful for countries that do not yet have unsustainable debt burdens but do have limited fiscal space for SDG investment”. However, he also mentions the limited results “in part due to high transaction costs”. Guterres proposes “a reference framework (which could include template term sheets and performance indicators) could help standardise contracts to the extent possible”, together with support in the form of partial guarantees or collateralisation, similar to those used in the 1990s in the Brady bonds.⁶⁶ In a similar direction, the Group of G77, the largest intergovernmental group of global south countries in the UN, calls for the international financial institutions (IFIs) to support “developing countries in the formulation and financing of SDG swaps” and for the UN Conference on Trade and Development (UNCTAD) to “help standardise the use of debt swaps, and scale up their use from a multilateral approach with the constructive participation of public and private creditors, and recommendations to avoid downgrading from credit rating agencies when these mechanisms are executed”.⁶⁷

Box 4: Debt relief for climate action

We have also recently seen several proposals following a similar logic to that of debt swaps: connecting debt relief to climate and development action. One of these initiatives is the “Debt Relief for Green and Inclusive Recovery” (DRGR) proposal put out by the Heinrich Böll Foundation, the Centre for Sustainable Finance (SOAS, University of London), and the Global Development Policy Center (Boston University). It proposes a debt restructuring mechanism, including substantial debt write off, conditional to the development of a “Green and Inclusive Recovery Strategy” defined by each country, outlining the actions they commit to in order to advance their development and climate goals.⁶⁸ The V20, a group of countries vulnerable to climate change, issued a statement in October 2021 with a proposal along the lines of the DRGR.⁶⁹ According to their own definition, this proposal would be “a sort of grand-scale climate-debt swap where the debts and debt servicing of developing countries are reduced on the basis of their own plans to achieve climate resilience and prosperity”.

The proposal is based on the commitment from debtor countries to redirect debt servicing payments towards new investments that could include “adaptation and nature-based solutions to render infrastructure projects more resilient to climate harm, while outdated thermal coal, diesel or other fossil power plants could, for instance,

be recapitalized and transformed into hubs for green hydrogen production, waste to energy or biomass power generation facilities”. Instead of a small-scale debt relief operation, this would be linked to a large-scale debt restructuring, addressing not only short-term needs but also long-term needs to “lay the foundation for inclusive, sustainable growth and development”. In both the DRGR and the V20 proposals, the World Bank and/or other multilateral development banks would act as guarantors for the restructured debt through a new guarantee facility. These proposals also argue that, to determine the level of debt restructuring and debt write-off, the IMF and World Bank should develop new debt sustainability analysis methodology, in order to take into account the climate and other sustainability risks and spending needs for climate action and achieving SDGs.

Along the lines of debt swaps for climate action, the Institute for Environment and Development (IIED) also developed a proposal that would move “from project swaps to programme swaps”.⁷⁰ Based on the need for much larger scale debt swaps, IIED proposes the freed-up resources to be invested in “budget support programmes for climate resilience or biodiversity protection for poverty reduction”. According to them, this approach “would allow a much more cost-effective, high-volume spending instrument that is more strategically linked to policy than projects”.

2.1 From Seychelles to Gabon: the future of debt swaps?

The increasing focus on debt-for-climate and debt-for-nature swaps has been spurred by the recent cases managed by TNC and others in Barbados, Belize, Ecuador, Gabon and Seychelles (see Section 1.1.c). These cases have been presented as the future of debt swaps and are attracting increasing interest from both institutions and governments. For instance, United Nations Development Programme (UNDP) is exploring a potential debt-for-nature swap in Lao PDR. The European Investment Bank (EIB) has also recently announced that they are in advanced talks with Barbados for a debt-for-climate swap. The nature of the operation or the role of the EIB has not yet been clarified. However, according to news reports, it is inspired by the combination of debt buy-back and environmental, social and corporate governance (ESG) bond issuance with credit enhancement we have seen in recent debt-for-nature swaps.⁷¹

Beyond newcomers, TNC plans to scale up debt-for-nature swaps to at least 20 countries. In a map shared by a coalition of CSOs critical of TNC swaps, on top of the ongoing cases, debt-for-nature swaps were being scoped in countries like Mexico, Jamaica, the Bahamas, Angola, Kenya, Tanzania and South Africa. Meanwhile Peru, Chile, Brazil, Cabo Verde, Senegal, Ghana, Namibia, Mozambique, Madagascar, Mauritius, Sri Lanka, Indonesia, Vietnam, Micronesia, Solomon Islands, Tuvalu, Fiji and Tonga were amongst the potential countries to develop debt-for-nature swaps.⁷² Barclays bank analysts have calculated that there is a market for debt-for-nature swaps that could potentially exceed US\$800 billion in both public and private deals.⁷³

For the CSO erlassjahr.de, the expansion of the TNC model for debt-for-nature swaps is corrupting the nature of debt swaps because, in the debt-for-nature modality, the creditors do not make any effort to reduce debt, and they are receiving what their claims are worth in the markets at the moment of the swap. For erlassjahr.de, "Unlike some philanthropic private creditors in the earlier phases of the global debt

crisis, today's investors are not prepared to waive their claims beyond what they have already lost due to the falling market price".⁷⁴ For erlassjahr.de, the motivation of private creditors in these operations is purely financial, as the nature conservation element is minimal. Such operations should therefore be qualified just as debt buy-backs rather than debt-swaps.

Box 5: A resurgence of bilateral swaps

2023 has seen a resurgence of bilateral debt swaps. In January, Cabo Verde signed a debt swap deal to convert up to €140 million owed by the African country to Portugal. The deal is the result of a pilot programme that IIED, together with Bankers without Boundaries, UNECA, International Union for the Conservation of Nature (IUCN), Global Green Growth Institute (GGGI), ADAD (a Cabo Verde NGO) and Potomac Group implemented in Cabo Verde and Senegal to promote debt swaps. One of the key novelties in this debt swap programme is the use of climate and nature Key Performance Indicators (KPIs) identified by the debtor government, based on existing national commitments and strategies and local stakeholders' priorities, and negotiated with the creditor country. In a first phase, Cabo Verde will pay – into an environmental and climate fund created for the occasion – €12 million of debt payments to Portugal scheduled until 2025. The total debt payments scheduled between Cabo Verde and Portugal, according to the World Bank International Debt Statistics, between 2023 and 2025 is €61 million, of which €33 million is concessional debt. The debt swap deal will initially cover 19 per cent of the total debt payments from Cabo Verde to the Portuguese government in the next three years. Depending on the performance in relation to the agreed KPIs, more debt relief can come after 2025, up to the full amount owed. The annual climate financing needs for Cabo Verde are estimated to be US\$200 million per year and total public external debt is US\$1.98 billion.⁷⁵

In September 2023, a new bilateral debt swap deal was announced between Peru and the US, in this case with the participation of four international conservation NGOs: Conservation International (CI), The Nature Conservancy (TNC), Wildlife Conservation Society (WCS), and World Wildlife Fund (WWF). The deal follows the traditional bilateral debt swap agreement under the US Tropical Forest and Coral Reef Conservation Act (TFCCA) and will redirect over US\$20 million of Peru's debt to the US government to a conservation fund that will provide grants to local NGOs for projects protecting the Amazon tropical forests. This operation covers all of Peru's public debt to the US government, 2.33 per cent of Peru's debt to bilateral creditors and 0.05 per cent of all external public debt.⁷⁶

Finally, in October 2023 Egypt became the first country to sign a memorandum of understanding for a bilateral debt swap agreement with China. The details of the debt swap are not officially public, but according to media reports, the deal will focus on health and transportation sectors, and it will involve the participation of Chinese corporations.⁷⁷ Earlier this year Egypt also signed an agreement with Germany for a bilateral debt swap of €54 million to be invested in energy transition.⁷⁸ The possibility that Chinese lenders invest in debt swaps has been addressed by several analysts, given the importance of China as a bilateral but also commercial lender.

3. Questions, concerns and challenges around debt swaps

In the context of increasing debt vulnerabilities and shrinking fiscal space, debt swaps are presented as an opportunity to deal with the two problems at once. Many analysts agree that swaps are not an adequate tool for substantially reducing debt levels (see Section 3.1), but nonetheless addressing debt vulnerabilities is one of the arguments used by many of the institutions promoting debt swaps.

Even if we see debt swaps as a tool to release resources to invest in development or climate action, rather than focusing on resolving debt problems, both past and recent experiences teach us that we need to be cautious about the effectiveness of the tool and wary about some wrongdoings in their implementation. The following section explores some of these concerns and challenges in the conceptualisation, definition and implementation of debt swaps.

3.1 Are debt swaps fit to deal with unsustainable debts?

As mentioned above, there is broad agreement among analysts that debt swaps are not an effective instrument for significantly reducing debt levels. The history of debt swaps shows that the overall impact on debt levels has been rather limited, mainly due to the reduced scale of the operations and of the actual debt cancellation involved. Writing for the Institute of Development Policy and Management, Essers, Cassimon and Prowse argue that “traditionally, debt swaps have been piecemeal operations with a negligible effect on overall debt burdens (involving millions rather than billions of US dollars)”.⁷⁹ As mentioned above, there is not a comprehensive study or calculation of how much debt has been treated through debt swaps or how much has been invested through these instruments.

Table 7 shows some of the partial calculations made by different authors, including Eurodad’s calculation of recent debt-for-nature swaps. Adding all these together (although it is a rough estimate, as we do not know if some of the calculations overlap with the others), we could get to a total of US\$8.4 billion of debt treated through swaps between 1987 and 2023. Over these three decades, low- and middle-income countries paid more than US\$7.6 trillion in debt service.⁸⁰ That is, debt swaps over the past 36 years treated around 0.11 per cent of total debt payments by low- and middle-income countries during the same period. As mentioned, HIPC and MDRI debt relief delivered on almost US\$120 billion, over 14 times more than through debt swaps.⁸¹

Table 7: Selected calculations on amounts treated and invested through debt swaps

	Debt treated in swaps	Funds invested in projects through swaps
Debt-for-nature swaps from 1987 to 2008 (48 operations in 15 countries) ⁸²	US\$170 million	US\$150 million
UNICEF debt swaps programme between 1989 and 1990 (21 operations) ⁸³	US\$199 million	US\$52 million
Bilateral debt swaps between 1988 to 2008 (128 operations in 38 countries) ⁸⁴	US\$6.13 billion	US\$3.32 billion
Debt-for-nature swaps 2015-2023 (5 operations in 5 countries)	US\$1.93 billion	US\$811.6 million

Source: Eurodad based on Sheikh,⁸⁵ Ruiz,⁸⁶ Filmus and Serrani,⁸⁷ and other sources.

For a debt swap to have a meaningful impact on debt levels, it should include a significant proportion of the country’s debt in the swap, but also entail a significant discount. That is, there has to be an ambitious amount of outright and unconditional debt cancellation included. For researchers Cassimon, Renard and Verbeke, the first wave of debt swaps resulted in nothing more than “an attempt to ‘rearrange the deck chairs on a sinking Titanic’”.⁸⁸

On top of the limited impact, as several international institutions acknowledge, debt swaps “are not a means to restore debt sustainability in countries with solvency challenges”.⁸⁹ They cannot be a substitute or a way to avoid a comprehensive debt restructuring, including debt cancellation. In this direction, the G77 states that, while acknowledging debt swaps for SDGs can unlock additional financial resources to address the financing gap, it also recognises that “debt swaps cannot replace broader debt treatments in unsustainable debt situations”.⁹⁰

3.2 Are debt swaps an opportunity to provide development and climate finance?

As inadequate tools to address debt problems, debt swaps should be seen as mechanisms to free up funds for governments with fiscal space constraints, in order to invest in development, climate action or nature conservation. Different authors consider that debt swaps should be considered in the case of countries with high but sustainable debts, that lack fiscal space and have limited access to grants or concessional finance.⁹¹ Faced with the many pressing financing needs of countries in the global south, and the limited opportunities to access non-debt creating development and climate finance, the prospect of liberating resources from debt payments for investing in SDGs, energy transition, adaptation or conservation projects is an opportunity that most governments will consider beneficial.

That does not mean that debt swaps will be able to substantially contribute to the SDGs, climate and conservation financing needs. The increasing focus on debt swaps can give the (wrong) impression that the financing gap is being addressed through this 'innovative' mechanism. This detracts attention and efforts away from the need to fulfil the existing ODA and climate finance commitments, and to step up both unconditional grants and highly concessional finance to all countries in the global south.

According to IMF research, climate conditional grants (grants addressed to climate projects or goals) are more efficient than debt-for-climate swaps, given the length, complexity and high transaction costs that these operations entail and the fact that grants are normally more targeted and lead to a higher net fiscal transfer. For the IMF researchers, the most cost-efficient from the perspective of a creditor or donor would be to combine "a climate-conditional grant which exactly pays for the climate investment with some additional, unconditional debt relief".⁹²

Box 6: What is in it for the creditor?

One question that we should be able to answer is why creditors are interested in debt swaps. On the one hand, for bilateral creditors, and according to Lazard's report for the European Commission, debt swaps can support the development finance strategies of donor countries, as well as fostering diplomatic relations between donor and recipient countries. Some donor countries will be interested in the possibility of increasing their ODA or climate finance,⁹³ others will use the debt swaps to influence the recipient country's development or climate policies. This can give the donor a sense of having control over the use of the freed-up resources, particularly if it is compared with unconditional debt cancellation. This is control that can be secured by introducing some type of clawback mechanism or performance targets, on top of the use of funds oversight.⁹⁴ Creditors may also think that debt swaps can be more popular domestically than unconditional debt relief, which might have a connotation of rewarding failure.

The other side of the coin is that the priorities set by creditors might not be aligned with the development or climate agenda of the debtor country, undermining the debtor country's ownership over the projects or programmes funded by the swap and jeopardising the quality of those projects. Authors Cassimon, Bernard and Verbeke write that the excessive earmarking and donor micro-management should be abandoned in favour of country priority setting and implementation in order for debt swaps to "hold at least some promise of translating into an efficient and effective instrument of development".⁹⁵

For private creditors, the incentives are definitely different. For those looking to green their portfolios, swapping their claims through new ESG bonds issuance (even if these include a discount) that might improve their ESG rating can be reason enough. However, in the case of swapping highly distressed debt, the risk assessment of facing a higher haircut in the event of a debt restructuring is surely of bigger importance. In the case of the involvement of other private sector intermediaries, the interest is probably in the business opportunity that debt swaps pose, given the high fees involved.

3.3 Is it all about scaling up debt swaps?

If debt swaps are unlikely to cancel enough debt to contribute meaningfully to the debt crisis and so far have not been successful in significantly increasing fiscal space, is it all about making debt swaps bigger? The case for scaling up debt swaps is a constant in the literature and analyses, but we need to consider what is the potential for such scaling up.

For Lazard, analysing the suitability of bilateral debt swaps for European Union institutions and governments, even in its most efficient form – i.e. a full conversion of all ODA claims held by Paris Club members into local currency – bilateral “debt swaps do not have the potential to significantly help bridge the SDG financing gap overall”.⁹⁶ Only 2 per cent of financing needs for low-income countries and low- and middle-income countries between 2019 and 2030 would be met. In the case of low-income countries, most debt is bilateral – mostly owed to China and other non-Paris Club lenders without the tradition of debt swaps – and multilateral. It is worth remembering that multilateral creditors refuse to participate in debt relief, including debt swaps. In the case of middle-income countries, most debt is owed to bondholders. As we have seen, the potential of scaling up debt swaps with bondholders will depend on the bonds being traded at discount for a long period of time.

3.4 Details matter: disbursement schedule and local vs foreign currency

The way the funds are disbursed by the debtor country (both in terms of the calendar and currency) is key to determining the impact debt swaps have in freeing up fiscal space. These include the disbursements schedule and the currency in which the debtor agrees to mobilise the freed-up resources.

In relation to the calendar, the arrangement should make sure that there is not an additional budgetary pressure for the debtor government having to advance disbursements upfront when the original debt payments were more spread out.¹⁰² For instance, in a debt-for-education swap between Spain and El Salvador, where no discount rate was granted – the government had to disburse all the debt treated – and payments had to be made upfront. This meant that the fiscal space in the country actually shrunk. It is therefore key to make sure that the calendar for the debtor to disburse the freed-up resources is sustainable and realistic, not adding additional fiscal pressure. In cases of unsustainable debts and liquidity problems, if the debtor government was struggling to make the debt service payments in the first place, “it is unlikely that they will have the resources to invest in areas agreed in the debt swap”.¹⁰³

Box 7: The additionality factor

In order to make a real impact, debt swaps should be additional to existing ODA and climate finance commitments, which are systematically unmet by countries in the global north. In the case of bilateral debt swaps, the debt relief in a debt swap can be counted as ODA according to the OECD Development Assistance Committee (DAC) rules. For Eurodad, however, debt relief should not be counted as ODA, as it not only inflates the aid figures, but it also opens the door to double counting and is a threat to additionality.⁹⁷ Other CSOs, including those that are part of the Climate Action Network International (CAN-I), also argue that it is “problematic to propose that the resources mobilised through debt swaps can be counted towards official climate finance or ODA”.⁹⁸

Additionality means that the debt discount should not reduce the level of other funds, for development or climate, that the creditor should be providing. From the debtor side, additionality means that the development, climate or conservation action that will be undertaken, thanks to the swap, would not have been implemented in the absence of the operation.⁹⁹ Such additionality is very difficult to assess given the lack of predictability of both elements, and the difficulty to set the “counterfactual of what would have happened if the debt swap had not taken place”.¹⁰⁰ For Cassimon, Renard and Verbeke, “the combination of donors targeting overall ODA levels and debt swaps being ODA eligible is a recipe for non-additional debt relief”.¹⁰¹

In traditional bilateral debt swaps, one of the key elements that usually benefits the debtor country is that, while in many cases the debt payments are in foreign currency, the deal establishes that the investments committed by the debtor will be disbursed in the local currency. This diminishes the pressure on the foreign reserves of the country, and usually brings in savings for the debtor country.

However, in the case of a currency devaluation, that can play against the debtor country. In a debt swap between Senegal and Argentina, with the participation of UNICEF, the agreement was for Senegal to pay a reduced amount of the original debt to UNICEF for projects in the country, in local currency. However, “one month after the debt swap agreement was signed, the local currency devalued by 50 per cent, doubling the Government obligation”.¹⁰⁴ Currency devaluation or exchange rate instability, in some cases coupled with inflation, can jeopardise the real value of the benefits of the debt swap and undermine its implementation.¹⁰⁵ All of these elements, together with the issues of additionality and transaction costs (see Section 3.6), are key when assessing whether a debt swap will actually create additional fiscal space.

Box 8: A fair burden sharing for all creditors?

One of the elements that some analysts raise in relation to the adequacy of debt swaps is that they are not compliant with the principle of comparability of treatment. The experience with debt swaps shows that there is always only one creditor (or multiple bondholders) involved. This means that the effort this creditor is willing to make to provide a debt write-off is not going to be matched by other creditors. In the end, this means that “some of the debt relief generated by debt swaps will end up subsidising non-participating creditors”.¹⁰⁶ Debt swaps involving different creditor classes (bilateral, private and multilateral) or different creditors within a group (i.e. two bilateral creditors) have been mentioned as a possibility in theoretical proposals, but have never been implemented. For Lazard, in their report with recommendations for the EU, European institutions “should be careful in granting any sort of debt relief that would not be matched by other creditors, especially non-Paris Club ones”.¹⁰⁷ So, why should European creditors be making an effort if China is not willing to?

3.5 Are debt swaps another open door to donor conditionality?

In general, debt swaps can be defined as conditional debt relief. By their nature, they inherently bear conditionality, as the debt swap will not happen if the debtor country does not agree to invest the freed-up resources in the area or project to be approved by the creditor. Lenders therefore have “much more control over where freed-up resources are allocated than if the debt was just cancelled outright”.¹⁰⁸ While this is an issue that is barely raised by institutional analyses on debt swaps, it is usually a concern for CSOs and independent researchers. The main concern is that the lender will use this door to impose their own interest and priorities over those of the borrowing country. The urgent need for funds and fiscal space would make it difficult for a debtor country to reject a debt swap proposal based on having different priorities. The present focus on debt-for-climate and debt-for-nature swaps, displacing the appetite of debt-for-other SDGs, can illustrate this dilemma. Ultimately, the debt swap can be perceived as leading to a “loss of sovereignty in the allocation of fiscal and natural resources by the debtor country”.¹⁰⁹

Beyond the issue of priorities, debt swaps can also give the creditor a lot more power over how the resources will be allocated and how the projects will be implemented. In past bilateral experiences, lender countries have used debt swaps to impose, for example, a contractor from the donor country (following the practices of tied aid). For instance, in Spain, out of 20 debt swaps implemented between 2001 and 2015, five of them include in the contract that the projects will be implemented “with the participation of Spanish companies or development organisations”. In the other 15 cases, the contract reads that it will be implemented by either Spanish or local entities (from the debtor country), leaving the door open to the participation of Spanish corporations.¹¹⁰ Other bilateral creditors, including Italy and the US, have also occasionally tied their debt swaps to the participation of national entities.¹¹¹

In the case of recent debt-for-nature swaps, the prominent role of international conservation foundations or foreign corporations in setting up the deal also raises concerns about ownership by the debtor country and breach of sovereignty. In the case of Ecuador, for instance, the resources devoted to marine conservation will be managed by the Galápagos Life Fund (GLF), a foreign not-for-profit endowment fund where six of the 11 seats of the board are for private actors. This includes two from Pew Bertarelli Ocean Legacy and Oceans Finance Company (Climate Fund Managers subsidiary) and representatives from local tourism and fishing industry and researchers. Only five seats are to be allocated to the Ecuadorian government. For local, regional and international CSOs analysing the deal, this “undermines sovereign rights for independent definition of conservation policies and the management of its natural resources”.¹¹²

Debt swaps have not proved to be effective in reducing debt levels in a substantive way and they cannot be considered a viable alternative to debt restructuring or outright debt cancellation

Box 9. Debt swaps and carbon credits

Some authors highlight the possibility of coupling debt swaps with carbon markets. For instance, for the authors of the IMF working paper on debt swaps write that “public or private creditors undertaking debt swaps could be given credits to offset their carbon footprint”. While they acknowledge that this actually allows for higher emissions in the creditors’ country (mainly the global north), they argue that it would also facilitate the funding of projects focusing on effective emissions reductions.¹¹³ Cassimon, Essers and Prowse also highlight how debt swaps can “package up and sell carbon offset creditors”. This is not a hypothetical proposal, as they take the example of a debt-for-wind-power swap between Spain and Uruguay in 2005-2007. The deal earned Spain certified emission reduction credits through the now defunct Clean Development Mechanism (CDM).¹¹⁴ For the IMF researchers, such a mechanism, which could be facilitated with a new facility like the CDM and could help lower the cost of new ESG debt in cases of debt-buy-back, “would need to be designed to avoid risks of greenwashing and align climate actions underpinning debt swaps with global mitigation efforts”. For them, this means focusing on projects that would not have happened without the debt swap, so any mitigation gains are additional.¹¹⁵ However, that additionality will be difficult to assess.

The promotion of coupling debt swaps with carbon credit transfer is an opportunity for creditors to claim as their own climate mitigation efforts that are actually made by the debtor. It is not just difficult to avoid the greenwashing but also an open door for the bigger emitters to avoid their mitigation responsibilities. “This perception could be all the more prevalent as the production and consumption patterns of advanced countries, which have historically been responsible for most of the world’s environmental degradation, are not changing”, according to a briefing published by Banque de France.¹¹⁶ The briefing also highlights the risks of double counting climate change mitigation efforts between countries (that could be reported both by the creditor and the debtor).¹¹⁷ Such a scheme would neither be aligned with the principles of Common But Differentiated Responsibilities (CBDR), as the mitigation effort is made by those who are least responsible for the climate crisis.

3.6 Slow, complex and costly

Debt swaps are complex instruments, time-consuming and burdensome at negotiating the terms of the swap, but also at setting up the operational structures for implementation and oversight. Those structures differ in the cases of bilateral, third party involvement or private sector intermediated swaps. Bilateral debt swaps usually involve the set up of one or more binational committees, tasked with monitoring the implementation throughout the life of the debt swap agreement. The composition of these binational committees varies, and can incorporate civil society from both the creditor and the debtor country (see Section 3.7). In the case of third-party involvement swaps, one of the arguments their promoters use is that these structures are already in place, so the time and costs for setting them up are saved. However, the negotiations can still be lengthy. In the case of the private intermediated swaps through debt buy-back, the structures are much more complex and it can take up to several years to negotiate. In the case of Seychelles, for instance, it took up to five years to close the deal.

The complexity of the process, the number of agents involved, the lengthiness of the negotiation and implementation, and the multiplication of transaction and management costs inherent to the fragmentation of projects being dealt with separately,¹¹⁸ lead to debt swaps tending to have high transaction costs, particularly in relation to the amounts involved. For Caliri, “scaling-up operations through multi-creditor funds can minimise transaction and negotiation costs and create efficiencies”.¹¹⁹

However, in the case of the recent debt-for-nature swaps, where the amounts dealt with have been scaled up, transaction costs remain high given the complexity of the operations. In the recent debt-for-nature swaps managed by TNC in Barbados, Belize, Gabon or the Seychelles, and the one managed by a consortium of private investment firms in Ecuador, the high transaction costs and the lack of transparency around them has been a key issue for civil society. In the case of Ecuador, for instance, transaction costs will be covered by the 1.33 per cent interest rate difference between the blue bond and the blue loan to Ecuador.¹²⁰ In the Belize case, while only US\$84 million of the US\$553 million deal went to actual marine conservation, up to US\$86 million was allocated to intermediaries and service providers such as re-insurers, advisers and credit providers, with an additional US\$10 million provided by Belize to help cover the closing cost for the transaction.¹²¹ Moreover, the part of the transaction costs to pay the fees of the banks involved are in fact free money, because the insurances backing the operations make them risk free.

In order to lower transaction costs, some institutions and analysts are proposing a standardisation of the mechanism, a sort of template that would “make the instrument less bespoke and less cumbersome”,¹²² and therefore less costly.

3.7 Transparency, accountability and civil society participation

The opacity has been a constant in recent cases of debt-for-nature swaps. The secretive negotiations prior to the debt buy-back operation are justified to avoid a revaluation of the distressed debt being swapped. However, even once the operation is sealed, the quality and comprehensiveness of the information available is not sufficient and can lead to misunderstandings around the operations involved in the complex debt swaps. We need to take into account that these are mechanisms dealing with sovereign debt, so public resources, as well as transparency and accountability, should be a given. In the case of Ecuador, only after local civil society requested information through a constitutional act of access to public information, the government released the details of the debt swap for conservation in Galapagos.

On some occasions, bilateral debt swaps have incorporated the participation of citizens, civil society or other local entities of both the lender and borrowing country. According to Lazard, this “has had significantly positive impact on the implementation of the instrument”.¹²³ For instance, the evaluation of a debt swap between Peru and Germany between 2003 and 2015 concludes that the operation impacted positively on the promotion of citizens’ participation at a local level. There was better organisation of citizens’ oversight and better participation of civil society in political processes, an increase in women’s participation and a strengthening of dialogue between citizens and local authorities.¹²⁴

However, not all the experiences are so positive. First of all, civil society participation has been quite reduced. Of the 128 debt swaps reviewed by Serrani and Filmus, there was some form of citizen representation in the binational committees in just 29 cases; and in 77 cases, civil society was represented in technical committees.¹²⁵ Another element is the quality of that participation. The evaluation of the French C2D programme shows how, despite the promises by the government to involve civil society, there was formal participation in only five of the 18 eligible countries. In just four of them, participation went beyond the formalities (Democratic Republic of Congo, Cameroon, Côte d'Ivoire and the Republic of Congo). The experience in these four cases is not completely satisfactory, and the report concludes that civil society could not influence the orientation or implementation methods of the C2D programme. In the case of Spain, an evaluation of debt swaps found that CSOs were only involved in technical committees, but not in the Oversight Binational Committee. This excluded them from decisions on the design and regulation of the debt swap. Moreover, the creditor country, Spain, only guaranteed participation by Spanish civil society, while participation of local civil society was contingent on the decision of the debtor country.¹²⁶

The lack of systematic monitoring, accountability and evaluation of the impacts of debt swaps is also an area of concern. While bilateral debt swaps often undertake periodic reviews of the financial aspects of the debt swap,¹²⁷ a more comprehensive monitoring, systematic accountability mechanism and ex post evaluation should be the starting point.

Debt swaps cannot become an excuse for creditor countries to avoid their commitments to deliver ODA and climate finance

Box 10: Indigenous peoples and local communities at the centre

Beyond the tick-box exercise of civil society participation that many debt swap cases have implemented, historically there has been a staggering exclusion of indigenous peoples and local communities in the definition and implementation of debt swaps, particularly when it comes to debt-for-nature swaps. Outcomes from the early debt-for-nature debt swaps in the 1980s and 1990s included “restricting access to traditionally owned natural resources and land uses and the dispossession of indigenous peoples from their lands”.

The exclusion of indigenous peoples from using their lands or coastal resources was illustrated by the very first debt-for-nature swap in Bolivia, which prevented the Tsimané Indians from securing formal tenure for their land and “restricted their traditional practice of foraging for food and fuel”.¹²⁸ Unfortunately, the experience in Bolivia was not an exception, and other cases of communities experiencing exclusion, denial of access to traditional lands and resources, displacement, knowledge extraction and biopiracy and human rights violations have occurred linked to debt swaps.

Debt-for-nature swaps focusing on ocean conservation can also come with problematic practices for coastal and small-scale fishing communities, “including the privatisation of fishing rights, advancing blue carbon trading, expanding high end eco-tourism and commercial fish farming”.¹²⁹ Unfortunately, the lack of transparency and details available regarding how local communities, indigenous peoples and small-scale fishing communities are being involved, or not involved, in the recent cases of debt-for-nature swaps, does not leave much room for optimism.

3.8 The risk of greenwashing and legitimising illegitimate debts

The risk of greenwashing in relation to debt-for-nature and debt-for-climate swaps is not just a possibility, it is a reality that even financial market institutions have highlighted. The concerns raised by ICMA or Barclays about wrongly labelling the new bonds in debt-for-nature swap schemes as “blue bonds”, when most of the proceedings were not being used for ocean conservation but to buy debt back, are the tip of the iceberg. The multiple challenges raised in this section around the use of conditionalities, the sovereignty breach and the risk of tied aid, the high transaction costs and hidden profits for the many agents involved, the lack of transparency, participation, accountability and engagement of indigenous peoples and local communities, as well as the lack of really significant impacts in debt levels or development and climate finance, are being widely ignored in the PR campaigns around the promotion of debt-for-nature and debt-for-climate swaps. The bigger greenwashing risk is that creditors and the international community, including international conservation NGOs, appear to be delivering on their climate finance and environmental conservation commitments, while the actual results are still to be seen and concerns remain unaddressed.

In addition, social movements and CSOs have frequently highlighted the risk of swapping and therefore legitimising and erasing responsibilities on illegitimate debt. The term “illegitimate debt” generally refers to debt with features that are irregular, inappropriate, irresponsible, dubious or fraudulent – those that go against widely accepted legal, political, financial, economic, environmental and particularly ethical standards and principles. For Filipino activist Lidy Napcil, “when defining illegitimacy, the first thing we need to take into account is that there is more than just legality at stake”.¹³⁰ A key demand of many debt justice organisations has been the unconditional cancellation of illegitimate debts that should not have been acquired in the first place. In the sense that debt swaps are conditional debt relief instruments, they should not be used in the case of illegitimate debts.¹³¹

For other CSOs, however, debt swaps could be considered as a mechanism for reparation in the case of illegitimate debts. In 2007, erlassjahr.de submitted a proposal to the Indonesian and the German government to convert the proceeds from a 1992 loan to sell ships to the Suharto dictatorship into a compensation fund for the victims of the atrocities committed by the army. Interestingly the German development minister at the time was prepared to consider it, but the democratically elected government of Indonesia was not.

4. Conclusions: to swap or not to swap?

Debt swaps have not proved to be effective in reducing debt levels in a substantive way and they cannot be considered a viable alternative to debt restructuring or outright debt cancellation, especially in the case of unsustainable debt. With their high transaction costs, complex governance structures and the use of conditionality, debt swaps are a less efficient form of fiscal support for countries in the global south than unconditional grants or even highly concessional finance. However, for countries without access to grants or concessional finance, debt swaps can play a role in mobilising extra resources for SDGs or climate projects. Well-designed debt swaps providing funds for local projects that respect the priorities of communities and meaningfully include community participation from the early stages of operation can have a positive impact. However, experience shows that their impact on the fiscal outlook and debt situation will not be particularly relevant.

When evaluating the efficiency and adequacy of debt swaps, a key distinction has to be made between the traditional bilateral or third-party involvement debt swaps, and the recent debt-for-nature swaps via debt-buy-back operations. The latter, involving new bond issuances to refinance existing distressed debt, are perpetuating the debt dependency and the dependency on financial markets, which is in turn enhancing the financialisation of development and climate finance. These can even be seen as a bail-out and subsidising of private creditors, as the operation ensures the resources for the debt-buy-back thanks to public guarantees (credit enhancement) on distressed debt that, otherwise, could have been the object of a more comprehensive debt restructuring, including debt write-offs.

Moreover, in all types of debt swaps, concerns around the democratic quality and fairness of debt swaps remain unanswered. The challenges and risks highlighted in this briefing should be considered before defining and implementing debt swaps, including: disbursement modalities and prioritisation of local currency; ownership by the borrowing country and respecting the aid efficiency principles (discarding any type of tied aid or coupling with carbon credits); reducing transaction costs and ensuring additionality; transparency, accountability and systematic evaluation; civil society participation, particularly respecting the voices and rights of local communities and indigenous peoples; and considering the origins of the debt and the call for unconditional debt cancellation of illegitimate debts. As exposed in this report, it is not just an issue of scaling up, but the devil is in the details. In order to work for economic, climate, gender and social justice, quality and the governance failures in debt swaps should be actively tackled before promoting them any further.

Debt swaps cannot become an excuse for creditor countries to avoid their commitments to deliver ODA and climate finance, nor should they be used to inflate ODA or official climate finance figures. The 0.7 per cent of GDP for ODA is a longstanding commitment that has been systematically undermined. As Eurodad has recently shown, “reported ODA to GNI is stuck at an average of 0.34 percent – not yet halfway to the longstanding UN target of 0.7 per cent”.¹³² Moreover, countries in the global north are also failing to deliver on climate finance commitments, while offering more than 70 per cent of the climate finance flows in the form of more debt.

Debt swaps will not cover up the shame of the lack of political will and commitment amongst countries in the global north to support the global south. Countries in the global north should recognise their historical responsibilities in perpetuating neo-colonial economic governance and dynamics that keep countries in the global south tied to debt dependency. They should also fully comply with the principles of Common But Differentiated Responsibilities (CBDR) decided within the UNFCCC agreements, as those most responsible for the climate crisis, and pay back the ecological and climate debt that they owe to the global south. As the debt justice movement claims, “like the debt crisis, the climate crisis is rooted in the plunder of the resources of the South, for which we demand reparations and restitution for the massive climate debt owed by the North”.¹³³

Finally, progress on debt swaps should not be an excuse to detract attention from the urgent need to move forward the fundamental reform of the international debt architecture. Establishing a timely, transparent, rules-based and comprehensive sovereign debt resolution mechanism, together with other reforms of the international financial architecture – including the regulation of Credit Rating Agencies – would offer countries the possibility of undertaking fair and unconditional pre-emptive debt restructurings. The attention that debt swaps are gaining in international development finance arenas should not become a distraction from the structural reforms that the international financial architecture so desperately needs.

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 - iii. Gail Hurley, consultant
 - iv. Paul Steele and Sejal Patel, International Institute for Environment and Development (IIED)
 - v. Vlassis Tigkarakis, Debt2Health, Innovative Financing for Health, The Global Fund to Fight AIDS, Tuberculosis and Malaria
 - vi. Ulrich Volz, Centre for Sustainable Finance at SOAS, University of London
 - vii. Robert Weary, CEO/Founder of Aqua Blue Investments, previously at TNC
 - viii. Tenke Zoltani, Senior Thematic Debt Advisor to UNDP
 - ix. The World Bank and AOSIS shared their interviews in writing.
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