Debt-for-climate SWAPS
Can they be aligned with debt and climate justice?
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Discussion document
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Can they be aligned with debt and climate justice?

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There is growing international support for debt swaps to increase financing for climate actions in Southern countries. This is partly inspired by recent debt-for-ocean swaps arranged by US conservation finance organisations in five countries, resulting in the restructuring of over US$2.5 billion in government foreign currency bonds. It has been proposed that these and other bilateral debt swaps can be scaled up, reducing the debt crisis in Southern countries.

Debt swaps are highly controversial, and previous swaps have had a minimal positive impact on transitioning countries towards sustainable debt management. The terms of these swaps can benefit Northern creditors and companies that limit genuine wealth transfers to citizens in debt-distressed countries and can artificially inflate reporting on climate financing. These problems are exacerbated by a lack of transparency, civil society participation and accountability mechanisms.

Promoting debt swaps to achieve either climate or debt justice remains divisive. If they continue to embed the above-mentioned issues, their promotion may distract and delay the reforms needed to break the nexus between debt and climate injustice. Alternatively, while recognising these are not a panacea, approaches to debt swaps could be improved. This requires refining the financial terms of these agreements to include more ambitious debt cancellation. It also requires resisting conditionalities imposed by creditors and better aligning debt swaps to participatory policies on transitioning to sustainable societies. If debt swaps are to be scaled up, there is an urgent need for stakeholders in Southern countries to determine how debt conversion schemes can work to their advantage.
COP 28 could change the path of Greenhouse Gas (GHG) emissions and promote real solutions to the climate crisis, considering the lack of time humanity has to tackle it. However, the expected results are not encouraging. Once again, it will most likely expose the international community’s failures to respond to the climate catastrophe. It will also highlight the extent to which developed nations provide Southern countries with financial support and compensation for climate adaptation and mitigation. Currently, over 80% of climate finance is provided through loans. A contentious report issued in November by the OECD\(^1\) described that developed countries were getting close to meeting the US$100 billion pledge set in 2009\(^2\). However, this also described that a vast surge in spending is needed. According to the OECD—repeating what many other organisations believe—the majority of future funding must come from the private sector. This document aims to contribute to a more informed and analytical discussion on debt-for-climate swaps in the current context.

The backdrop to COP 28 is a spiralling debt crisis in Southern countries. UNCTAD reports that over the past decade, precipitated by the financial crash of 2008, the number of Southern countries with high public debt levels has increased from 11 to 59\(^3\). The primary driver of this has been the increasing debt service generated by reckless borrowing by Southern governments from private investors, principally through Eurobonds. At the same time, development grants provided by industrialised countries and multilateral organisations have shrunk in an era of austerity. Many Southern countries are, therefore, stuck in a spiralling debt trap: borrowing more at higher interest rates. Government debt has doubled in Latin America and the Caribbean since 2009, from roughly US$2000 billion to over US$4000 billion, leading to interest payments that in some countries reach 5.8% of GDP. Government debt has nearly tripled in sub-Saharan Africa since 2009, going from US$565 billion to nearly US$1900 billion.

It is now more widely appreciated that the climate and biodiversity crisis are interwoven with this debt crisis\(^4\). One cannot solve one without the other. This is why campaigns for climate justice are now fused with debt justice campaigns. This relationship is thought to work in multiple ways:

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2. It is contentious as the accounting methodology used by the OECD allows developed countries to inflate their climate finance.
The climate crisis will push Southern countries further into debt: The climate/biodiversity crisis undermines economic growth, while catastrophes, such as extreme flooding, droughts and hurricanes, demand high public spending. In the Caribbean, a climate disaster resulting in damage and losses of at least 5 per cent of GDP can now be expected every few years⁵. As such, the climate crisis will reduce government revenues and place further strain on servicing public debts.

The burdens of servicing debt deny Southern countries the ability to pay for nature protection, climate adaptation, and mitigation: UNCTAD reports that 50 countries in the South currently spend more on debt repayments to foreign creditors than they do on health and education combined. With decreasing public budgets, it is feared that spending on biodiversity and climate is often deemphasised in government budgets.

Vulnerabilities to climate disasters raise borrowing costs: Credit rating agencies are considering vulnerabilities to climate disasters and biodiversity losses. This has substantially pushed up borrowing costs for Southern countries, and many analysts predict this trend will worsen⁶. This also presents an uncomfortable reality for those advocating scaling up private finance for the climate crisis, as access to loans from the private sector will cost more for those who need it the most.

Debt is a barrier to transitioning to a green or blue economy: The pressures of servicing the debt trap reinforce a historical dependency in Southern countries on dirty extractive industries, such as fossil fuels, mining and industrial agriculture, because these produce substantial foreign exchange to repay loans⁷.

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⁵ UN Department of Economic and Social Affairs (2021) 'Disasters after disasters: Short recovery intervals and large financial gaps in Small Island Development States'. Link
⁷ For example, see the report by Debt Justice. (2023) "The Debt-fossil fuel trap". Link
But are debt swaps the answer?

In this context, debt swaps are presented as mechanisms that can offer a way out of this spiral. They can be understood as conditional debt restructuring: creditors offer concessions on the terms of debt owed to them based on an agreement that the debtor will compensate for this by doing something positive for the environment or other developmental goals.

The enthusiasm for such swaps is because they simultaneously increase spending on positive environmental actions while decreasing the debt burden in Southern countries. Proponents of this view describe that debt swaps are proven to work. In recent years, debt swaps managed by US organisations at the forefront of so-called conservation finance were finalised in Seychelles, Belize, Barbados, Ecuador and Gabon (linked to ocean conservation). This has restructured debt worth over US$2.5 billion. At the same time, another 15 are reported in the pipeline. Cabo Verde and Egypt have also recently concluded debt swaps where the proceeds are earmarked for climate mitigation and adaptation. As the managing director of the IMF, Kristina Georgieva, has argued, based on these positive examples, "swaps need to be scaled up significantly." It is likely that at COP 28, momentum for this will increase, meaning debt swaps will become an example of public-private cooperation to bridge the funding gap.

However, debt swaps remain highly controversial. Kristina Georgieva recognises that they might not be suitable for all countries, depending on their debt management priorities and the availability of alternatives. However, recommendations on using debt swaps also overlook that they have been used for over 30 years and denounced by civil society organisations, academics and even economists working at the IMF and the World Bank. Critics have argued that how debt swaps have been structured means they can benefit Western creditors and foreign NGOs more than citizens in the global South.

This briefing provides an overview of the critical issues confronting the debt swap concept. The question, however, is whether improvements in their design can make debt swaps an acceptable part of climate and debt justice. The brief does not set out to provide a list of recommendations. Instead, it aims to clarify the critical points of debate, predominantly for civil society and governments in Southern countries.

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8 Standing, A. (forthcoming), 'The financialisation of marine conservation: the case of debt-for-ocean swaps', Development. Link


10 See for example the statement denouncing debt swaps by the Climate Action Network. CAN. (2023). Position on Debt Swaps. Link
Before considering the controversies surrounding debt swaps, these instruments need to be briefly explained. A historical perspective is necessary. The current interest in scaling up debt swaps to support climate actions is based on transactions invented in the late 1980s. These were known as debt-for-nature swaps (DFNS), and they inspired a range of other swaps tied to developmental outcomes, such as health or education. However, DFNS and their derivatives cover many different arrangements, complicating understanding their impacts. The different types of debt swaps can be simplified between commercial and public based on the origin of the debt being traded.

**Commercial swaps**

US conservation organisations created DFNS. They were agreements some described as the offspring of debt-for-equity swaps that emerged in the 1980s as a response to the global debt crisis\(^{11}\). The structure of these agreements involved the US conservation organisation entering into a deal with Southern country governments to purchase commercial debt they owed to Western banks. This purchase exploited the discount on sovereign debts banks were willing to give on so-called secondary markets. Given the scale of the debt crisis—and an acceptance that the face value of bank loans was unlikely to be repaid—Banks were willing to sell debt for as low as 5% of their face value.

By purchasing sovereign debts on secondary markets, US conservation organisations could negotiate with Southern governments for compensation of a similar value to the debt being bought. **Although some swaps involved payments in kind or in cash, the most common approach was for Southern governments to establish conservation endowment funds, or local currency bonds.** The principal of these funds represented all (or part) of the face value of the debt being purchased by conservation organisations. Annual dividends from these funds were then ringfenced for conservation projects. **Most DFNS involved a local conservation group being the recipient of these funds,** although based on an agreement that they would work collaboratively with the foreign conservation organisation.

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An essential variable in the financial structure of DFNS was the amount Southern countries agreed to set aside for conservation spending. Some deals involved governments agreeing to provide 100% of the face value of debt in local currency bonds. In others, governments negotiated for lower payments, effectively splitting the difference in the discount provided by secondary debt markets between conservation organisations and themselves.

Commercial DFNS were popular for about a decade. They lost momentum for several reasons, including changes to banks' accounting procedures and more ambitious international strategies to address distressed sovereign debt. However, US conservation organisations—led by The Nature Conservancy (TNC)—reignited their interest in DFNS after the financial crash of 2008, knowing that a build-up of distressed debt was on the horizon. Although they had been planned for many years, the first example of the new DFNS happened in 2021 in Belize. TNC has subsequently finalised agreements in Barbados and Gabon12. The US Conservation organisation PEW, working in collaboration with a start-up company registered in the Netherlands, the Ocean Finance Company, concluded a deal in Ecuador.

Although the new wave of DFNS resembles the first wave, there are many differences between them. This partly reflects changes in the nature of commercial debt held by Southern countries, which has seen a shift from syndicated bank loans to Eurobonds. It also represents a change to US conservation organisations as they have moved into conservation finance. Since 2008, many have forged closer working relations with international investors and investment banks. Consequently, a significant difference between the old and the new DFNS is how they are financed. Whereas US conservation organisations used grants to buy discounted debt on secondary markets before, today they are financing much larger debt buybacks by issuing new commercial bonds in partnership with investment banks such as Credit Suisse and Bank of America. These bonds in debt-for-ocean swaps have been controversially labelled to investors as ‘blue bonds’.

By financing DFNS through blue bonds, US conservation organisations are now lending money to Southern countries so that they can retire existing bond notes. These transactions depend on owners of bond notes agreeing to sell at a discount, with the market value of bond notes determining how much this is. In all four debt-for-ocean swaps, bondholders have been paid slightly above the market value of their bond notes, albeit at a price lower than the face value of these when they were issued13.

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12 The first debt-for-ocean swap by TNC occurred in 2015 in the Seychelles. However, this did not involve commercial debt.
13 These bonds do not meet international guidelines on blue bonds as the use of proceeds is not dedicated for conservation spending. Criticisms of the use of the blue bond label by US conservation organisations and investment banks has meant the label will be changed in future offerings.
US conservation organisations require political risk assurance to raise money via international capital markets to finance these transactions. This lowers the rate at which blue bonds are issued. The US Development Finance Corporation (DFC) and the Inter-American Development Bank (IDB) have acted as the political guarantor in these deals so far.

The structure of these new debt-for-ocean swaps is far more complex than the old DFNS. The basic model is that US conservation organisations establish a new company registered in the US state of Delaware (a tax haven) that channels money raised from issuing a blue bond to the Southern government. The legal entity issuing the credits is registered in yet another tax haven such as Ireland. It then receives money from the Southern government to channel back to paying investors in the blue bond. A chain of companies registered in offshore jurisdictions lies between the investment bank orchestrating the issuance of the blue bond and the Southern government. Information on the beneficial owners of these companies is not always accessible to the public.

Because of the new way of financing these deals, the value of the transactions is also much larger. Between 1987 and 2000, conservation organisations paid for 47 separate debt-for-nature swaps, amounting to a total net spend of $42.5 million. This bought developing country debt with a combined face value of $326 million\(^\text{14}\). US conservation groups have refinance debt worth over US$ 2.5 billion in just four debt-for-ocean swaps. What is also important to realise is that the new commercial debt swaps commit debtor countries to paying for conservation projects in US dollars, not local currencies. While this works to the benefit of conservation organisations, this exposes debtor countries to the risks of currency devaluation.

### Box 1. Salient features of commercial swaps

**Significant features of these deals include:**

- As with the classic DFNS, Southern countries agree to provide a steady stream of money for conservation spending. This is based on how much the country would have spent servicing Eurobonds without the debt buyback. However, these payments are no longer in local currencies but in US dollars. This protects conservation spending from currency depreciation.

- The blue loans issued to Southern countries (financed through blue bonds) are more than is needed to finance debt buybacks. Additional money is lent to Southern countries to cover the costs of other expenditures. This includes various fees for lawyers and banks involved, the cost of the political risk assurance, and money set aside for setting up marine endowment funds. These endowment funds are managed by US-registered companies, with an agreement that interest earned will be spent in the Southern country for marine conservation projects after the blue loan has been repaid.

- Whereas the classic DFNS ringfenced conservation spending for local NGOs in Southern countries, debt-for-ocean swaps establish an entirely new organisation to receive revenues, with a maximum of 20% of the income for administrative costs. These organisations are also registered in the US and appear to be owned/controlled by the US conservation organisation. Their board contains a mix of representatives from NGOs and the debtor country government, with a majority assured for the latter. The role of these new organisations is to provide ad-hoc grants to projects in the debtor country.

- Debtor country governments sign a contract on conservation actions. Mandatory targets include enlarging Marine Protected Areas to 30% of the country’s oceans, creating national committees to develop a national Marine Spatial Plan, and other activities related to strengthening fisheries management or marine conservation. A failure to meet these targets results in financial penalties paid to the newly established conservation organisation. These are substantial, rising to over US$ 1 million per breach of contract. Contracts are signed with facility agents which in certain cases are private banks legally representing US-registered companies. These banks hold large shares of total sovereign debt. The blue loan legal contract incorporates collective clauses reaffirming payment of pre-existing debts.
Public debt swaps

When US conservation organisations invented DFNS, they attracted the interest of development agencies in Western countries. Several of the early DFNS were partly financed with development aid from the US and European countries\(^ {15} \). This led to debates on whether the debts owed to Western countries could be used in debt conversions in addition to the debt owed to commercial banks. In 1989, the German government was the first to experiment with this idea when it agreed to forgo debt repayments from Kenya worth US$405 million in return for commitments to protect nature. This was an example of a debt swap where the debtor country offered payment in kind rather than cash.

In 1990, a clause was agreed by members of the Paris Club, allowing debt swaps for environmental and developmental projects. These rules capped the amount of debt Paris Club donors can include in debt swaps and restricted the use of debt swaps on non-ODA debt (i.e. from loans that are not concessional). Subsequently, at least 11 Paris Club members have used debt swaps for varying purposes, with Germany continuing to be the leading proponent. Also, in 1990 the US launched the Enterprise for the Americas Initiative. Along with policies for advancing free-trade agreements with Latin American and Caribbean countries, it also established rules for conducting debt swaps. Eligible countries had to demonstrate commitments for pro-market reforms, support for free trade agreements with the US, and cooperation with the US war on drugs. In 1998, the debt swaps component of the Enterprise for the Americas Initiative was superseded by the Tropical Forest Conservation Act: a dedicated programme for debt swaps focused on tropical forest conservation that was eligible for developing countries worldwide.

A comprehensive database on debt swaps for environmental and social objectives does not exist. An OECD report estimated that between 1990 and 2003, bilateral debt swaps for the environment were used in 30 developing countries, affecting over US$3.5 billion of debt and generating approximately US$1 billion in environmental funds\(^ {16} \). A report commissioned by the US Congress in 2018 estimated that US debt swaps under the Tropical Forest Conservation Act had generated US$339 million in funds for forest conservation. However, details on the value of the debt restructuring in these deals were not publicly available in most cases.

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\(^ {15} \) In 1989, for example, the Dutch government bought US$33 million worth of Costa Rica’s commercial debt for US$5 million as part of a national scheme in Costa Rica for DFNS.

Historical records suggest that debt swaps for environmental and developmental programmes were used most extensively during the 1990s, during the height of the previous debt crisis. However, debt swaps have continued to be used since then, diversifying into new thematic areas. The first debt-for-education swap was concluded in 2001 between Germany and Indonesia, while the same countries were the first to pioneer debt-for-health swaps in 2007. Several bilateral swaps have involved multilateral organisations for project implementation. For example, in 2017, Russia agreed to a debt swap with the government of Mozambique that generated approximately US$40 million for spending on school meals, administered by the United Nations World Food Programme.

Bi-lateral debt swaps have been organised in various ways. The most common approach has been an agreement to write off debt obligations in foreign currency, with all or part of this money being established as a fund in local currencies for spending on dedicated environmental or social projects. Usually, these funds are administered by a non-government organisation or a new fund co-managed by the debtor government and representatives from the creditor’s country. Under the Tropical Forest Conservation Act, US conservation organisations have played a prominent role in advising and overseeing the use of funds.

The Tropical Forest Conservation Act also introduced the option of third-party involvement in debt swaps. Therefore, US conservation organisations can contribute money to buy US bilateral debt. These are sometimes referred to as subsidised debt swaps. For example, in 2003 the US government provided US$6.5 million to restructure outstanding debt owed by Panama to USAID, while TNC provided US$1.3 million. This resulted in a reduction of the debt owed by Panama to the US of US$ 10 million and a commitment to establish a forest fund for US$10 million through a contract with TNC.

Another variation of debt swaps occurred in 2015 in the Seychelles, the first debt-for-ocean swap. In this case, members of the Paris Club agreed to sell the Seychelles US$21.6 million at a discount of 6%. The Seychelles financed this debt buyback via a loan from TNC of US$15 million and a grant by a consortium of philanthropists of US$5 million. The debt reduction generated from this deal was subsequently used to establish a new conservation fund in the Seychelles.

17 WFP. (2017). Russia Debt-For-Development Initiative to support School Meals in Mozambique. Link
The evolving nature of the debt swap concept

Box 2. The case of Egypt: Italy, Germany and China

Egypt has signed several debt swaps with foreign creditors. Egypt has entered into four rounds of debt swaps with Italy since 2001, with the latest being agreed to in 2021. This has involved refinance debt of approximately US$350 million. Germany has agreed to two debt swaps in Egypt, with the first occurring in 2011 and the most recent, in 2023 for US$54 to finance green energy transitions. In October 2023, Egypt became the first country to sign an MOU with China for debt swaps. There are no public details of this agreement, including how much of the reported US$8 billion of debt owed to Chinese banks will be involved.

The conversion rate is a key variable in debt swaps involving public (bilateral) debt. This varies widely between donors. In the case of debt for education swaps between Germany and countries such as Indonesia, the debt swap involved a conversion rate of 50%. Thus, the Indonesian government committed to spending 50 cents on educational projects for every dollar cancelled in the debt swap. In contrast, many debt swaps have a 100% conversion rate: every dollar cancelled requires a dollar spent on educational projects.

Box 3. Barbados: Financing a debt swap through a Sustainability-Linked Bond

In November 2023, it was announced that the government of Barbados had secured credit guarantees worth US$300 million from the European Investment Bank and the Inter-American Development Bank. The government of Barbados will use these guarantees to issue a Sustainability-Linked Bond (SLB) of US$295 million tied to improving the country’s freshwater management and wastewater. The deal was publicised as being part of a debt swap. At the time of writing, it is not clear how this will work, but the proceeds of the SLB are likely to be used to refinance commercial debt, with the savings being directed to government-financed projects. SLBs are controversial bonds as they provide investors with variable rates of return based on the extent the government uses this money to achieve key performance targets. Investors are, therefore, paid a step up in interest rate payments if the government fails. This can expose countries to paying higher interest rates due to government mismanagement but may also penalise them for climate disasters, such as drought or hurricanes.

19 Egypt, China debt swap agreement benefits health and transportation sectors. Link
III. CONTROVERSIES

Having been in existence since the late 1980s, debt swaps have produced an enormous amount of analysis. As debt swaps cover multiple variations, generalisations must be treated cautiously. However, the controversies surrounding debt swaps can be simplified into several broad themes.

The contribution to debt relief

Advocates have often presented debt swaps as deals that have win-win outcomes: providing much-needed debt relief and increasing the funds available for positive environmental or social spending. Yet there has been considerable doubt on the first of these claims.

The extent to which debt swaps provide debt relief depends on various factors unique to each agreement: the scale of the debt written off, the discount rate provided by creditors, the conversion rate and the spread of payments for new conservation or social spending in countries. Understanding the net fiscal impact for debtor countries is therefore complex, and it requires some consideration of counterfactuals—what would have happened if the debt swap had not taken place?

A straightforward observation on debt swaps is that most have been too small to have any meaningful impact on debt sustainability in Southern countries. The classic DFNS produced large sums of money for conservation projects but were not credible solutions to the debt crisis. Several studies on DFNS also argued that these agreements' slight debt relief was an illusion. Foreign debt was not cancelled in these deals; it was transferred into new debt obligations owed to NGOs. The positive aspect of such swaps was to exchange payments in foreign currency to foreign banks for payments in local currencies to local NGOs. However, from the perspective of the debt crisis, where countries could no longer afford essential public services, debt swaps simply shifted one debt to another without producing the urgent fiscal breathing space debtor countries needed.
A slightly better outcome was created where DFNS involved debtor countries ‘splitting the difference’. This meant that the debtor country paid local NGOs less than they would have paid back to foreign banks, thereby relieving some pressure on their annual budgets\(^\text{20}\). The same principle applies to public debt swaps involving bilateral donors. In Germany’s swaps, the conversion rate has been 50%, so these include genuine aid cancellation. However, many other debt swaps, such as those used by the US government, have conversion rates of 100%, meaning no cancellation occurs.

Understanding the situation in other debt swaps is again more complex. The recent deals involving US conservation organisations involve debt buybacks financed through interest-bearing loans in foreign currency. **Understanding the gains for debtor countries requires understanding the terms and contracts of debt being bought compared to the new debt that has replaced it.** This information is not always public. There is a high variability in these deals due to differences in the value of debt trading on secondary markets. In Belize and Ecuador, the market value of distressed debt was roughly 50% of the face value, whereas in Barbados and Gabon, this was between 5 and 15%. Although debtor countries agree to conservation pledges in these deals, comparative evidence shows they are no more beneficial than other debt restructuring cases on Eurobonds, with no links to conservation pledges\(^\text{21}\). Furthermore, **the high transaction costs charged by US conservation organisations and other intermediaries make these deals less advantageous for debtor countries.** A new conservation organisation also consumes up to 20% of any savings in these deals, adding additional overhead costs for management and operation.

What is also troubling in these new commercial deals is the terms of the loans provided to governments to finance the debt-buy back. Analysis of the contract in Ecuador suggests the new loans come with more stringent clauses than the Eurobonds restructured to finance the swap\(^\text{22}\). This includes higher default penalties that eliminate the possibility of upfront payments or cancellations.

Although advocates of debt swaps can claim these are intended to improve debt sustainability, few, if any, appear to be primarily motivated to have this outcome. Instead, they can appear as opportunistic deals that help foreign organisations leverage money to increase project spending, while they may also allow certain groups (both domestic and foreign) increased control over valuable assets that bring reputational and financial gains.

\(^{20}\) It worth noting here that relief comes here for a direct decision by new debtors and not the result of fiscal savings from differences in interest rates, time frame or transactional hair-cut.


They also provide favourable returns to commercial and bilateral creditors as governments fail to capture the full discount available on secondary markets. The resulting fiscal breathing space for debtor countries can be minimal and far from offering decisive debt restructuring.

**Box 4. Greenwashing odious debt?**

Campaigns for debt justice focus on the odious nature of much of the sovereign debt accumulated by Southern countries. This includes loans where governments used the proceeds for spending that did not benefit citizens, and creditors of these loans were fully aware of this but chose to ignore it for their financial interests. It also includes bilateral loans where the actual beneficiaries have been companies from the donor’s country. Dismantling the unfair architecture of global finance requires ridding citizens of the obligation to repay these odious debts. As a consequence, many campaigns of debt justice argue that any sovereign debt restructuring should proceed with public audits on the origin of the debt. This is essential if the cycle of unsustainable debt, including the practice of *predatory lending*, is to be broken. Dept swaps, however, reinforce the perspective that unsustainable debt is primarily the fault of Southern countries.

**The illusion of additionality**

There is a moral imperative for a massive increase in the transfer of wealth from North to South to compensate for the scale of the climate and biodiversity crisis. This must not be presented as a charity; instead, it must be framed concerning the incalculable ecological debt owed to Southern countries. Such wealth transfers must deliver on existing ODA pledges and meet climate finance promises in a new, predictable and additional manner in line with United Nations Climate Change Convention (UNFCCC) principles.

It is now well established that developed nations have resisted calls for climate finance and loss and damage, thereby protecting their own economic interests. However, in addition to the failures to meet existing pledges, several accounting tricks are used by Northern countries to artificially inflate wealth transfers, taking advantage of unclear rules and procedures pending the agreement in climate negotiations.

This has been a permitted feature of debt swaps and may contribute to understanding why these arrangements are popular with some creditors. The rules on reporting Official Development Assistance (ODA) established through the Development Assistance Committee
Controversies

(DAC) of the OECD allow bilateral donors to report the value of debt swaps as grants. In this way, any reductions in payments to them on loans are subtracted from their commitments to overseas aid. If this practice continues, scaling up bilateral debt swaps will provide a mistaken veneer of generosity and will fail to contribute positively to an increase in genuine ODA\(^2\). Southern countries will allow Northern countries to replace genuine aid with debt restructuring deals, with the underlying debt often derived from loans that worked to the economic interests of creditors anyway. Meanwhile, subsidies provided to financial intermediaries in these transactions, as well as the provision of credit guarantees, could be further used by OECD countries to demonstrate additional contributions to climate finance, distracting from the real unfulfillment of their climate finance commitments so far.

While debt swaps may work to the financial interest of creditors, a related concern lies with the conditionalities attached to these deals—such as the link between US debt swaps and free trade agreements. The terms of many debt swaps also ensure money is spent by organisations and companies from the creditor’s country. This is an example of tied aid. For example, the reports of China’s MOU with Egypt suggest debt relief is conditional on spending the saved money on projects provided by Chinese companies. US debt swaps financed through the Tropical Forest Conservation Act have always required partnerships with US conservation organisations. This is another way in which the transfer of wealth to Southern countries benefits the interest of Northern actors.

More research is needed to explore the geopolitical interests in debt-for-ocean swaps, for example, given the intensification of competition over scarce resources (oil, fisheries, etc) and also maritime security. There are strong links between US conservation organisations, companies and investors exploiting maritime resources and the US government, which alerts us to the risks that debt swaps might be strategic for other agendas.

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Much of the literature on debt swaps focuses on their fiscal implications on debtor countries. Less attention has been given to how the resulting funds have been used and whether this has had a positive impact. On this, it might be considered that funds generated through debt swaps behave similarly to funds generated through other mechanisms, such as bilateral aid projects. However, there are also reasons why proceeds from debt swaps may be more vulnerable to failures and perverse outcomes.

The result of many debt-for-nature swaps has been to increase the budgets of those engaged in conservation efforts significantly. Mostly, this has benefited the revenues of a few NGOs specialised in conservation finance as governments are not often the recipients of these funds. It is a matter of opinion whether NGOs are more effective at spending conservation funds than governments, and DFNS have reinforced attitudes towards privatisation and outsourcing of public services, such as the management of national parks. However, an overlooked impact of DFNS has been the tensions between under-funded state departments and the rise of more affluent NGOs. The outcome of DFNS in some countries has been NGOs with annual budgets surpassing state agencies.

24 Bedarff, H. Debt-for-Nature Swaps: Environmental Colonialism or a Way Out from the Debt Crisis that Makes Sense?. Link
Controversies

In the case of the new debt-for-ocean swaps, new organisations are established to spend revenues from these deals. Again, these have substantial annual budgets, with Ecuador’s Galapagos Life Fund established by PEW set to receive US$14 million every year for the next 15 years. The governing board of this organisation will comprise a majority of representatives from NGOs and a minority of those from the government. However, no public documents explain what this money will be used for, nor are there underlying studies explaining the problems being addressed. Therefore, debt-for-ocean swaps lack a theory of change and any transparent analysis linking the proceeds to the country’s needs.

Accountability

Consequently, these new organisations created and financed through debt swaps have a broad remit on what activities they will fund and why. There are no measures of success nor strategies to identify and respond to risks, such as coastal communities’ human rights and development. There is far less oversight and accountability to the funds from these debt swaps than funds from other sources, while the use of proceeds falls far short of international best practice. The systems established for spending revenues from debt-for-ocean swaps fail to meet the Paris Declaration on Aid Effectiveness requirements and the Accra Agenda for Action requirements. They also fail to meet the recommendations for participatory planning and oversight of the International Guidelines for Responsible Governance of Tenure for Forests, Fisheries and Land.

Some types of debt swaps are better than others. Several bilateral debt swaps have ensured the use of proceeds is coherent with existing national policies and supports existing institutions (as opposed to creating new ones). A review of debt swaps in Latin America related to education and social development published in 2006 found that civil society representatives usually played a role in determining the type of projects being funded. However, local civil society participation was absent regarding management and steering committees, these being dominated by government and non-government foreign organisations from the creditors country. In the case of debt swaps of Peru, whether the process was more participatory, performance oversight by stakeholders and civil society was also absent. In fact, no structure was defined or recognised by the funds to conduct such a task.

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25 A useful discussion on this is provided by Caliari, A. (2020), ‘Linking debt relief and sustainable development: lessons from experience’, Heinrich Boll Stiftung. Link
26 Ugarteche, O. 2006. Experiencias de canjes de deuda; lecciones para el ámbito de la educación. Fundación Carolina-CeALCI. Link
A controversial dimension of debt swaps has been public access to information. The early examples of DFNS were opaque transactions where negotiations took place between conservation finance organisations, banks and government representatives, without detailed reports being shared widely with the public in Southern countries. Contracts of these agreements were treated as confidential documents. Since then, international and domestic expectations of transparency have increased substantially, and technology has allowed far more information to be made accessible to members of the public. However, many debt swaps remain secretive across the different stages of development (i.e., motivation, origination, design, implementation, and operation). This has been a criticism of the debt-for-ocean swaps. The blue bond prospectuses used to raise money for these deals are confidential. At the same time, contracts signed between conservation finance organisations and host governments have either been witheld from the public or published after the deals have taken place.

There are many problems with this lack of transparency. It prevents citizens from engaging in informed public debate on the merits of the deals before they take place. It also provides opportunities for corruption and fraud. One aspect that has not been given adequate attention is the risk of insider trading in Eurobond debt swaps, given that knowledge of debt swaps may work to inflate the value of bond notes on secondary markets. Furthermore, it is unclear what role different organisations play in these deals and how much money each has made in the transaction. There has been no explanation by those engaged in debt-for-ocean swaps as to why information is treated as confidential.

This level of secrecy contradicts the binding rules established in the Escazu Agreement on Access to Information, Public Participation and Access to Justice on Environmental Matters in Latin America and the Caribbean. Civil society organisations have used the Escazu Agreement to force the Ecuadorian government to share information on the deal. However, no similar Freedom of Information law exists in Gabon, so civil society has no legal means to promote their right to access information.

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28 Deacon, R. T. The Structure of an Environmental Transaction: The Debt-for-Nature Swap. Link
IV. POLICY IMPLICATIONS/AGENDA FOR REFORM

International support for scaling up debt swaps to bridge the climate and biodiversity crisis funding gap raises several significant objections. Here we identify four critical themes for further debate.

The role of debt swaps and international responses to the debt crisis

Debt swaps exist due to the failure of the international financial system. Perverse incentives have produced another build-up of costly loans to Southern countries, failing to produce economic returns that enable debt repayments. Many of these loans have been misused to benefit foreign businesses and corrupt political elites linked to extractive economies with unaccounted social and environmental costs. However, debt swaps have been weak instruments to resolve these failures, offering only tokenistic relief. There are strong arguments that these swaps distract from the root causes of the debt crisis, which includes a failure to recognise and address the odious origins of the debt being swapped and redirect investment to economic activities with positive social and economic impacts. This supports the policy idea of public audits of sovereign debts as a precursor to international negotiations on major debt restructuring events. Illegitimate debts should not be greenwashed through debt swaps.

Some argue that debt swaps are counterproductive in advancing progressive international debates on debt justice. These relieve pressure for more comprehensive solutions. What adds to this view is that existing debt swaps often work in the favour of foreign creditors without requiring them to make significant sacrifices. This is evident in commercial debt swaps that result in foreign investors being paid above market rates for their bond notes. It is objectionable that foreign creditors, both public and private, accept no responsibility for the underlying debt crisis, for which they have derived considerable benefits. Indeed, the same investment banks and asset management firms designing and benefiting from debt swaps have been responsible for the reckless loans in Southern countries that are the origin of these swaps. A historical view of debt swaps involving bilateral creditors reveals similar dynamics.
Although denouncing debt swaps is a valid position in international debates on dealing with the debt crisis, another approach lies in improving the terms of debt conversion beyond the prevailing form of swaps. This requires more strategic thinking by debt managers in Southern countries and suggests the merits of cooperation between them. Multistakeholder forums between Southern countries to exchange views on debt swaps and alternative approaches to debt restructuring should be considered urgent as international momentum or scaling them up continues. Opportunities for improving the terms of debt conversions include lowering rates, keeping transaction costs to a minimum and reducing reputational risks. Debt swaps should be designed to resist conditionalities and tied aid. It may also require more generous discounts from creditors, ensuring that debt swaps contain a more significant element of debt cancellation considering that the original capital has already been paid and refinancing of remaining interests is a lucrative side business. Getting a better deal in debt swaps should also recognise that actions by Southern countries tied to these swaps support the global commons, such as protecting nature and enhancing carbon storage.

The role of debt swaps and increasing climate/biodiversity finance

Debt swaps are being presented as one mechanism that can increase funding for Southern countries to bridge the funding gap for transitioning to sustainable economies. At the same time, they may also be presented as instruments that can contribute to compensate for the increasing need for loss and damage. As such, debt swaps are one of several innovative financial instruments proposed by developed countries and multilateral organisations, including green and sustainability-linked bonds. However, what is now clear is that these instruments can be used to displace genuine aid and circumvent pledges for climate finance while distracting attention from the current unfulfillment of financial commitments under the Climate Convention.

Governments and CSOs in Southern countries must guard against manipulative accounting strategies and insist that climate finance is additional, new and predictable. It is also critical to recognise that existing mechanisms for private finance to bridge the funding gap, based on interest-bearing loans, will transfer wealth from the South to the
North, potentially contributing to a debt crisis (i.e., the vicious circle of debt service and fiscal deficit) and the growing North-South divide. An important focus lies with clarifying and improving the rules on aid reporting, such as those established through the DAC of the OECD. More generally, stakeholders from Southern countries should continue to object to the methods used in international forums, such as the COPs on climate and biodiversity, to conceptualise finance for bridging the funding gap, which can muddle private and public finance, despite the fact these work in different ways. Further research that critically examines the realities of climate and biodiversity finance must be supported to inform international advocacy.

The approach to debt swaps has fallen short of international best practices on transparency. There is an urgent need for advocacy and international cooperation to ensure that information on debt swaps is made public and accessible and that their impacts are monitored, reported and verified. This lends itself to collaborative efforts involving organisations specialising in public accounting and anti-corruption, including national audit and accounting authorities. Questions requiring further research include why parties to debt swaps resist transparency and on what grounds parties may justify confidentiality, such as information being commercially or politically sensitive. A lack of transparency is a feature of loans to Southern countries, including the international bond market, and debt swaps should be approached as an opportunity to disrupt this culture of secrecy.

For Latin America and the Caribbean countries, raising transparency in debt swaps should be considered in the framework of legal requirements for national authorities as set out in the Escazu Agreement. This includes the requirement for maximum disclosure of information that has a public interest to support public participation and access to justice. Southern governments and CSOs could further consider opportunities to strengthen voluntary mechanisms for financial reporting. International guidelines on ESG bonds are established by the ICMA and the EU, for example. However, there is a gap in regulatory standards regarding commercial debt swap agreements. Ultimately, rules on debt swaps should provide full disclosure on financial aspects (such as commission fees and profits for intermediaries), the use of proceeds, and contracts. Beneficial ownership transparency should also be raised, which could undermine the risk of debt swap transactions providing insider trading, money laundering or tax evasion.

Debt-for-climate swaps

Democratic decision-making and participation

Debt swaps can provoke considerable tensions regarding a lack of democratic and participatory approaches to conservation and climate actions. Debt swaps transfer considerable powers to unelected organisations, including foreign conservation groups, who are working in close partnership with asset management firms and investment banks. Their influence is not only in making decisions on how money saved in debt restructuring is used, but also in determining national policies in the realms of blue or green growth. It is undoubtedly objectionable that a single US conservation organisation now manages sovereign debt worth billions of dollars across four countries, with plans to increase this to another 15. This represents an unprecedented concentration of power for an unaccountable conservation finance organisation, raising its revenues beyond that of the governments in many countries it is working in.

This problem of debt swaps threatening national sovereignty is exacerbated when national authorities have yet to develop coherent and comprehensive strategies for conservation, climate actions or the transition to more sustainable economies. This creates opportunities for external actors to determine the priorities of how proceeds from debt swaps are used. Instead, any proceeds from debt swaps ought to be handled as one of several sources to finance pre-existing policies for sustainable development. This also highlights the potential for national conservation and climate funds to fall under the auspices of sovereign wealth funds, as opposed to some of these funds being managed by private companies registered in foreign tax havens.

A related challenge facing southern countries is to ensure that additional finance obtained through mechanisms such as debt swaps do not erode national institutions for participatory democracy. Alternatively, they may be used to strengthen them. Critically, this includes credible systems for indigenous peoples and marginalised groups to be engaged from the outset. This would require Southern countries to resist the conditionalities that have been a feature of many debt swaps. International standards on aid effectiveness provide an essential framework to think about this, as do experiences with national REDD+ strategies.
CONCLUDING THOUGHTS

Debt swaps are re-emerging as a popular financial instrument. Most importantly, they are now being considered as one instrument that could be used to bridge the so-called funding gap for climate actions. Over the past few years, their use has been limited to a few countries. It seems likely they will be used more extensively over the next few years. However, there are valid reasons why debt swaps can be rejected by those campaigning for both debt and climate justice. These arguments are partly based on an appreciation of how debt swaps have been designed so far. Furthermore, there is a serious risk these instruments will be abused to distract from the current unfulfillment of international commitments from rich countries (regarding ODA and climate finance). They may also perpetuate forms of domination by Northern actors that use the climate umbrella to sustain their own agendas.

Alternatively, a more pragmatic approach is based on a realisation that there are worse scenarios facing Southern countries in managing a build-up of unsustainable debt. Negotiating a debt swap might be preferable to protracted disputes with creditors regarding defaults or even being the victim of predatory vulture funds. The current situation, characterised by a spiralling debt crisis and failing international responses to climate finance and loss and damage, is an opportunity to design debt conversion schemes better. This could help redirect scarce public funds currently used to service foreign debts into local spending that supports climate actions. As set out in this brief, the broad parameters of how this could be done are evident. It requires stakeholders in Southern countries to collaborate to develop progressive guidelines or principles linked to complimentary international agreements on human rights and sustainable development. It also requires more favourable terms to these agreements and a strong position opposed to conditionalities.