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Debt for Nature: A Swap whose Time has Gone?

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Abstract

This paper purports to review the performance of the Debt for Nature Swap (DNS) Programs in light of their dual objectives of lowering deforestation rates as well as the cost of debt servicing. It evaluates the performance of private and Public DNS and inquires whether such swaps have made any significant dent on the debt and deforestation problems besetting many developing countries. It also assesses the prospects for such swaps in the future. We argue that since the prospects for DNS are limited, a more conducive solution for the deforestation problem in many developing countries may lie in generalized resource transfers to these countries of the sort envisaged in recent proposals for a World Environmental Organization (WEO).

Introduction

In the aftermath of the second oil price shock (of 1979) soon after the first shock of 1973, developing countries were faced with mounting international payment obligations. As industrial countries reacted to a deterioration in their terms of trade with raises in the price of their own exportables, developing countries (particularly oil importing developing countries) were faced with even worse external payments conditions. As a consequence, several of them borrowed heavily from multinational banks. This increasing debt burden was further aggravated because of three factors: (i) dramatic increases in real interest rates; (ii) poor returns on money borrowed; and (iii) deterioration in the terms of trade. This burden soon erupted into a full-scale crisis over the global economy (during 1982) with the statement by Mexico that it was unable to meet its international debt obligations. This crisis of inability to repay international debt in time rapidly spread to many developing countries.

Soon, it became evident that repayment of this debt through higher and higher exports was causing serious environmental degradation in these countries because the production of many such exports were highly resource-intensive, with little value added and, as mentioned, often deteriorating terms of trade. Hence, in many countries the expansion of exports together with the impoverishment in the countryside that resulted from the debt-induced economic crisis entailed considerable deforestation and loss of biodiversity.

It quickly became evident that since the value of forests and biodiversity was not expressed in market terms, these resources were being undervalued and, therefore, overexploited. Thus, Kahn and MacDonald (1995) found evidence of a positive relationship between the levels of external debt and deforestation. Murphy (1994) also found compelling evidence of a positive relation between deforestation and external debt in a cross-section of developing countries facing credit constraints on their external borrowing. Similar arguments have been advanced by Chambers et al. (1996).

As the crisis of debt repayment unfolded, and as has been noted by Sandler and Tschirhart (1993), a latent demand for tropical forest protection became explicit. Many observers, particularly environmental non-governmental organizations (NGOs) in the North, pointed to a mutual coincidence of needs with conservation organizations emphasizing the urgency of protecting the forest cover in the developing countries whereas these countries, themselves, sought a reduction in their external debt repayment obligations. If conservation organizations could pay developing countries through the means of debt reduction to conserve forests both parties would stand to gain. An important question at this juncture then was how this latent demand for protection of forests should be expressed and how should it be tied to the repayment of least developed countries (LDC) debt. ¹ A debt for nature swap (henceforth DNS) was floated as a means of facilitating this type of issue linkage.

The idea for a DNS was initiated by Thomas Lovejoy, then with the Washington-based NGO, World Wildlife Fund (WWF). He, in an op-ed piece in the *New York Times*, for the first time linked the issues of debt and deforestation and articulated the rationale for a DNS. He argued that the financial crisis in developing countries had resulted in disastrous reductions in their already meager environmental budgets. ² Indeed, because of their economic and financial predicament, many developing countries had to put considerable emphasis on export promotion, which led to increased exploitation of forest and other natural resources. ³ However, there could be a hidden demand for the protection of the natural forest cover in these countries that could be made to match the demand for debt relief in the LDC. ⁴ In response to this "coincidence of wants" the first DNS was initiated in 1987 by Conservation International, a Washington based NGO in respect of Bolivia. There was then a natural expectation that the potential of instruments such as DNS among other forms of foreign support to protect the environment would be high.

The purpose of this paper is to review the performance of the DNS program in light of their dual objectives of lowering deforestation rates as well as the cost of debt servicing. In doing this, it is useful to ask the following questions: (i) how well have DNS performed in practice? (ii) have these swaps made a dent on the problem of external debt facing the developing countries? (iii) have these swaps made an impact on the problem of deforestation in these countries? (iv) what are the prospects for such swaps in the future? And, to conclude, (v) does the potential relevance of DNS merit the support of a World Environmental Organization (WEO) to help handling these arrangements? We turn now to these questions.

¹ The fact that in light of the debt crisis, much of LDC debt was trading at discounted prices in secondary debt markets reduced the financial obligation of the funding conservation agency.

² In Latin America, for example, public expenditure cuts weakened the environmental improvement efforts from the beginning. The new ministries for the environment, the national commissions for the environment, the institutions in charge of implementing the new environmental laws are still severely underbudgeted and weak.

³ See also Miller (1991) on this topic.

⁴ Cowfer and Epp (1993) find empirical evidence that individuals are willing to pay for tropical forest preservation through NGOs.

I. The Performance of Debt for Nature Swaps

In practice, two kinds of DNS have been agreed upon. These can be broadly classified as "private swaps" and "public swaps". A typical private swap involves three participants: (a) an international organization, usually a conservation organization that usually initiates the process, and agrees to purchase part of the LDC's international debt at a discounted price in the secondary market; (b) the second party is a national conservation organization (NGOs) which may be linked to the international conservation organization in the developed country. This second party is primarily responsible for implementing environmental action; (c) the third party to the swap is one or more governmental agencies in the host developing country. The first such agency is the central bank of the developing country. The central bank agrees to convert a portion of the country's external debt to domestic

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