



*Smoke and Mirrors?*

# DEBT FOR CLIMATE SWAPS

**An Explainer**

*APMDD Debt Justice Program*

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The COVID-19 pandemic accelerated the worsening multiple crises faced by peoples in the Global South. The intensifying debt crisis and the climate emergency have stood out among the critical hurdles the world must surmount for recovery and survival. An increasing number of countries in the Global South are deep in unparalleled levels of public debt and debt service, and greater dependence on borrowings to fund development programs as well as debt repayments. Meanwhile the world is nowhere near the Paris Agreement goal of keeping global temperature below 2°C, which leaves many Southern countries with already unsustainable debt burdens even more vulnerable to the devastating impacts of climate change. The climate finance pledged by rich countries remains largely unfulfilled while, more they continue to push debt to fund climate action, ignoring their historical responsibility for the climate emergency and the Global South's demand for adequate, non-debt creating and unconditional climate finance as a just resolution to a crisis it did not cause.

Debt swaps refer to a type of financing agreement where the debts of a borrower country

(debtor) is reduced in exchange for its commitment to a foreign lender (creditor) that it will redirect debt service payments (in local currency equivalent) to a mutually agreed purpose. Debt swaps have been around since the 1980s, the most popular of which is debt-for-nature swaps (DfNS) whose purpose is to finance nature conservation projects. Proponents of debt-for-climate swaps (DfCS) point to the supposed success of DfNS to advocate this model for the purpose of supporting the implementation of the Paris climate agreement, specifically by funding climate mitigation and adaptation projects that contribute to the debtor's Nationally Determined Contributions (NDCs).

Debt-for-climate swaps are being promoted as “win-win” solutions to address both the debt and climate catastrophes. At first glance, the idea of “canceling” a portion of the public debt and repurposing it as public investments in climate projects in the borrower country appears persuasive. But is it really this simple? Are there hidden costs in the borrowing country? What are the risks and tradeoffs?

## **What are the types, elements and mechanics of a debt-for-climate swap?**

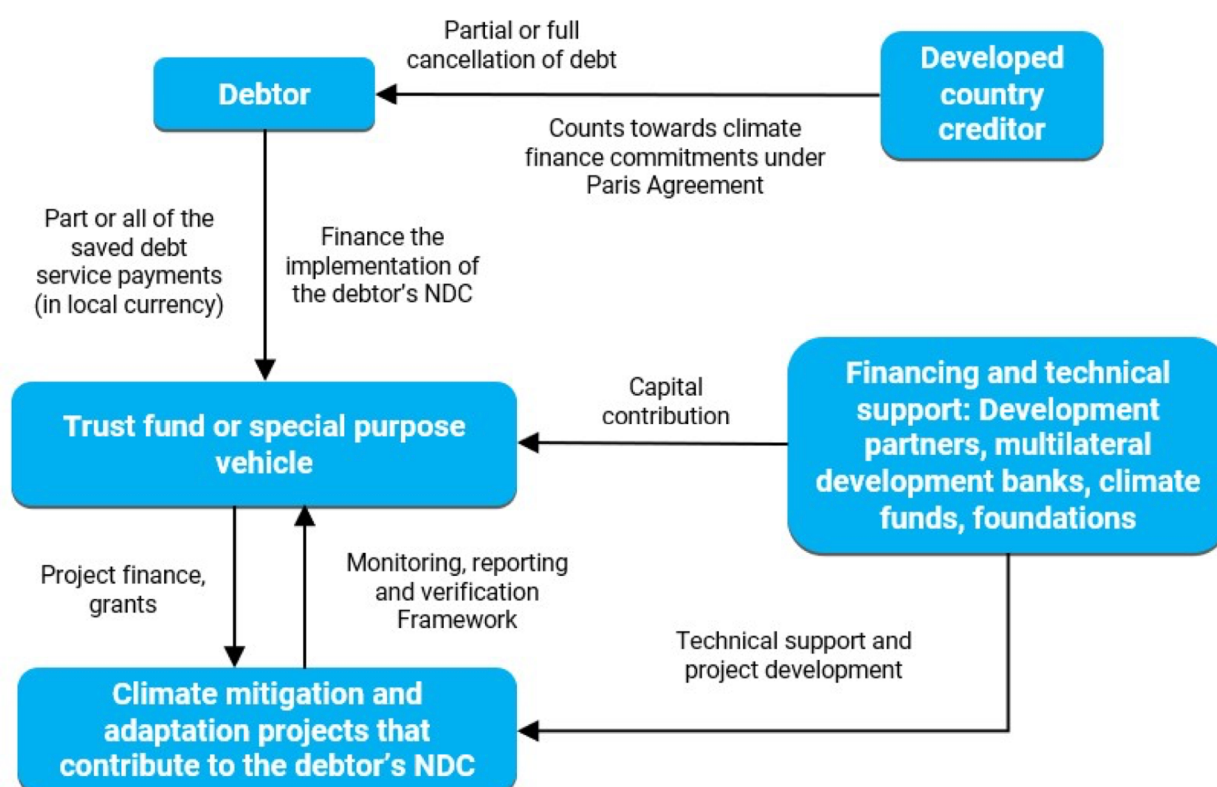
The specific terms of debt swaps vary from one agreement to another. For example, the amount to be swapped may be the total or partial value of the outstanding debt. It may also vary in terms of whether official (foreign government) or commercial/private lenders are involved. Moreover, it may be a direct borrow-

er-lender transaction or a tripartite agreement wherein a third party will buy back the debt from the lender and in turn works out with the debtor government the mechanics for collecting the financial obligations and managing project funding.

The way debt-for-climate swaps work depends on the lender (ex., official or commercial/private). The diagram below shows a sample schematic of one type of swap – a direct, bilateral “debt-for-climate swap scheme to support the implementation of the Paris Agreement.” It becomes a multilateral swap when several lending countries are involved. Note that it proposes debt cancellation to count as Official Development Assistance or as climate finance commitments under the Paris Agreement. It is argued that debt swap funds “constitute a

*bilateral transfer of resources to the developing country debtor. As such, it would count towards the global commitment of developed countries to provide \$100 billion per year in climate finance.”* It also includes setting up a trust fund or special purpose vehicle (SPV) to manage the funds and implement the projects selected by the borrower. The trust fund or SPV may “invite entities such as development partners, multilateral development banks, climate funds, or foundations to provide additional capital” and various forms of technical assistance.

**Figure 1. A Debt-for-Climate Swap Scene to Support the Implementation of the Paris Agreement**



Source: ESCAP.

A second type of swap and the most common, uses an indirect approach. Called third-party swaps, this arrangement commonly involves lenders, borrowers and a third entity, which could be a bank, asset firm or any private sector actor, or a Non-Governmental Organization (NGO). The third party buys the borrowing country’s debt at a discount (i.e., lower than its face value) and subsequently offers it back to the borrower with some of the debt cancelled or at discounted repayment terms in exchange for the commitment to use the funds for specific projects (e.g., biodiversity conservation). The intermediary acts as a kind of “middleman” that

facilitates the transaction between lenders and borrowers, and as might be expected, makes a profit. These processes happen in the financial market where stocks, bonds and other forms of assets and securities are traded and sold among investors.

For lenders in any of these types of swaps, it is better to be paid less than not to be paid at all. Thus, the incentive in forging such an agreement is to cut losses, especially when faced with the likelihood that debts would not be fully paid.

## Debt for nature/environment/climate swaps over the years, cautionary tales?

The early 80s was rocked by an economic debacle, during which several “Third World” countries defaulted on large accumulated external debts as interest rates soared, commodity prices fell and economic growth stagnated. Among the responses to the debt crisis and increased resource extraction, was a proposal from environmentalist groups to use debt to finance environmental activities, in the same manner that debt was being used in debt-to-equity swaps, whereby the lender is enabled to convert debt into equity in the borrowing country. The US sponsored most of the early debt-for-nature swaps, and focused these on heavily debt-burdened countries in Latin America that were also facing massive deforestation during that time.

The first debt-for-nature agreement on record was signed in 1987 between Conservation International and Bolivia. By 1992, 12 countries (Bolivia, Costa Rica, Dominican Republic, Ecuador, Ghana, Guatemala, Jamaica, Madagascar, Mexico, Philippines, Poland and Zambia) had negotiated tripartite debt-for-nature swaps. Around \$61 million in local currencies was generated but the nominal value of the debts retired through these swaps came to only over \$100 million.

Some of the worrying risks and downsides are highlighted by these swaps. Though promoted as both advantageous for debt reduction and financing climate action, past years’ experience show otherwise. As pointed out in the UN 2020 Financing for Sustainable Development Report, “debt swaps generally do not reduce a country’s debt burden; rather they swap a country’s debt-servicing payments for investments in sustainable development.”

In the last few years, more debt-environment swaps have been signed, as shown in the table below. Similar to the Latin American debt crisis of the 80s that sparked a global crisis, the current situation of debt distress in an increasing number of countries on top of an intensifying climate crisis is re-fueling debt-for-nature swaps. Barclays estimates the market for debt-for-nature-swaps to reach over \$800 billion.

Often heard in these deals is the term “ESG” (environmental-social-governance) investing, which simply refers to standards supposedly ensuring that investments are sustainable and climate- or environment-friendly. But this also presents additional loopholes that could be exploited by corporations, asset firms, commercial and other entities to provide a mantle of legitimacy over questionable, illegitimate debts.

**Table 1. Debt-for-nature swaps (2016 – present)**

Country	Creditor/ Organization	Debt relief amount (US\$)	Environmental Commitments	Year of Agreement
Indonesia	Norway	56 million	Reduction of greenhouse gas emissions through land-use planning and forest preservation	2016
Colombia	Conservation International/ GEF	36 million	Forest and other ecosystem preservation, sustainable agriculture, and reforestation	2016
Costa Rica	US Government	27.1 million	Reforestation, the creation of new national parks and other protected areas, ecotourism	2017
Peru	Conservation International/ GEF	25 million	Forest preservation and sustainable agriculture promotion	2018
Seychelles	The Nature Conservancy/ GEF	21.6 million	Expansion of current marine protected areas and creation of new ones Environmental Commitments	2019
Belize	The Nature Conservancy	364 million	Marine conservation	2021

Ecuador	International Bondholders	1.1 million	Ocean conversation in and around the Galapagos Islands, including research-based projects and observation	2023
Gabon	International Bondholders/ The Nature Conservancy	125 million	Widening of marine reserves and strengthening of fishing regulations	2023

Source: *Debt Swaps Debt Guide*

## ■ Insignificant debt reduction and financing of environmental action

*Eurodad* estimated “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. 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.”

The *Climate Action Network* also cites the example of the 2016 Seychelles debt-for-nature swap deal with the Nature Conservancy and other private investors who purchased 5% of the country’s debt amounting to \$21 million. A trust fund set up to hold the debt offered lower interest rates on repayments, but this hardly made a dent in debt reduction since the \$8 million “saved” by the Seychelles accounted for less than 2% of the public debt. The question also remains as to whether the debt swap funds will indeed be invested in marine life conser-

vation, as agreed, considering the Seychelles’ fiscal constraints that led them to agree to the debt swap. “This could potentially lead to increased budget deficits which may need to be covered by loans, thereby adding to debt burdens, or by diverting resources through austerity measures in other areas. With this in mind, debt swaps are especially inappropriate.”

In the case of Belize, the swap brokered by Credit Suisse relieved it of debt that amounted to only 12% of GDP when it had an original debt burden of 125% of GDP. The deal also proved very costly for Belize.

The *IMF* admits that, “For countries with unsustainable debt, a swap cannot restore solvency unless it involves a sufficiently large share of a country’s debt and substantial relief—an extreme case. So far, no swap has come close to achieving this....Swaps are thus not substitutes for debt restructuring when it is needed.”

## ■ Conflict of interest: Risks to the borrowing countries’ environmental and climate-related concerns

A report by *Center for Global Development* illustrates that the avoided debt service does not necessarily work towards benefitting nature or the environment. While “the total face value of debt treated globally through these swaps has been \$3.7 billion, according to recent analysis by the African Development Bank, ... the amount actually allocated to environmental projects was less than half of the debt relieved (around \$1.5 billion—a total over 20+ years that is only 1.5 percent of the \$100-billion-per-year climate finance goal).”

Another example is the 1987 debt-for-nature swap brokered by the US investment firm Citicorp between Bolivia and Conservation Inter-

national (CI). The latter purchased \$650,000 of Bolivia’s debt in the secondary market for \$100,000, after which it cancelled the debt upon the agreement of the Bolivian government to establish protection measures over forest and watershed sites. But as it turned out, the CI – Bolivia debt swap allowed commercial loggers into the buffer zone of the Beni Biosphere reserve. The reforestation requirements were not followed.

**“In the two years since the world’s first debt-for-nature swap set up a buffer zone around an existing Amazon forest preserve in Bolivia, not a single tree has been planted under the required reforestation program. But thousands of mahogany trees have been hacked down by Bolivian lumber companies....,” noted one account. In fact just two months before the debt swap came into force, the government granted permits to seven lumber companies to set sawmills.<sup>1</sup>**

Leaders of indigenous Indian communities living in the buffer zone reported that they were not consulted and that commercial logging interests prevailed over conservation efforts.

**“These concessions conflict with existing uses of the forest area by the semi-nomadic tribes, who also fear further encroachment by settlers via the roads built by the logging concerns. Conservation International has apparently been the recipient of funds from the logging interests, in particular the International Timber Trade Organization, a Japanese-based organization, and has sided with the government of Costa Rica in opposing the tribes’ desires to establish integrated tribal areas in the region.”<sup>2</sup>**

### **Fiscal and Macroeconomic Risks**

Macroeconomic developments can quickly turn a debt swap into a disadvantage for the borrower. *Senegal entered into a debt swap in 1993 with UNICEF* as a third-party. Brokered by ING Bank, the deal entailed UNICEF buying a portion of Senegal’s bilateral debt to Argentina for \$6 million (25% of the face value of \$24 million).

On the part of the Senegal government, it agreed to pay UNICEF \$11 million (in local currency) over three years to support UNICEF’s development projects in Senegal. A month after closing the debt swap, Senegal’s currency devalued by 50%, causing its payments to double. The debt swap had to be eventually renegotiated.

### **Complex, Costly and Opaque Transactions**

More recent debt swaps are similarly burdened by the lack of transparency and complicated, lengthy and costly negotiations. As reported in one *commentary on Belize’s debt swap lessons*, the initial transaction costs of \$10 million eventually ballooned to \$85 million; only this amount of the \$553 million swap actually went into marine conservation measures while a big chunk covered interest payments, Credit Suisse’s share in the deal, insurance premiums and other intermediaries and service providers.

**“The deal saved Belize’s credit rating, minorly improved the serviceability of its debt, and diverted a stream of finance for marine conservation. Simultaneously, however, it overpromised and underdelivered: higher transaction costs, *less conservation-for-your-buck*.... The outsized expense of the Belizean debt-for-nature swap compared to the value of the debt is a feature of such complex multilateral processes, where every additional transactor typically stands to gain financially, ultimately at the expense of the debtor country. While the deal successfully averted default or austerity measures attached to an IMF loan, it is not an unmitigated victory.”<sup>3</sup>**

The exorbitant costs in the Belize deal further illustrate a form of greenwashing, i.e., where the huge financial profits made by private and commercial entities involved in the process are passed off as gains in support or climate or environmental concerns. According to a *Bloomberg report citing Barclays analysts*, “the amount of money that goes toward the nature conservation goal attached to such deals is only a small fraction of the transaction size, which means the products are ‘misleading’ in their packaging”. They further noted “the real risk of greenwashing, especially if funds to repurchase debt are supplied by a third-party funding itself via ESG-labeled bonds.”

<sup>1</sup>Merrill Collett, “Bolivia Blazes Trail... to where?,” July 10, 1989. <https://www.csmonitor.com/1989/0710/onatur.html>

<sup>2</sup>Robert M. Sadler, Debt-for-Nature Swaps: Assessing the Future, 6 J. Contemp. Health L. & Pol’y 319 (1990). <https://scholarship.law.edu/cgi/viewcontent.cgi?article=1590&context=jchlp&httpsredir=1&referer=>

<sup>3</sup>Alejandra Padin-Dujon, “Do debt-for-nature swaps work? Learning from Belize,” Feb. 28, 2023. <https://blogs.lse.ac.uk/internationaldevelopment/2023/02/28/do-debt-for-nature-swaps-work-learning-from-belize/>

## Conclusions

Taking a stand on debt swaps requires us to revisit APMDD's analysis, position, calls and demands vis-à-vis the debt and climate crises.

### ***Unconditional and immediate cancellation of unsustainable/unpayable and illegitimate debts for all countries of the Global South.***

The accumulated debt burdens and deepening debt dependence of the South are rooted in a colonial history of political domination, exploitation, extractivism and transfer of wealth to the North. Keeping the South indebted and compliant to loan conditionalities are functions of a grossly unjust and broken international economic and financial system, that privileges a handful of rich countries and corporations to sustain this status quo and continue profiting from the peoples and natural resources of the South. By way of debt servicing, the Global South has paid far more than what is being claimed as our financial debt, including paying for illegitimate debts – those contracted dictatorships and repressive regimes, destroyed natural resources, violated human rights, bound to anti-poor and neoliberal austerity conditionalities, restructured under terms set by undemocratic international financial institutions, rich-country lenders and private entities.

*Climate justice – Reparations for the Climate Debt* owed by those most responsible for climate change, towards those who are least responsible and yet suffer its greatest impacts. The mobilization of unprecedented levels of finance is needed to enable people, communities and nations to deal with present and as well as already unavoidable future impacts of climate change, and on the other hand to make the systemic and technological transformation necessary to prevent the worst catastrophes, solve global warming and heal the planet.

Climate finance must be mobilized based on the acknowledgement that a huge climate debt is owed by those who are responsible for the

climate crisis. The responsibility rests heavily on the Global North for their excessive abuse of the atmosphere. A huge climate debt is owed by countries of the north, corporations, and IFIs to countries of the South, as well as Southern elites. Those who owe climate debt must pay reparations to all countries and peoples of the South who have been deprived for their right to fair share of atmospheric space and bear the brunt of the consequences of climate change.

The resurgence in selling debt swaps to the Global South must be met with hard scrutiny in terms of the problems encountered from experience –

- Insignificant public debt reduction
- Greenwashing (minimal climate/nature-related gains)
- Costly, complex and lengthy transactions; benefitting third-party private entities
- Lack of transparency and accountability
- Conflicts of interest (interests of creditors, donors, banks, communities)
- Erosion of sovereignty and autonomy to decide on climate/environmental priorities
- Legitimizing illegitimate debts
- Allowing rich countries to evade their responsibility of delivering climate finance to the Global South through grants

Debt-for-nature/climate swaps are, at best, distractions that take away attention from our main contention. Arriving at just, long-lasting solutions to the debt and climate crises require massive mobilizations of public development and climate finance that does not add to debt burdens and at the same time, acknowledges the burden of responsibility on rich country-governments for causing the climate crisis. These are steps that should be taken in the direction of systemic and structural transformations in the global debt and financial architecture as well as energy systems for building just, post-carbon sustainable economies and societies.

## References:

1. UNESCAP ["Debt-for-Climate Swaps as a Tool to Support the Implementation of the Paris Agreement"](#)
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4. Dialogue Earth ["Explainer: What are debt-for-nature swaps?"](#)
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6. CAN ["Climate Action Network Position on Debt Swaps"](#)
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12. Baker McKenzie [ALSF SOVEREIGN DEBT KNOWLEDGE PRODUCT AND CAPACITY BUILDING PROJECT: DEBT SWAPS DEBT GUIDE](#)
  - a. "argue that debt-for-nature and similar swaps serve as a distraction to this cause, with criticisms relating to the relatively small size of such swaps to date versus total debt levels; expensive negotiation periods and advisor fees; being a "greenwashing" exercise for creditors; undue control over sovereign use of funds by lenders in a privileged position; and fundamental criticisms of monetising the subjects of the projects (nature, education 4 "The debt and climate crises: Why climate justice must include debt justice", Debt Justice Society, 2022. etc.) and acknowledging the legitimacy of the original debt.
13. Wan-Ting Xiong ["Debt for Development Swap: Opportunities & Challenges"](#)

