Order Code RL31286

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Debt-for-Nature Initiatives and the Tropical Forest Conservation Act: Status and Implementation

Updated July 12, 2004

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Debt-for-Nature Initiatives and the Tropical Forest Conservation Act: Status and Implementation

Summary

In the late 1980s, extensive foreign debt and degraded natural resources in developing nations led to the creation of debt-for-nature initiatives that reduced debt obligations, allowed for debt repayments in local currency as opposed to hard currency, and generated funds for the environment. These initiatives, called debt-for-nature swaps, typically involved restructuring, reducing, or buying a portion of a developing country's outstanding debt, with a percentage of proceeds (in local currency) being used to support conservation programs within the debtor country. Most early transactions involved debt owed to commercial banks and were administered by nongovernmental conservation organizations and referred to as three-party swaps. Since 1987, three-party transactions have generated more than an estimated $117 million in local currency for conservation projects, as a result of the purchase of approximately $168 million in debt (face value) for $49 million (all monetary values are in U.S. dollars in this report, unless otherwise noted). Other debt-for-nature initiatives involved official (public) debt and were administered by creditor governments directly with debtor governments (termed bilateral swaps).

In the early 1990s, the United States restructured, and in one case sold, debt equivalent to a face value of nearly $1 billion owed by Latin American countries; these transactions were authorized by Congress as part of the Enterprise for the Americas Initiative (EAI), which broadened the scope of debt swaps to include a number of social goals. Nearly $178 million in local currency for environmental, natural resource, health protection, and child development projects within debtor countries was generated from these swaps. The model for debt-for-nature initiatives, outlined in the EAI, was expanded in the Tropical Forest Conservation Act (TFCA) to include countries around the world with tropical forests. Under this program, debt can be restructured in eligible countries, and funds generated from the transactions are used to support programs to conserve tropical forests within the debtor country.

Since 1998, $42.8 million has been used under the TFCA to restructure loan agreements in seven countries, and nearly $70.4 million in local currency will be generated in the next 12-26 years for tropical forest conservation projects. Creditor countries other than the United States have also used bilateral debt-for-nature transactions to reduce debt and generate funds for the environment in developing nations. For example, Paris Club countries have swapped over $1.6 billion in debt for local currency claims as of December 2000. Debt-for-nature transactions are generally viewed as a success by conservation organizations and debtor governments because of the funds generated for conservation efforts. The appeal of debt-for-nature transactions has been tempered in recent years, however, by higher debt prices on secondary markets and lower appropriations. As a result, fewer transactions have taken place.

This report provides a description of debt-for-nature transactions and a summary of the Tropical Forest Conservation Act and will be updated as developments warrant.

Contents

List of Tables

List of Figures

Debt-for-Nature Initiatives and the Tropical Forest Conservation Act: Status and Implementation

Background Information

Debt-for-nature initiatives were conceived to address the rapid loss of resources and biodiversity in developing countries that were heavily indebted to foreign creditors. Conservationists had noted that the pressure to pay off foreign debts in hard currency was leading to increased levels of natural resource exports (i.e., timber, cattle, minerals, and agricultural products) at the expense of the environment. In many cases, indebted developing countries had difficulty meeting their hard currency debt obligations and defaulted. Reducing foreign debt and allowing for portions of it to be paid with local currency while increasing funds for the environment was thought to improve environmental conditions in developing countries and had the advantage of relieving the debtor country's difficulties in procuring sufficient hard currency to pay off its debts.[1] Money generated from debt-for-nature transactions has been used to fund a variety of projects, ranging from national park protection in Costa Rica to supporting ecotourism in Ghana and conserving tropical forests in Bangladesh.

Since 1993, there has been a decline in the number of debt-for-nature transactions involving official (public) and private funds. Accounting changes requiring new appropriations to support official (public) debt transactions in creditor countries such as the United States, and a higher price of commercial debt on secondary markets, are two reasons suggested for the decline of debt-for-nature transactions. While Congress has periodically authorized U.S. participation in three-party debt-for-nature swaps and has supported two bilateral debt-for-nature initiatives, appropriations to support these types of efforts have not been consistently provided from year to year.

Debt-for-Nature Initiatives and Their Mechanisms

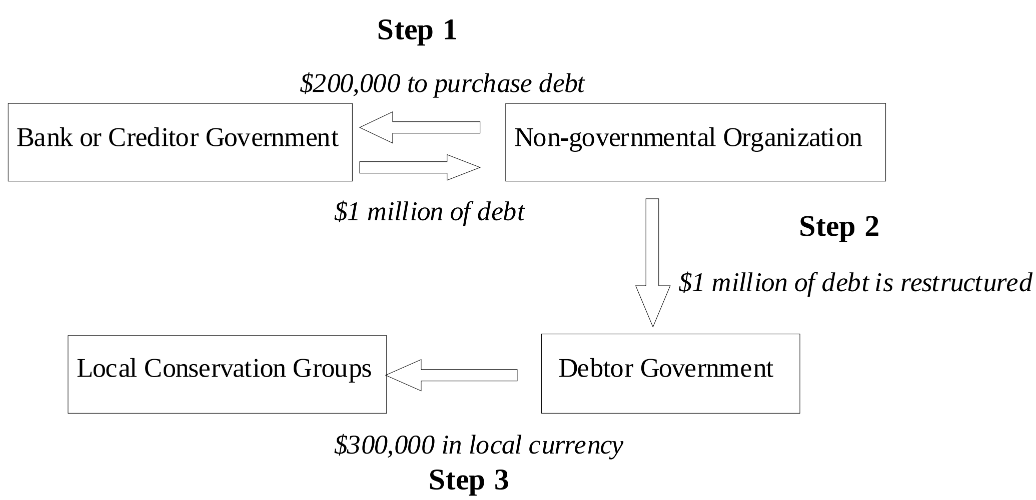
Three-Party Swaps

Three-party debt-for-nature swaps, involving nongovernmental organizations such as The Nature Conservancy and Conservation International, were the first debt-for-nature agreements to be formed. In a three-party swap, a conservation group

[1] Thomas E. Lovejoy III, "Aid Debtor Nations' Ecology," *New York Times*, Oct. 4, 1984, sec. A, p. 31.

purchases a hard currency debt owed to commercial banks on the secondary market or in some cases a public (official) debt owed to a creditor government at a discounted rate compared to the face value of the debt, and then renegotiates the debt obligation with the debtor country. The proceeds generated from the renegotiated debt, to be repaid in local currency, are typically put into a fund that often allocates grants to local environmental organizations for conservation projects (see **Figure 1**). In these cases, the fund is administered by the conservation organization, representatives from local environmental groups, and the debtor government. Money to buy the debt may come from the nongovernmental organization, governments, banks, or other private organizations.

Figure 1. An Illustrative Example of a Three-Party Debt-for-Nature Swap Agreement



- Step 1 = An outstanding debt is sold to a NGO at a discounted rate (e.g., 20% of a face value of $1 million, which is $200,000).
- Step 2 = The debt is cancelled by the NGO as part of an agreement that requires the debtor country to provide funds in local currency equivalents for local conservation groups (e.g., 30% of the original face value, which is $300,000).
- Step 3 = The debtor country provides the agreed to funds to local conservation groups.

In 1989, Congress authorized the United States Agency for International Development (USAID) to provide assistance to nongovernmental organizations to purchase the commercial debt of foreign countries as part of a debt-for-nature agreement (P.L. 101-240; 22 U.S.C. 2282-2286). Several nongovernmental organizations participated in debt-for-nature swaps with financial assistance from USAID; however, specific information on funds given by USAID to support three-party debt-for-nature swaps is not available.

While debt initiatives conducted with three-party swaps are numerous, they have resulted in less reduction in total debt than the debts swapped under bilateral agreements (government-to-government), and slightly less in conservation funds generated. In total, $168 million in debt (face value) has been reduced, restructured, or swapped using this mechanism, generating approximately $117 million in local currency for conservation purposes (see **Table 1**).

Table 1. Countries Participating in Three-Party Debt-for-Nature Swaps, 1987-Present (excluding TFCA transactions)

(U.S.$, in thousands)[2]

Country	Year	Purchaser	Cost	Face value of Debt	Conservation funds generated
BOLIVIA	1993	TNC/WWF	$0	$11,500	$2,860
	1987	CI	100	650	250
Total Bolivia			**100**	**12,150**	**3,110**
BRAZIL	1992	TNC	**748**	**2,200**	**2,200**
COSTA RICA	1991	RA/MCL/ TNC	360	600	540
	1990	SW/WWF/ TNC	1,953	10,574	9,603
	1989	TNC	784	5,600	1,680
	1989	Sweden	3,500	24,500	17,100
	1988	Holland	5,000	33,000	9,900
	1988	NPF	918	5,400	4,050
Total Costa Rica			**12,515**	**79,674**	**42,873**
DOMINICAN REP.	1990	PRCT/TNC	**116**	**582**	**582**
ECUADOR	1992	Japan	NA	NA	1,000
	1989	WWF/FN	640	5,400	5,400
	1987	WWF	354	1,000	1,000
Total Ecuador			**994**	**6,400**	**7,400**
GHANA	2000	CI	80	100	90
	1991	CI/SI	250	1,000	1,000
Total Ghana			**330**	**1,100**	**1,090**
GUATEMALA	1992	CI/USAID	1,200	1,334	1,334
	1991	TNC	75	100	90
Total Guatemala			**1,275**	**1,434**	**1,424**
JAMAICA	1991	TNC/USAID/ PRCT	**300**	**437**	**437**
MADAGASCAR	1994	WWF/JPM	0	1,341	1,072
	1994	CI	50	200	160
	1993	WWF	909	1,868	1,868
	1993	CI	1,500	3,200	3,200
	1991	CI/UNDP	59	118	119
	1990	WWF	446	919	919
	1989	WWF/ USAID	950	2,111	2,111
Total Madagascar			**3,914**	**9,758**	**9,449**

[2] A cost of $0 indicates that funds were written off by the bank to restructure the debt.

Country	Year	Purchaser	Cost	Face value of Debt	Conservation funds generated
MEXICO	1998	CI	256	550	318
	1996	CI	192	391	254
	1996	CI	327	496	443
	1996	CI	440	671	561
	1995	CI/USAID	246	488	337
	1994	CI	399	480	480
	1994	CI	236	280	280
	1994	CI	248	290	290
	1993	CI	208	252	252
	1992	CI/USAID	355	441	441
	1991	CI	0	250	250
	1991	CI	183	250	250
Total Mexico			**3,092**	**4,838**	**4,155**
NIGERIA	1991	NCF	**65**	**150**	**93**
PERU	1993	WWF	NA	2,860	1,573
	2002	WWF, CI, TNC, U.S.	5,500	14,000	10,600
Total Peru			**5,500**	**16,860**	**12,173**
PHILIPPINES	1993	WWF	13,000	19,000	17,100
	1992	WWF/USAID	5,000	10,000	9,000
	1990	WWF/USAID	439	900	900
	1989	WWF	200	390	390
Total Philippines			**18,639**	**30,290**	**29,090**
POLAND	1990	WWF	**11**	**50**	**50**
ZAMBIA	1989	WWF	**454**	**2,270**	**2,500**
Grand Total			**49,001**	**168,193**	**117,627**

Sources:
M. Moye, *Commercial Debt-for-Nature Swaps: Summary Table* (Washington, DC: World Wildlife Fund, 2003).
M. Guerin-McManaus, *Ten Years of Debt for Nature Swaps 1987-1997* (Washington, DC: Conservation International, 2000).
The World Bank, *World Debt Tables, 1996* (Washington, DC: The World Bank, 1996).

Notes: Funds generated may be cash or bonds. Figures given do not include interest earned over the life of the bonds. Full titles of abbreviations are given below. Grand total given is an estimate since some figures were not available.

USAID = Agency for International Development
CABEI = Central American Bank for Economic Integration
CI = Conservation International
FN = Fundacion Natura
JPM = J. P. Morgan Chase and Co.
MBG = Missouri Botanical Garden
MCL = Monteverde Conservation League
NCF = Nigerian Conservation Foundation
NPF = National Parks Fdn. of Costa Rica
PRCT = Puerto Rican Conservation Trust
RA = Rainforest Alliance
SI = Smithsonian Institution
TNC = The Nature Conservancy
UNDP = United Nations Development Prog.
U.S. = U.S. federal government
WWF = World Wildlife Fund

Bilateral and Multilateral Debt-for-Nature Initiatives

Bilateral debt transactions are conducted with official (public) funds directly between the creditor and debtor governments. The creditor government determines the criteria for eligibility, which usually involve the existence of certain financial and political conditions in the debtor country. Debt agreements are usually cancelled and then restructured to extend payback periods, or in some cases, debt is bought back by the debtor country for a discounted price. Money for the environment can be generated through interest payments from the debtor country if the debt is restructured, or from a percentage of the buyback price (see **Figure 2**). Multilateral debt-for-nature agreements have also been conducted between more than one creditor country and a debtor country (see **Table 2**). Poland, for example, benefitted from a multilateral debt-for-nature agreement from 1991 to 1997. During this time, five countries restructured debt obligations with Poland, generating over $473 million in local currency for environmental projects. The United States was the primary participant in this deal, swapping 10% of Poland's debt to generate $367 million for environmental programs.[3]

Table 2. Countries Other than the U.S. Participating in Bilateral and Multilateral Debt-for-Nature Initiatives

(U.S.$, in thousands)

Creditor	Debtor Country	Year	Face value reduction	Face value of debt	Conservation funds generated
Canada	Columbia	1993	67% reduction	18,000	12,000
	El Salvador	1993	100% forgiven	7,500	6,000
	Honduras	1993	n/a	22,000	15,000
	Nicaragua	1993	n/a	12,000	9,000
	Peru	1994	75% reduction	15,000	3,800
Belgium	Bolivia	1992	n/a	13,000	n/a
Finland	Poland	1990	n/a	n/a	14,000
	Peru	1995	70% reduction	27,000	8,100
France	Egypt	1992	n/a	n/a	11,600
	Philippines	1992	n/a	n/a	4,000
	Poland	1993	10% reduction	520,000	52,000
Germany	Peru	1994	70% reduction	22,970	6,100
	Indonesia	2003	15,000,000	n/a	n/a
Holland	Peru	1996	n/a	n/a	n/a
	Costa Rica	1996	100% reduction	17,000	17,000
	Costa Rica	1988	5,000,000	33,000	9,900
Norway	Egypt	1993	n/a	17,300	n/a
	Egypt	1993	n/a	6,200	n/a
	Nigeria	1993	n/a	10,200	n/a
Sweden	Costa Rica	1989	3,500,000	24,500	17,100
	Tunisia	1992	100% reduction	1,100	1,100
	Tunisia	1993	100% reduction	520	520
	Bolivia	1993	n/a	35,400	3,900

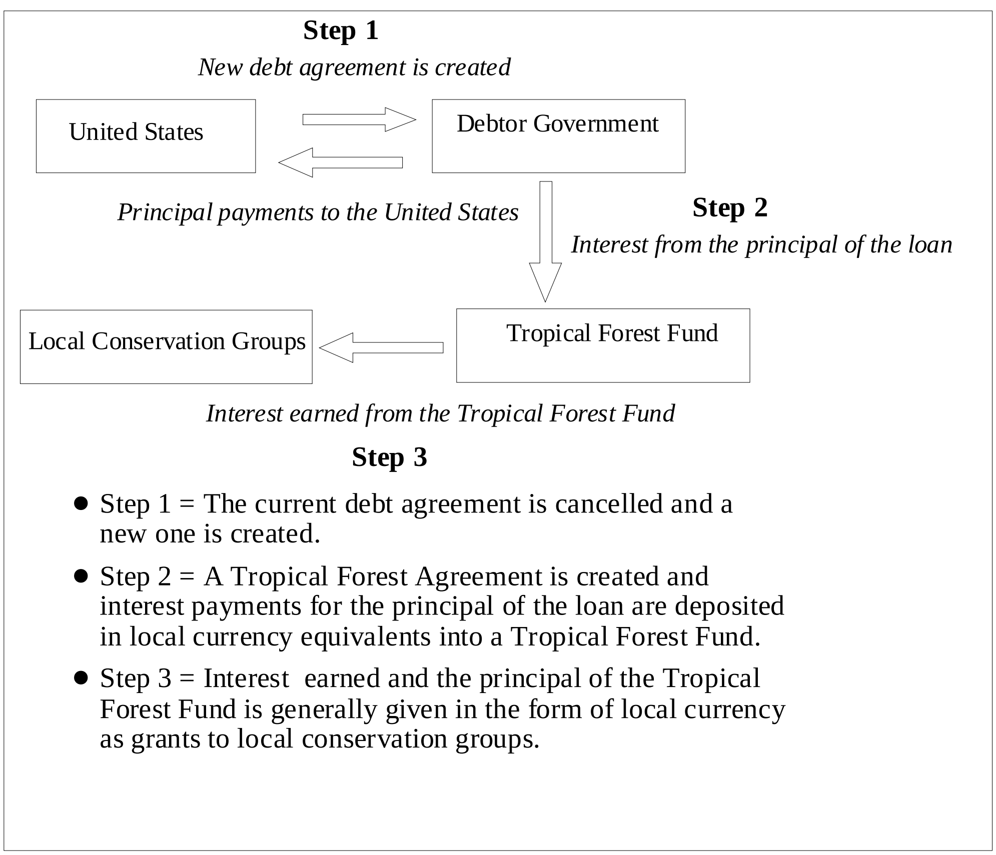
[3] Organization for Economic Cooperation and Development, "Swapping debt for the environment: The Polish EcoFund," Paris: EU Phare program (1996).

Creditor	Debtor Country	Year	Face value reduction	Face value of debt	Conservation funds generated
Switzerland	Peru	1992	n/a	130,800	32,600
	Tanzania	1993	n/a	22,200	3,300
	Poland	1993	10% reduction	480,000	48,000
	Bulgaria	1995	20% reduction	83,500	16,700
	Egypt	1995	20% reduction	115,000	69,000
	Guinea Bissau	1995	100%	8,400	400
	Philippines	1995	50% reduction	32,300	16,100
U.K.	Nigeria	1993	7,300,000	7,300	n/a
	Tanzania	1993	n/a	15,400	15,400

Source: R. Curtis. "Bilateral Debt Conversions for the Environment, Peru: An Evolving Case Study," IUCN World Conservation Congress, Montreal (1996). n/a = information not available.

U.S. Bilateral Debt-for-Nature Initiatives. The model for bilateral debt-for-nature agreements conducted by the United States was first defined in 1990 by the Enterprise for the Americas Initiative (Title 15, Section 1512 of the Food, Agriculture Conservation and Trade Act of 1990, "1990 Farm Bill," P.L. 101-624; 7 U.S.C. 1738) and has since been expanded numerous times (see Appendix). It was last amended by the Tropical Forest Conservation Act (TFCA) in 1998 (P.L. 105-214; 22 U.S.C. 2431).

Figure 2. An Example of a Bilateral Debt-for-Nature Transaction Modeled After the TFCA



The Enterprise for the Americas Initiative legislation authorizes the sale, reduction, cancellation and country buyback of eligible P.L. 480[4] (P.L. 101-624; 7 U.S.C. 1738m, p-r, etc.), AID[5] (P.L. 102-549; 22 U.S.C. 2430 and 2421), CCC[6] (P.L. 102-549; 22 U.S.C. 2430 and 2421), and Exim[7] (P.L. 102-429; 12 U.S.C. 635i-6) debt of eligible Latin American and Caribbean countries.[8] Debtor countries must meet certain political and macroeconomic criteria in order to be eligible. Eligible countries are required to (1) have a democratically elected government, (2) not support terrorism, (3) not fail to cooperate with the United States on drug control, and (4) not engage in gross violations of human rights. From an economic perspective, eligible countries are required to have (1) an IBRD (International Bank for Reconstruction and Development) or IDA (International Development Association) structural or sectoral adjustment loan or its equivalent, (2) a macroeconomic agreement with the International Monetary Fund or equivalent, and (3) instituted investment reforms, as evidenced by a bilateral investment treaty with the United States, an investment sector loan, or progress towards implementing an open investment regime. Each country that participates in the EAI must enter into an America's Framework Agreement with the United States to establish an America's Trust Fund and create enforcement mechanisms to insure payments into the fund and prompt disbursements out of the fund.[9] Funds can be used to support environmental, natural resource, health protection, and child development programs within the debtor country.

Debt swaps, buybacks, and restructuring are three mechanisms used to conduct debt-for-nature transactions under the EAI. Seven of the eight countries that have participated in debt-for-nature transactions under the EAI used the debt-restructuring mechanism to generate environmental funds (see **Table 3**); only Peru took advantage

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[4] P.L. 480 "Food for Peace" loans were low-interest loans given to developing countries to purchase U.S. agricultural products. For more information, see CRS Report RS20520, *Foreign Food Aid Programs: Background and Selected Issues*, by Geoffrey S. Becker and Charles E. Hanrahan.

[5] USAID Foreign assistance loans.

[6] Commodity Credit Corporation loans are given to developing countries to enable them to import U.S. agricultural products. For more information, see CRS Report IB98006, *Agricultural Export and Food Aid Programs*, by Charles E. Hanrahan.

[7] Export-Import Bank loans are made to foreign importers of U.S. goods and services. For more information, see CRS Report 98-568 E, *Export-Import Bank: Background and Legislative Issues*, by James K. Jackson.

[8] Although debt under the P.L. 480 program was the first to be authorized for debt-for-nature transactions, authorization quickly followed for reduction of debt owed to the United States under three other programs: (1) Commodity Credit Corporation programs, (2) Export-Import Bank loans, and (3) foreign aid loans administered by USAID.

[9] The America's Trust Fund can be either an endowed fund or a sinking fund depending on the agreement reached by the United States and the debtor country. Interest payments made by debtor countries on their new restructured loans are deposited into the fund. These payments form the principal of the fund, and interest earned on this principal and the principal itself can be used to fund environmental, community development, and child survival and development programs.

of the debt buyback option. In a debt-restructuring agreement, the original debt agreement is cancelled (i.e., a percentage of the face value of the debt is reduced) and a new agreement is created with a provision for an annual amount of money (in local currency) to be deposited into an environmental fund. In 1992, for example, the United States reduced 10% of a $310 million (face value) debt owed by Colombia in return for the deposit of $41.6 million in local currency into an environmental fund by the Colombian government over 10 years.[10] In a debt buyback, the debtor country purchases its debt at a reduced price. The lesser of either 40% of the repurchase price or the difference between the face value of the debt and the repurchase price is deposited in local currency into an environmental trust to support environmental and child support programs in the debtor country (P.L. 104-107, Title V, Sec. 574). For example, in 1998 Peru took advantage of this program and bought back $177 million in debt for $57 million, generating nearly $23 million (40% of the repurchase price) in local currency funds for conservation and child development programs. For all eight debtor countries, nearly $1 billion (face value) of debt was reduced from a total debt of $1.8 billion, and almost $180 million of conservation funds were generated under the guidelines of the EAI (see **Table 3**).

Table 3. U.S. Bilateral Debt-for-Nature Transactions Under EAI

(U.S.$, in thousands)

Country	Year	Face value reduction	Face value of Debt	Conservation funds generated	Duration (years)
Bolivia	1991	30,700	38,400	21,800	15
El Salvador	1992	463,300	613,000	41,200	20
Uruguay	1992	3,700	34,400	7,030	12
Columbia	1992	31,000	310,000	41,600	10
Chile	1991 & 1992	31,000	186,000	18,700	10
Jamaica	1991 & 1993	311,000	406,000	21,500	19
Argentina	1993	3,800	38,100	3,100	14
Peru	1998	120,000	177,000	22,840	n/a
TOTAL		993,998	1,803,300	177,770	

Source: The United States Department of Treasury. "The Operation of the Enterprise for the Americas Facility and the Tropical Forest Conservation Act, Report to Congress," March, 2001.

Tropical Forest Conservation Act. Acknowledging that tropical rainforests were valuable for preserving biodiversity, reducing atmospheric carbon dioxide, and regulating hydrological cycles, Congress sought to expand the EAI authorization to countries throughout the world with tropical forests. The result was the 1998 Tropical Forest Conservation Act (TFCA), which was established to generate funds to conserve tropical forests by reducing external debt in countries with such forests. TFCA is an extension of the Enterprise for the Americas Act, in that it allows debt swaps, debt restructuring and debt buybacks to generate conservation funds. These funds, however, are specifically designated for the conservation of

[10] R. Curtis, "Bilateral Debt Conversions for the Environment, Peru: An Evolving Case Study," IUCN World Conservation Congress, Montreal (1996).

tropical forests and are not confined to Latin America. To date, seven countries have participated in this program, establishing agreements that will reduce a total of $18.8 million from the face value of their debts to the United States and generate a total of $70.4 million in local currency in the next 12-26 years for tropical forest conservation projects (see **Table 4**).

Table 4. U.S. Bilateral Debt-for-Nature Transactions Under TFCA

(U.S.$, in thousands)[11]

Country [a]	Year	Budget Cost	Private Funds Leveraged[b]	Face value reduction of debt	Conservation funds generated	Duration (years)
Bangladesh	2000	$6,000	$0.0	$600	$8,500	18
Belize	2001	5,500	1,300	1,400	9,000	26
El Salvador	2001	7,700	0.0	3,000	14,000	18
Peru	2002	5,500	1,100	3,700	10,600	12
Philippines	2002	5,500	0.0	100	8,300	14
Panama	2003	5,600	1,200	10,000	10,000	14
Columbia	2004	7,000	1,400	n/a	10,000	12
TOTAL		**$42,800**	**$5.0**	**n/a**	**$70,400**	

Source: Email communications with Scott Lampman and Carrie McKellog, received November 24 and November 25, 2002, respectively. U.S. Agency for International Development, *Operation of the Enterprise of the Americas Facility and Tropical Forest Conservation Act, Report to Congress* (Washington, DC, March 2004).

[a] The Republic of Thailand signed a debt reduction agreement in September 2001. The signing of the second required agreement, the Tropical Forest Agreement (TFA), never took place. The government annulled the agreement on January 30, 2003, amidst false media reports that warned that the U.S. government would retain control over forests involved in the agreement. The $5.6 million funds appropriated to the TFCA was recovered and are available for another TFCA agreement. Email communication from Scott Lampman, Program Analyst, U.S. Agency for International Development, March 17, 2003.

[b] In some debt-for-nature transactions, a third party is involved (generally a non-governmental organization or NGO) in the process and subsidizes a portion of the debt-reduction done by the United States. Non-governmental organizations such as the World Wildlife Fund, The Nature Conservancy, and Conservation International have subsidized these transactions.

To be eligible for this program, a developing country must contain at least one tropical forest with unique biodiversity, or a tropical forest tract that is representative of a larger tropical forest on a global, continental or regional scale.[12] Political and macroeconomic criteria for eligibility are almost identical to those used for

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[11] In the transaction with Peru in 2002, $1.1 million was given by The Nature Conservancy, World Wildlife Fund, and Conservation International, and $5.5 million was given by the U.S. government.

[12] *Developing country* is defined as a "low" or "middle" income country as determined by the International Bank for Reconstruction and Development in its *World Development Report*. In 2001, the cutoff for low-income countries was a per capita annual income of $745 or less. For middle-income countries, the range is $746-$9,205, and the cutoff is $9,205.

participation under the EAI.[13] Conservation funds (in local currency) from these transactions are deposited in a tropical forest fund for each country. The fund is overseen by an administrating body composed of one or more appointees chosen by the U.S. government and the government of the beneficiary country, and individuals who represent a broad range of environmental, academic, and scientific organizations in the beneficiary country (the majority of the board is represented by these individuals). This fund operates in the same manner as the America's Fund: Local currency payments of interest accrued on restructured loans are deposited into a tropical forest fund and serve as the principal. Interest earned from this principal balance and the principal itself is usually given in the form of grants to fund tropical forest conservation projects. Eligible conservation projects include (1) the establishment, maintenance, and restoration of parks, protected reserves, and natural areas, and the plant and animal life within them; (2) training programs to increase the capacity of personnel to manage parks; (3) development and support for communities residing near or within tropical forests; (4) development of sustainable ecosystem and land management systems; and (5) research to identify the medicinal uses of tropical forest plants and their products.

Congressional Role in Debt-for-Nature Initiatives

Authority for Debt-for-Nature Initiatives

Early debt-for-nature legislation concentrated on understanding and promoting third-party debt-for-nature swaps (see Appendix for legislation summaries and *United States Code* citations). Congress in 1989 directed the Secretary of the Treasury to ask the U.S. Executive Director of the World Bank to develop a pilot debt-for-nature program and other ways of reducing debt owed by foreign countries while generating funds for the environment. A subsequent law, the International Development and Finance Act of 1989, authorizes USAID to make grants to nongovernmental organizations (NGOs) to purchase debt in three-party swaps. Official (public) P.L. 480 debt owed to the United States by eligible Latin American countries was authorized to be reduced by the 1990 farm bill (P.L. 101-624; 7 U.S.C. 1738b). The 102nd Congress authorized debt reduction for foreign assistance loans made by USAID (P.L. 102-549; 22 U.S.C. 2430 and 2421), the Export-Import Bank (P.L. 102-429; 12 U.S.C. 635i-6), and the Commodity Credit Corporation (P.L. 102-549; 22 U.S.C. 2430 and 2421). Together, the P.L. 480, USAID, CCC, and Ex-Im debt reduction authorizations were undertaken as part of President George H. W. Bush's Enterprise for the Americas Initiative. In 1996, USAID was further authorized by Congress to conduct swaps, buybacks, and cancellations of debt owed to the United States by eligible Latin American and Caribbean countries (P.L.104-107). In 1998, the Tropical Forest Conservation Act (TFCA) was passed, allowing debt

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[13] Instead of having in place major investment reforms in conjunction with an IADB loan or making progress toward implementing an open investment regime, the country must have in place a bilateral investment treaty with the United States, investment sector loans with the IADB, World Bank supported reforms, or other measures as appropriate (22 U.S.C. 2431c).

swaps, buybacks, and restructuring to generate funds for tropical forest conservation worldwide. The TFCA was reauthorized by Congress in 2001 (P.L. 107-26).

Rationale for and Criticism of Debt-for-Nature Initiatives

Advocates of debt-for-nature initiatives argue that reducing debt in developing countries will help create free-market systems (as part of the reforms required for eligibility), stimulate economic growth and trade liberalization, provide incentives for foreign investment, and help protect the environment. Converting hard currency debts to local currency debts, advocates argue, will lower debt burdens on developing countries and in the long run may reduce resource extraction at the expense of the environment. Critics of debt-for-nature initiatives argue that only a small percentage of debt is reduced, thereby minimizing the positive benefits of debt reduction in developing countries. Supporters point out that while the percentage of debt reduced by debt-for-nature transactions is small, conservation funds generated for debtor countries are generally significant relative to what the country would have originally spent on conservation.[14] The relationship between debt reduction and lower resource extraction rates is controversial. Some analysts suggest that debt reduction has no direct relationship to lower extraction rates of minerals or timber in developing countries with foreign debt.[15]

Advocates of debt-for-nature initiatives note that the United States has a history of supporting debt reduction initiatives in developing countries and appropriating funds for environmental causes. Recent appropriations by the United States to support the Heavily Indebted Poor Countries (HIPC) initiative (22 U.S.C. 262p-6) support the claim for reducing debt in developing countries.[16] HIPC was created by international creditors, the World Bank, and IMF to reduce debt of poor countries that have demonstrated social and economic policy reforms that enable fluid export revenues and capital inflows.[17] Funds generated for the environment in developing countries are argued to improve local environmental conditions, promote sustainable resource use, and help to preserve global biodiversity and ecosystem services. Advocates also suggest that debt-for-nature transactions that generate funds to

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[14] For example, Ecuador reduced its external debt of $8.3 billion by only $1 million from a debt-for-nature swap, yet doubled its budget for parks and reserves with money received from the resulting conservation fund.

[15] Dal Didia, "Debt-for-Nature Swaps, Market Imperfections, and Policy Failures as Determinants of Sustainable Development and Environmental Quality," *Journal of Economic Issues* (2001), pp. 477-486; and Esben Brandi-Hanson and Kaspar Svarrer, "Debt-for-Nature Swaps: One or the Other, or Both?" Royal Veterinarian and Agricultural University of Denmark, Department of Economics, 1998, 17 pp.

[16] Eligibility requirements for participating in the HIPC program include that a country must receive only concessional financing from the World Bank and IMF (i.e., borrowing only from the World Bank's International Development Association (IDA) and from the IMF's Enhanced Structural Adjustment Facility (ESAF)), establish a track record of economic reforms under IMF and World Bank-sponsored programs, and hold a debt burden that is unsustainable under existing (Naples terms) relief arrangements.

[17] See CRS Report RL30214, *Debt Reduction: Initiatives for the Most Heavily Indebted Poor Countries*, by Larry Nowels.

support tropical forest conservation are especially appropriate. Most tropical countries with high levels of total debt owed to the United States also have some of the largest areas of tropical forest cover. For example, Brazil and Peru have debts to the United States totaling over $1 billion each, and have two of the largest areas of tropical forest cover in the world.[18] Other countries, such as the Democratic Republic of Congo and Sudan, also fit this pattern; however, these countries may be ineligible for debt-for-nature transactions under the TFCA due to political and economic eligibility requirements.[19]

Those who oppose debt-for-nature transactions often argue that they are not adequately enforced by debtor countries, generate insufficient funds to improve environmental problems, and may infringe on national sovereignty.[20] Three-party debt swaps have historically had weak enforcement mechanisms; however, bilateral debt swaps such as those conducted under the EAI generally include safeguards and default provisions to protect the U.S. government from losing funds. National sovereignty became an issue in Bolivia when a conservation organization was reported to have obtained title to forested lands. There was a public outcry and ensuing political crisis when the Bolivian people thought a large part of their country had been given to a foreign organization. Consequently, conservation organizations involved in recent three-party swaps have generally refrained from directly buying land in debtor countries with conservation funds earned from swaps.

Decline of Debt-for-Nature Transactions

The number of debt-for-nature transactions has declined in recent years, perhaps due to accounting changes that require greater appropriations to fund debt-for-nature transactions with official (public) debt, and a higher price of commercial debt on the secondary market (see **Figure 3**). Before 1991, no appropriations were required for debt cancellations, and the United States cancelled between $11 and $12 billion in debt between 1988 and 1991. This changed with the Federal Credit Reform Act of 1990 (2 U.S.C. 661a et seq.). This law requires that the net present value (NPV) to the United States of debts of foreign countries be used to report the cost of debt restructuring, buybacks, swaps, and cancellations to the U.S. government. The NPV of the cash flow of the loan is calculated often giving consideration to projected default losses, fees, and interest subsidies. Therefore, appropriated funds for these programs must be used to cover the interest fee no longer coming to the United States

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[18] U.S. Department of Treasury and Office of Management and Budget, "United States Government Foreign Credit Exposure As of December 31st 1999" (2001). Food and Agriculture Organization of the United Nations, "State of the World's Forests 2001," Rome (2001).

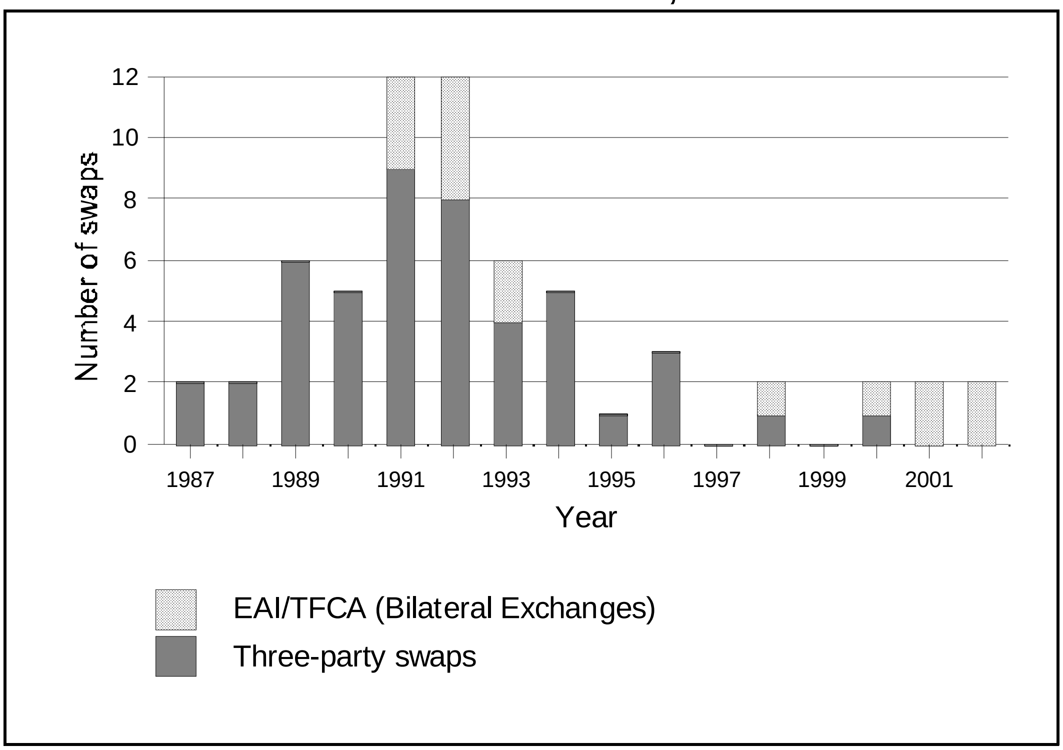
[19] Participation in three-party debt-for-nature swaps through USAID is not subject to the same economic and political criteria required for participation in TFCA and EAI debt-for-nature transactions. An eligible country must be committed to, plan for, and have a government or local nongovernmental organization responsible for the long-term viability of the programs under the swap agreement.

[20] R. T. Deacon and P. Murphy, "The Structure of an Environmental Transaction: The Debt-for-Nature Swap," *Land Economics* (1997), pp. 1-24.

(in the case of funds set up under EAI and TFCA) and the difference in the NPV of the loan that may result from restructuring.[21]

A decline in three-party commercial debt-for-nature swaps may also be due to the conclusion of Brady Plan operations by Latin American countries. The Brady Plan allowed for partial debt forgiveness with a restructuring of the remaining debt into bonds that could be traded on the securities markets. When this program was concluded, the price of debt on the secondary market increased and financing leverage decreased, making it difficult and less attractive for environmental organizations to acquire debt for resale.[22] Further, debt relief for developing countries is available through other programs that allow for relatively greater amounts of debt to be cancelled (e.g., HIPC). These programs may be more desirable to developing countries with debt than debt-for-nature initiatives under the EAI or TFCA. Lastly, the political and economic requirements needed to be eligible for debt-for-nature transactions make it difficult for several countries to participate in EAI or TFCA programs.

Figure 3. Three-Party and U.S. Bilateral Debt-for-Nature Transactions, 1987-2002



[21] Stacy Warden, "The Tropical Forest Conservation Act," PowerPoint presentation, U.S. Department of Treasury, Washington, D.C., 2001.

[22] The World Bank, "World Debt Tables, 1996," Washington, D.C., 1996.

Emergence of Subsidized Debt-for-Nature Transactions

In 2001, a different form of a debt-for-nature transaction emerged under the TFCA. The Nature Conservancy and the United States joined to buy down a portion of debt that Belize owed to the United States. This partnership in debt-for-nature transactions is referred to as a subsidized debt swap. In a subsidized debt swap, an NGO generally matches 20% of the U.S. government contribution toward a debt-for-nature transaction. For example, in a recent transaction with Panama in 2003, the U.S. government provided $5.6 million and the The Nature Conservancy provided $1.2 million to reduce Panama's debt by $10 million and generate $10 million in conservation funds. The transaction is completed when three agreements are signed: (1) the U.S. government and the beneficiary country sign a debt restructuring agreement; (2) the U.S. government and the NGO sign an agreement to transfer NGO funds; and (3) the NGO and the beneficiary country sign a Forest Conservation Agreement.[23] In a subsidized swap, the U.S. government is *not* a signatory to the Forest Conservation Agreement, yet generally has representatives on the oversight committee.[24] Subsidized swaps have been implemented in the last three out of four transactions under the TFCA (see **Table 4**).[25]

Appropriations

Appropriations for debt reduction activities authorized by the EAI have totaled $90 million. Forty million dollars was appropriated for P.L. 480 debt reduction for FY1993 (P.L. 102-341) and $50 million for other debt restructuring under EAI in FY1993 (P.L. 102-391). For debt reduction activities under TFCA, funding has totaled up to $91 million from FY2000 to FY2003 (see **Table 5**). In 2001, the TFCA was reauthorized for appropriations of $50 million, $75 million, and $100 million for FY2002, FY2003, and FY2004 (P.L.107-26). Currently, there is a pending bill (H.R. 4654, introduced June 23, 2004, by Representative Rob Portman) that would extend the authorization for appropriations for the TFCA until 2007 and authorize funds to conduct audits and evaluations of the TFCA programs.

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[23] The U.S. government is a signatory on a Tropical Forest Agreement, which is used with debt-for-nature transactions that are not subsidized.

[24] This agreement generally addresses the structure of the conservation fund, its administrative council, and the use of monies from the fund, among other things.

[25] Scott Lampman, "Debt Swaps Create New Conservation Opportunities,"*Biodiversity* 13 (2003), pp. 1-3.

Table 5. Appropriations Provided Under the Tropical Forest Conservation Act of 1998

Fiscal Year	Requested Amount ($ in millions)	Appropriated Amount ($ in millions)	Actual amount used ($ in millions)[a]
2000	$50.0	$13.0	$6.0
2001	$37.0	$13.0	$14.4
2002	$13.0[b]	Up to $25.0 ($11.0 was given for the TFCA)[c]	$11.0
2003	Up to $40.0[d]	Up to $40.0 ($20.0 was given for the TFCA)[d]	$6.0
2004	$20.0	$19.8	n/a
2005	$20.0	n/a	n/a

[a] Cells with n/a indicate that funds have not yet been determined.
[b] The original appropriation bill language for FY2002 stated that $5 million and *up to* $20 million in funds from unobligated balances may be used for debt reduction activities under the TFCA.
[c] This figure consists of $5 million in direct funds and $6 million in funds transferred from unobligated balances.
[d] Funds are to be transferred from the development assistance accounts of U.S. Agency for International Development.

Future Directions

Bilateral debt-for-nature initiatives implemented by the U.S. government have been supported with appropriations (e.g., under the EAI and now the TFCA authorization) for 7 of the last 10 years. Transactions under the TFCA are expected since it is now included in the Administration's strategy to address global climate change.[26] Tropical forests make up the largest proportion of carbon stored in terrestrial land masses and are thought to be a carbon sink. Despite uncertainties on the part of some, it is generally thought that maintaining existing tropical forests will store carbon, and that preventing deforestation will reduce the entry of carbon into the atmosphere.[27]

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[26] See [http://www.whitehouse.gov/news/releases/2002/02/climatechange.html], last updated February 2002, and last accessed June 25, 2004. (Hereafter referred to as Climate Change Policy.)

[27] T. K. Rudel, *Sequestering Carbon in Tropical Forests: Experiments, Policy Implications, and Climate Change*, Society and Natural Resources, vol. 14 (2001), pp. 525-531.

Appendix: List of Related Laws and Appropriations That Support Debt-for-Nature Initiatives

- **Continuing Appropriations Act for 1988 (P.L. 100-202; Section 537(C)(1-3))**. Directs Secretary of the Treasury to analyze initiatives that would enable developing countries to repay portions of their debt obligations through investments in conservation activities.

- **International Development and Finance Act of 1989 (P.L. 101-240; Title VII, Part A, Section 711) (22 U.S.C. 2282 -2286).** Authorizes USAID to provide assistance to nongovernmental organizations to purchase debt of foreign countries as part of a debt-for-nature agreement (i.e., three-party swap). Authorizes USAID to conduct a pilot program for debt-for-nature swaps with eligible sub-Saharan African countries.

- **Support for East European Democracy (SEED) Act of 1989 (P.L. 101-179; Title I, Section 104) (22 U.S.C. 5414)**. Authorizes the President to undertake the discounted sale, to private purchasers, of U.S. government debt obligations from eligible Eastern European countries.

- **FY1990 Foreign Operations Appropriations Act (P.L. 101-167; Title V, Section 533(e)) (22 U.S.C. 262p-4i- 262p-4j)**. Directs the Secretary of the Treasury to (1) support sustainable development and conservation projects when negotiating reduction of commercial debt and assisting with reduction of official (public) debt obligations, (2) encourage the World Bank to assist countries in reducing or restructuring private debt through environmental project and policy-based loans, and (3) encourage multilateral development banks to support lending portfolios that will allow debtor countries to restructure debt that may offer financial resources for conservation.

- **Enterprise for the Americas Initiative (Title XV, Section 1512 of the Food, Agriculture Conservation and Trade Act of 1990 (P.L. 101-624; 104 Stat. 3658) (7 U.S.C. 1738b)**. Amends the Agriculture Development and Trade Act of 1954 to allow the President to reduce the amount of P.L. 480 sales credit debt owed to the United States by Latin American and Caribbean countries.

- **Export Enhancement Act of 1992 (P.L. 102-429; Title I, Section 108) (12 U.S.C. 635i-6).** Authorizes the sale, reduction, cancellation, and buyback of outstanding Export-Import Bank (Exim) loans for EAI purposes.

- **Jobs Through Exports Act of 1992 (debt forgiveness authority under EAI) (P.L. 102-549; Title VI, Section 704) (22 U.S.C. 2430) and (22 U.S.C. 2421).** Authorizes the sale, reduction, cancellation, and country buyback (through right of first refusal) of eligible Commodity Credit Corporation (CCC) debt. Also authorizes the reduction of foreign assistance (USAID) debt.

- **Enterprise for the Americas Initiative Act of 1992 (P.L. 102-532)(7 U.S.C. 1738m, p-r, etc.).** Establishes guidelines for debt-for-nature swaps for Latin American and Caribbean countries.

- **Agriculture Appropriations for FY1993 (P.L. 102-341)**. Provided $40 million for P.L. 480 debt reduction under EAI.

- **Foreign Operations Appropriations for FY1993 (P.L. 102-391)**. Provided $50 million for debt restructuring under EAI.

- **Foreign Operations Appropriations for FY1995 (P.L. 103-306; Title II, Section 534).** Authorizes nongovernmental organizations associated with the Agency for International Development to place funds from economic assistance provided by USAID in interest-bearing accounts. Earned interest may be used for the purpose of the grants given.

- **Foreign Operations Appropriations for FY1996 (P.L. 104-107; Title V, Section 571).** Provides authority to perform debt buybacks/swaps with eligible loans made before January 1, 1995. For buybacks, the lesser of either 40% of the price paid or the difference between price paid and face value must be used to support conservation, child development and survival, or community development programs (Title V, Section 574).

- **Tropical Forest Conservation Act of 1998 (P.L. 105-214) (22 U.S.C. 2431).** Amends the Foreign Assistance Act of 1961 to facilitate the protection of tropical forests through debt restructuring, buybacks, and swaps in eligible developing countries with tropical forests.

- **Reauthorization of the Tropical Forest Conservation Act (P.L. 107-26).** Authorizes the appropriation of $50 million, $75 million, and $100 million for FY2002, FY2003, and FY2004. Reduces the magnitude of investment reforms that must be in place for eligible countries.