

The Belize Debt-for-Nature Swap

By Suzanna Egolf

Introduction

In the Fall of 2001, The Nature Conservancy (the Conservancy), the United States Government (USG), and the Government of Belize (GOB) agreed to enter into a debt-for-nature swap project to preserve approximately 23,000 acres of rainforest in Belize and provide for its management well into the future. The project, the first of its kind under the Tropical Forest Conservation Act (TFCA or the Act), provides for the reduction of debts with a total face value of \$9.7 million¹ owed by Belize, in exchange for payments to local conservation organizations. By contributing over \$1 million dollars² to the project, the Conservancy was the first non-governmental organization (NGO) to become an outside party in a sovereign-to-sovereign debt-swap.³

Background

The Tropical Forest Conservation Act

In 1998, the United States Congress passed the Tropical Forest Conservation Act. The purpose of this act is to provide for debt relief to developing countries in exchange for increased local conservation of tropical forests. The Act creates three mechanisms to reduce a country's debt while substantially increasing local funds for conservation. The Act requires that these funds are allocated to local NGOs or scientific organizations and not back into the debtor government.

Each mechanism requires the United States Department of Treasury (USDT) to calculate the discounted present asset value of the debt, also known as the net present value, which is what the debt is worth in present day dollars. The net present value is always less than the face value of the debt. On top of this reduction in the face value, the USDT may also provide for a "haircut," which further reduces the amount of debt that must be repaid. A "haircut" is considered outright debt forgiveness.⁴ These reductions in the amount of the debt that must be repaid are major incentives for debtor countries to participate in the TFCA.

The first of the three mechanisms created by the TFCA, a *debt buy-back*, allows the debtor country to purchase its debt from the USG in a lump sum payment, in U.S. dollars, at a reduced amount. The country makes a concurrent lump sum payment in local currency to a conservation fund. This deal is not frequently used because it requires a developing country to pay a large sum in U.S. dollars, which many developing countries find difficult.

The second mechanism, a *debt reduction*,⁵ has been used several times under the TFCA. In this deal the United States reduces a country's debt by a given amount and a new payment plan is arranged. While the debtor country continues to make payments on the principal amount of the debt to the USG, the interest stream is paid into a local forest conservation fund in local currency. The USG has used this mechanism in deals with Bangladesh and El Salvador.

The third mechanism is known as a *debt-swap*. Under this mechanism a third party purchases part of the nation's debt at a discounted amount. A variation on this mechanism is a *subsidized debt-swap*, where the third party pays for approximately 20% of the debt to the USG and funds appropriated under the TFCA pay for the rest. In return for a debt-swap or subsidized debt-swap, the debtor country agrees to

¹ This debt was calculated to have a net present value of \$8.6 million, explained *infra*. Different sources refer to this net present value (\$8.6 million) as the new face value of the debt.

² All dollar amounts in this case-study are in U.S. dollars.

³ This is also known as a public debt-swap; as opposed to a private debt-swap where the creditor is a private non-governmental institution.

⁴ This "forgiveness" is referred to as debt swap reduction by the USDT.

⁵ This type of mechanism is also known as a loan restructuring.

make payments to local conservation or scientific organizations. The ability to pay down debt in local currency is a large incentive under both a debt reduction and a debt-swap.

The TFCA requires that a potential debtor country meet a number of political, economic, and biophysical requirements to be eligible. Political eligibility requires that a country does not support terrorism and cooperates with international narcotics control matters. An eligible country must also have adequate intellectual property laws, must be a democracy, and have no serious human rights violations. Economic eligibility requirements mandate that the debtor country conforms to International Monetary Fund guidelines, and have put in place certain investment reforms. The TFCA limits debt eligible for reduction in an agreement to United State Agency for International Development (USAID) and Food for Peace program (PL-480) low interest loans. To meet the biophysical requirements, countries wishing to participate must have tropical rain forests of international significance. The USG interprets this last requirement rather liberally.

Both the USDT and the U.S. State Department play important roles in the TFCA. First, a country must express interest in an agreement under the TFCA, usually through a written communication to USDT. Then the USG must determine if the country is eligible: the U.S. State Department reviews the political eligibility; the USDT reviews the economic eligibility; and USAID reviews biophysical eligibility. These entities convey their findings to the National Advisory Council on International Monetary and Financial Policy (NAC), which makes the final determination on a country's overall eligibility, and notifies the U.S. Congress. After the USG establishes a debtor country is eligible, the USDT reviews the country's outstanding debt to determine what loans may be used in a deal.

If a debtor country decides to participate in the TFCA, the debtor government and the USDT sign a debt treatment agreement, providing for one of the preceding three mechanisms to reduce the country's debt to the USG. If the debtor country is participating in a debt buy-back or debt reduction, the country then negotiates a Tropical Forest Agreement with the State Department, providing for the payments a country will make to local conservation. A Tropical Forest Fund and Board are established to receive and allocate the payments, respectively. The Board disperses payments to local NGOs and scientific organizations through annual open grant competitions.

The debt-swap mechanism is a bit more flexible. It may result in a Tropical Forest Fund, or may result in a more structured agreement where conservation funds are permanently allocated to specified local NGOs or scientific organizations. This later alternative was used in the subsidized debt-swap for Belize.

Belize

Belize is a country of about a quarter of a million people located in Central America. The country is largely covered by tropical rainforest, especially in the southern half, known as the Toledo District. These forests, part of the Maya Mountain Marine Transect, provide habitat to numerous threatened and endangered species, such as the jaguar, ocelot, marguay, Baird's Tapir, and scarlet macaw. In addition, this area is part of a larger inter-related group of ecosystems, which includes many mangrove forests, watersheds, seagrass beds, and a barrier reef. While the Toledo District is sparsely populated, there are substantial threats to the survival of its ecosystems. Much of the land in this district is privately owned and in danger of being sold to parties who would use the land for farming, mariculture, logging or other development.

The Nature Conservancy in Belize

The idea of using the TFCA in Belize first originated early in the year 2000. The Conservancy had been working closely with its partner in Belize, the Toledo Institute for Development and the Environment (TIDE). Both groups were concentrating on protection of tropical rainforests in the Maya Mountain Marine Transect. The Conservancy, already familiar with the TFCA, recognized that Belize met many of the Act's requirements and thought a deal under the TFCA would help in preserving local rainforests. From the beginning, the Conservancy was interested in participating in a subsidized debt-swap, where it would purchase part of Belize's debt. The Conservancy had already raised \$1.3 million for rainforest conservation in Belize that could be used in such a deal.

The Belize Debt-for-Nature Swap

The Process

Early in 2000, after discussing a deal under the TFCA with TIDE, the Conservancy contacted both Belize's Ministry of Natural Resources and the Environment (the Ministry of Natural Resources), and the Ministry of Budget Management, Investment, and Trade (the Finance Ministry) to discuss a possible swap agreement. However, both Ministries were unfamiliar with the TFCA and showed little interest. The Ministry of Natural Resources thought the debt-for-nature swap was more of a financial matter and of more value to NGOs than GOB. The Finance Ministry, on the other hand, viewed it as a conservation deal.

Soon after these first attempts, the USDT invited several countries to send representatives to Washington, D.C. to learn more about the TFCA. Representatives from Belize's Finance Ministry attended the meeting and were very interested in the financial benefits of an agreement under the Act. The Ministry then sent a letter expressing its wish to participate in the program to the USDT. Once the USDT determined Belize met all of the requirements of the TFCA, it calculated the amount of debt eligible for a deal and the net present value of that debt.

After learning that the Conservancy was interested in participating in a subsidized debt-swap, the USDT consulted with the Conservancy about possible conservation deals. The Conservancy's conservation proposal centered on acquiring land in the Toledo District. The plan provided for the acquisition of approximately 12,000 acres of privately owned rainforest land. In addition, the government would donate an 11,000-acre parcel it owned to TIDE. All of this land, totaling approximately 23,000 acres, would then be held in trust by TIDE, free of tax, for the benefit of the government and people of Belize. The agreement would provide for additional money to manage the land in perpetuity.

The proposed deal provided for two additional local NGOs to be recipients of conservation funds. The Belize Audubon Society (BAS), which manages several national parks and the Programme for Belize (Pfb), which owns a substantial amount of conservation land in the country, would also receive management funds and endowments for their lands. Belize's Finance Ministry, the USG, the local NGOs, and the Conservancy all agreed on this proposal.

Before the original agreement could be completed, however, the parties encountered two major obstacles. First, Belize's Ministry of Natural Resources learned about the proposed agreement, and was concerned that it had not been adequately consulted in such a large conservation deal. While the Conservancy contacted this Ministry when first contemplating a debt for nature swap, they had not been involved in the later developments.

Second, another conservation organization in Belize, the Protected Area Conservation Trust (PACT), also learned of the agreement and was unhappy about not being included in the negotiations. There was a misunderstanding about whether PACT, a quasi-governmental organization and not an NGO, could receive funds under the TFCA. The USDT issued an opinion that PACT was a government entity, and therefore not eligible to be a recipient. In addition, other Belizean NGOs were not overly supportive of the plan because all of the benefits were limited to TIDE, BAS, and Pfb.

Because of these obstacles, the parties were unable to complete an agreement by the January 1, 2001 deadline. Seemingly, the deal was off. The Conservancy and TIDE proceeded to finalize a deal in which the Conservancy paid approximately \$500,000 for 4200 acres of land in the Toledo district, and TIDE received title to that land.

Early in 2001, several events took place to revive the Belize debt-swap agreement. The new Bush Administration in the United States strongly supported the TFCA, and was interested in completing a debt-swap under it. They contacted the Conservancy to see if another attempt could be made in Belize. The Conservancy first consulted with the local NGOs and PACT to arrange a new deal they could all participate in, and therefore support. The Conservancy proposed the creation of a foundation linked to PACT (and called the "PACT Foundation") that would award grants to other local conservation NGOs. The three original NGOs would still receive individual management funds and endowments, and TIDE

would still acquire and manage a large block of land in the Toledo District.

Next, the Conservancy once again contacted the GOB. The Finance Ministry, in addition to the Prime Minister, continued to support a debt-for-nature swap. With the local NGOs and PACT now on board, and the new proposed deal in place, the parties were able to gain the support of the Ministry of Natural Resource. The Conservancy formally communicated a new proposal to the GOB in July of 2001, and in October a debt-for-nature swap agreement was signed, a little over a year after it was first contemplated. Under the final project structure, the USG agreed to reduce Belize's debt by almost half. The USDT calculated the net present value of the debt to be approximately \$8.6 million. The USDT then provided for a \$1.4 million "haircut" for Belize. Under the agreement, the GOB will pay \$7.2 million plus interest to the local conservation organizations, in local currency. The new payments are divided in 10- and 26-year payment schedules.⁶ The Conservancy's contribution of \$800,000,⁷ plus \$5.5 million appropriated under the TFCA were paid to USAID to fund this subsidized debt-swap.

Subsidized Debt-Swap Agreements

Three different major legal instruments were created to govern the Belize debt-for-nature swap. The "Swap Fee Agreement" between the Conservancy and the USG set out the procedure for the Conservancy to contribute \$800,000 toward the reduction of Belize's debt. A second agreement between the USG and the GOB set out the requirements for the GOB to make payments into accounts for local NGOs, and deliver title of 11,000 acres of land to TIDE.⁸ In return the USG agreed to cancel approximately \$8.6 million (net present value) of debt.

The final instrument, the "Forest Conservation Agreement," is among the Conservancy, the GOB, TIDE, PFB, BAS, and PACT.⁹ This agreement sets out the obligations of each party under the debt-swap, including how money is paid into the accounts for each organization from the GOB, and how the organizations may use that money. The Forest Conservation Agreement enumerates the enforcement mechanisms under this deal, including a committee that oversees that funds are used correctly and provisions for dispute resolution.

The main benefit to the Conservancy of participating in a subsidized debt-swap was the ability to leverage its money and participate in deciding how funds were appropriated. As discussed earlier a debt reduction, the more widely used mechanism under the TFCA, requires the creation of a Tropical Forest Fund run by an administering board which re-analyzes the distribution of funds every year. Under this debt-swap, the agreement between the Conservancy, the local NGOs and the GOB predetermines exactly where all of the money goes, and how it may be used. In addition, a representative of the Conservancy sits on the board that oversees the agreement.

Methodology

The Belize debt-swap took on a slightly different methodology than the one outlined in this guide. The Conservancy played the part of both the third party NGO and the donor, and was therefore directly involved in almost every step of the process. In addition, the Conservancy, consulted with both the local government and local NGOs (the key stakeholders) in this agreement. Until the TFCA becomes a better-known tool for conservation and reduction of debt, large U.S.-based international conservation NGOs will probably continue to be the motivating parties in these agreements. These organizations will have the knowledge about the TFCA and its requirements. They will also likely have partners in debtor countries to help in developing comprehensive conservation plans.

In this deal the creditor government, the USG, did not need to be consulted to determine their level of

⁶ Originally, the payment terms to local conservation were set up to match the terms of the USAID loans. While at first the USDT believed these were divided into 10 and 26 year payment schedules, later developments showed all of the loans were actually on 10 year payment schedules. However, the parties were able to "divorce" the terms of the original loans from the terms laid out in the final agreement.

⁷ The Conservancy's total contribution to the Belize debt for nature swap agreement was \$1.3 million; \$500,00 for land acquired to be held in trust by TIDE, and \$800,000 for the debt-swap.

⁸ This is the debt treatment agreement between USDT and the debtor government, explained previously.

⁹ As discussed previously, under a debt buyback or a debt reduction this type of agreement (akin to a Tropical Forest Agreement) would be between the debtor government and the State Department.

interest. Under the TFCA the United States had already stated a desire to complete these types of deals with eligible countries. Also, during this debt-swap the local NGOs were involved in structuring the deal from the beginning. Because this debt-swap ultimately directly benefits specific organizations, as opposed to a debt-reduction, it was important to have their input while developing the agreement.

Analyses

The parties organized a successful debt-swap in Belize only after gaining the support of all major political and conservation players. In retrospect, the parties probably would have included the Ministry of Natural Resources and PACT earlier in the process. Even though these parties did not officially have to be involved in the deal, they are important members of the Belize's conservation community.

In future agreements, while the Finance Ministry of a country will always need to be contacted for a debt-swap, the Belize deal indicates parties may also want to include the Environmental Ministry when plans are being made for large-scale conservation. A third party NGO attempting to organize a debt-swap will want to identify the most influential conservation organizations in the country, and gain the support of as many local NGOs as possible. Every group will want an opportunity to benefit from the agreement. This is why development of a mechanism (the PACT Foundation) for creating the possibility of monetary benefits for all conservation NGOs was crucial to the success of the Belize debt-swap.

By participating in a subsidized debt-swap, the Conservancy leveraged a contribution of \$1.3 million for over \$11.6 million for conservation in Belize, when all cash, interest, and land transfers are totaled. In addition, the Conservancy participated in developing the agreement, and was able to ensure its contribution would help save valuable land in Belize. To have significant input in a Forest Conservation Agreement, the Conservancy learned a third party NGO will need to provide for the purchase of approximately 20% of a debtor country's debt, either directly or through other donors. For future agreements, more than one third-party NGO/donor may be involved in a single subsidized debt-swap.

The Conservancy also learned that any party wishing to initiate a deal under the TFCA will want to get the debtor government involved as early as possible. The debtor government is the party that must contact the USG and express a desire to participate in a deal. Determining the country's eligibility can be a major limiting time factor in the process. Once the country expresses its interest in a deal under the TFCA in writing and is determined to be eligible, the USDT can usually determine the debt eligible for a deal rather promptly.

In addition, the parties will want to know the net present value of the debt as soon as possible. Because public debts are not traded on an open market individuals will not have a reliable way to estimate the net present value until it is calculated by the USDT. When they know this value, the parties can start negotiating on exactly how much the government will pay to local NGOs, and the scope of the projects that can be undertaken.

The debt-swap with Belize showed there is an additional degree of flexibility in determining the payment terms under a subsidized debt-swap. The parties originally thought the payment terms to local NGOs should match those of the USAID loans being canceled under the TFCA. However, because there was a mistake when first calculating the terms of these loans, and the payment terms to local NGOs had already been calculated, the resulting agreement demonstrated that these two different sets of payment terms could be "divorced".

Finally, to provide a fiscally sound rationale for the participating debtor government, third party NGOs will want to emphasize the value of the initial "haircut", the fact that payments will be made in local currency and in-country,¹⁰ and that protecting forests is a long term value for both biodiversity protection and economic development.

¹⁰ This benefit also includes a multiplier effect, because payments are easier for the debtor government to make in local currency, and the currency is fed directly back into the economy of the debtor country.