Introduction

A Productive Partnership between Civil Society and the Academy

Ross P. Buckley

There is a considerable history behind this volume. I first researched and wrote about debt exchanges some 12 years ago.[1] Five years later Bill Walker, who then chaired Jubilee Australia's Policy Working Group, approached me with the idea of drafting a submission to the Australian government on why it should consider undertaking such exchanges. Steven Freeland and I wrote this submission to Treasury in 2003. In 2005 Bill Walker and I together wrote Jubilee Australia's official submission to AusAid for its white paper consultation. Later in that year I spoke at an AusAid event in Sydney.

In late 2006 I spoke at a Make Poverty History conference in Melbourne on debt-for-development exchanges, and that campaign's media liaison staff worked to ensure that an opinion piece I'd written on the idea appeared in the *Australian Financial Review* on the day of the conference.[2] As a result of reading the opinion piece, Bob Sercombe, opposition spokesman on overseas development assistance, came along to listen and asked questions in private afterwards. At about the same time, World Vision Australia (where Bill Walker has his day job) sponsored a research assistant to work on more formal scholarly research on the topic, and the outcome of that work appeared in 2007.[3]

In April 2007 Adele Webb and Luke Fletcher of Jubilee Australia organised an event titled "Is Australia a Responsible Lender?" as part of the 'fringe festival' for the national conference of the Australian Labor Party (ALP, which was then in opposition) at which the ALP Shadow Parliamentary Secretary for Overseas Development Assistance, Bob McMullan, and I spoke.

[1] Ross Buckley, "Debt Exchanges Revisited: Lessons from Latin America for Eastern Europe", *Northwestern Journal of International Law and Business* 18 (1998): 655–684.

[2] Ross Buckley, "Transparency Helps Narrow the Gap", *Australian Financial Review*, November 16, 2006, 63.

[3] Ross Buckley and A. Small, "Leveraging Australia's Debt Relief to the Philippines Using Debt-for- Investment Projects", *Macquarie Law Journal* 7 (2007): 107–124.

Debt-for-development exchanges were discussed at this event. Shortly thereafter, these years of advocacy efforts culminated in the Labor Party adopting a debt-for-health exchange with Indonesia as part of its policy platform. This became government policy with Labor's electoral victory in November 2007.

In this way was policy shaped. Adele and Luke's advocacy efforts at Jubilee Australia led the way, ably supported by Bill Walker at World Vision Australia and by the Make Poverty History campaign, a coalition involving the above nongovernmental organisations plus TEAR, Oxfam and many others.

The Debt2Health exchange was implemented in mid-2010. Under the exchange, Australia has cancelled A$75 million of its loans to Indonesia in return for Indonesia paying one-half of that sum to the Global Fund to be used in the fight against tuberculosis in Indonesia. May this be but the first of many productive debt-for-development exchanges between the two countries. Adele Webb and Luke Fletcher tell the complete story of how the Debt2Health exchange that Australia and Indonesia entered into in 2010 came about.

In 2007 I applied for, and was lucky enough to receive, a major three-year Australian Research Council grant to explore debt-for-development exchanges and their potential to contribute to the security of our region. This volume is one significant outcome of the research undertaken under that grant.

I tell this story in part to show the genesis of this volume and its long historical roots. But more significantly I tell the story to show the potential of partnerships between civil society organisations and university academics. It is almost inconceivable that my research would ever have influenced federal government policy without the input of two civil society organisations, Jubilee Australia and World Vision Australia. Likewise, however, the representations to government of those organisations may have been less credible without the support of my research. Civil society, around the world, may find in universities a well of resources that are highly valuable in their advocacy activities and yet have been tapped but lightly. This is particularly so if civil society understands that academic talent can be used in diverse ways: to generate research to underpin arguments and, depending upon the academics' personality and inclinations, to advocate for those arguments. If academics are invited to work on issues in ways that will generate publications, they are far more likely to be able to say yes than if they are asked merely to write reports or submissions that will never be formally published. People often go into university teaching wanting to make a difference in the world. A partnership with civil society can enable academics to bring about that difference.

Anyway, enough of this history; let's move on to the history of debt exchanges. These are the subject of the nine chapters in the first two parts of this book. These chapters commence by chronicling the emergence of debt-for-development exchanges from their forebears, debt–equity exchanges, and analyse why debt for development suffers from very few of the problems that plagued debt–equity. The different types of debt-for-development exchange by development project are then considered. So, for instance, one chapter considers debt-for-nature exchanges and another debt-for-education exchanges, and so on. Part II of the book proceeds to analyse the practices and trends in exchanges by donor countries, seeking to demonstrate the lessons learned in how each donor country has used, or in the case of France abused, this technique.

Part III introduces critical and analytical perspectives on exchanges. The chapters in Parts IV and V were presented initially at a workshop funded by the Australian Research Council and held at the University of New South Wales in March 2010. This one-day workshop allowed these authors and other interested participants to come together to learn of each other's work and thoughts and to explore new uses for this well-established financial technique.

In the initial chapter in Part III, Julia Roy makes the case that debt audits to determine the legitimacy of the debt are prerequisites of credible exchanges. Jürgen Kaiser then grapples with the sad reality that, in the absence of other mechanisms that enable the cancellation of illegitimate or odious debt, a nation may be better served by exchanging debt, notwithstanding the fact that in an ideal world it would be set aside as illegitimate or odious, because we don't live in that world and the nation will otherwise simply have to keep servicing the debt.

Gillian Moon then explores the human rights dimensions of exchanges, and M. D. Shamsuddoha considers Bangladesh's experience with debt and development and the contributions exchanges could make to that country.

In the final chapter in Part III, Joffre Balce explores some of the interesting applications of the debt-exchange technique in the Philippines, as well as some potentially innovative applications. Joffre's chapter ends on a provocative note, for he questions whether, while productive in a micro sense, exchanges are destructive in a macro sense, as they perpetuate the dependency of the financial systems of developing countries upon external finance. Joffre's question is significant, for it challenges directly a fundamental working assumption of the entire international financial system, namely that poor nations have inadequate domestic financial resources and are best served by borrowing from abroad. Certainly in East Asia, from where Joffre hails, this appears to be a deeply questionable assumption, and Joffre explores the idea of using exchanges to make the most of domestic financial resources within, and being remitted to, the Philippines.

The fourth and final part of the book is in many ways the most important, as it considers new and innovative uses for the funds generated by exchanges.

It begins with a chapter about one of the most exciting development projects I have encountered, projects to teach African farmers how to restore tree cover to their farms by caring for the stumps of indigenous trees, which in the past have been treated as impediments to farming. Most antidesertification efforts in Africa have focussed upon the planting of exotic varieties of trees. Tony Rinaudo in his excellent work with World Vision in a number of sub-Saharan countries has proved that the best trees with which to combat soil and wind erosion and to turn back the encroachment of the world's largest desert are the trees that are already there, in the ground, as stumps. These projects are perfectly adapted to funding by debt-for-development exchanges. Their costs are modest. The benefits are very substantial, and the projects in time become self-sustaining as farmers teach other farmers how to improve yields and generate other sources of income by nurturing stumps into coppiced trees.

The next brief chapter in Part IV considers the massive returns available from restoring mangrove forests, both as breeding grounds for fish and seafood catches, and as tsunami protection zones.

This is followed by John Langmore's analysis of how debt exchanges could be used to fund social protection programs (basic welfare support). John's chapter contains important and previously unpublished calculations by Professor Anthony Clunies-Ross of the amount it would actually cost the world to lift all who live in extreme poverty around the world out of it – an amount that is almost certainly beyond the capacity of debt exchanges to fund but is nonetheless surprisingly affordable for rich countries. And, of course, the fact that debt exchanges cannot fund the world's entire social protection needs doesn't mean exchanges cannot begin to do so for some specific countries that currently lack such programs. As I write this introduction, I have been sick for a month with whooping cough, a very nasty affliction in middle age. The incredible exhaustion this disease has caused me has brought home the hard truth of what it must be like for poor people in poor countries without social protection. It has been extremely sobering for me to realise that, as I have struggled to make lunches and help my children get off to school (before collapsing on the bed in exhaustion), people in the world as sick or sicker than I have had to work all day in physically demanding roles because for them to fail to work is to fail to eat. Social protection schemes are part of the answer to this inhumanity.

The two succeeding chapters, the first by Philip Ireland, the second by Alicia C. Qian and Tanvir A. Uddin, explore ways that debt exchanges could fund the general climate change adaptation efforts our world is going to need in abundance, and one specific climate change adaptation measure: climate change schools to teach Bangladeshi farmers how to respond to a changing climate.

The next chapter considers briefly the idea of debt-for-peace exchanges and explores the contribution that funding from a debt exchange could make in supporting community-based peace initiatives in Mindanao in the Philippines, the potential of US legislative schemes to fund debt-for-nuclear-nonproliferation exchanges and, finally, the security threats posed by environmental degradation and climate change.

The penultimate chapter in the volume is by Emmanuel T. Laryea and explores how information and communication technology systems funded by debt-for-development exchanges could be used to promote good governance and in turn development in developing countries.

The final chapter is written, most fittingly, by the man who first had the idea of Australia entering into debt-for-development exchanges, Bill Walker. Bill explores the potential of these exchanges to promote citizen action and voice in developing countries. Bill's contribution answers in part the question Joffre Balce raises at the end of Part III. The most sustainable long-term development path of all is one that empowers developing countries to develop and rely upon their own human and financial capital. Debt exchanges could play a role in this regard, but to realise this role will require a fundamental shift in thinking: a new paradigm. But I am getting ahead of myself, to material best considered in the book's conclusion.

PART I

Types of Exchanges and Their Development over Time

1

The Early Years: The Evolution of a Technique

Ross P. Buckley

I. INTRODUCTION

The beginning was the early 1980s. And in the beginning were bad loans, and from the loins of these bad loans sprang debt–equity exchanges, which quickly begat debt-for-nature exchanges, and then debt-for-education exchanges, and most recently, debt-for-health exchanges. And today, when all the begatting has been done, the progeny are known mostly as debt-for-development exchanges, or sometimes as debt-for-investment projects (by those who wish to suggest for the technique a more commercial focus).[1]

The first debt-for-development exchange was undertaken in 1987. Two decades later, in 2007, it was estimated that these financial techniques had resulted in the cancellation of US$5.7 billion of debt and the application of US$3.6 billion to development projects.[2] Early debt-for-development exchanges typically involved an environmental or other nongovernmental organisation (NGO), which purchased the debt for a discount in the secondary market and tendered it to the debtor government in return for a promise to apply an agreed-upon amount of local currency to mutually agreed-upon environmental or other projects in the debtor nation. The most common type of debt-for-development exchange today takes place directly between a creditor and debtor nation without NGO involvement. Under a typical exchange, the creditor nation will offer to cancel a specified part of a loan or loans if the debtor nation applies a portion of the amount cancelled (or perhaps the repayments

[1] R. P. Buckley and A. Small, "Leveraging Australia's Debt Relief to the Philippines Using Debt-for-Investment Projects", *Macquarie Law Journal* 7 (2007): 107.

[2] Working Group on Debt Swaps for Education, "Draft Report for the Director-General of UNESCO" (August 2007), 5, accessed August 2, 2010, http://www.unesco.org/education/EFAWGSDE/WGDSE_2nd_draftreportforDG_EN.pdf.

it would have made on the loan over the next 5 to 10 years) towards mutually determined development projects in the debtor nation.

Debt-for-development exchanges matter. In 2005 the United Nations urged developed nations to seek a 'durable solution to the debt problems of developing countries', and further noted that 'such mechanisms may include debt for sustainable development swaps',[3] and in 2007 the European Network on Debt and Development noted that 'debt-swaps have a real and growing presence on the political agendas of donor countries'.[4]

So it is worth understanding where these techniques came from and how they evolved. Indeed, it is the evolution of the idea that explains the technique's quaint title, for as my wife pointed out:

> Where is the exchange when a rich country offers to cancel some of its loans to a poor country, if the poor country spends money on a development project? Surely that's like our saying to our daughter, 'You don't have to repay the advance we gave you last week, provided you spend half of it at the shops next week'.

The history explains all this: not the shopping proclivities of women, I am not sufficiently erudite to explain that, but the title and evolution of a significant financial technique.

But first we must begin, and in the beginning bad loans were needed, loans that traded at a discount to their face value. For without a discount there is no reason to undertake a debt-for-equity exchange, and debt-for-development exchanges, while still worthwhile without a source of discounted debt, certainly lose some of their attraction.

Sadly, bad loans are rarely in short supply, and oceans of bad loans became available in late 1982. In mid-August 1982, Mexico announced the suspension of principal payments on its foreign debt and the debt crisis began.[5] Shortly afterwards, Brazil, Argentina and other Latin American nations announced that they required substantial additional funding to avoid defaulting on their debts.[6] Commercial banks stopped virtually all lending to the region and,

3 United Nations General Assembly, "Draft Resolution Referred to the High-level Plenary Meeting of the General Assembly by the General Assembly at Its Fifty-ninth Session: 2005 World Summit Outcome", September 15, 2005.

4 Marta Ruiz, "Debt Swaps for Development: Creative Solution or Smoke Screen?" (European Network on Debt and Development, October 2007), 4, accessed August 2, 2010, http://www.eurodad.org/uploadedFiles/Whats_New/Reports/Debt_swaps_ENG(2).pdf.

5 Darrel Delamaide, *Debt Shock* (London: Weidenfeld & Nicholson,1984), 6.

6 Allegra C. Biggs, "Nibbling Away at the Debt Crisis: Debt-for-Nature Swaps", *Annual Review of Banking Law* 10 (1991): 436; E. Webb, "Debt for Nature Swaps: The Past, the Present and Some Possibilities for the Future", *Environmental and Planning Law Journal* 11 (1994): 222.

within 15 months, 27 countries had rescheduled their debt or were in the process of doing so.[7] More were to follow.

The traditional sources of foreign capital for Latin America before 1970 were bonds, direct investment, official loans and supplier's credits.[8] Thus each wave of defaults was not a crisis for the international financial system, as the losses fell on a broad range of individual investors and suppliers, not on a relatively small number of banks.[9] For instance, the development of the United States in the nineteenth century was financed mainly by the issuance of bonds, principally to European nonbank investors,[10] and the defaults, of which there were plenty,[11] therefore did not threaten the financial system.

In the early 1970s, aided by the development of syndicated loans, the major commercial banks began to lend to Latin America. The lenders were now banks, not investors in bonds or projects or exports to the region.[12] For the first time in history the major thrust of development finance was commercial bank lending.[13] The pace of lending accelerated throughout the decade. The total external debt of the 17 highly indebted countries[14] in 1975 was US$76.6 billion.[15] This doubled by 1979, and doubled again by 1982, to a total of US$276.5 billion.[16]

[7] Philip A. Wellons, *Passing the Buck: Banks, Government and Third World Debt* (Boston: Harvard Business School Press, 1987), 255.

[8] Richard A. Debs, David L. Roberts and Eli M. Remolona, *Finance for Developing Countries: Alternative Sources of Finance – Debt Swaps* (New York: Group of Thirty, 1987), 10; Marilyn E. Skiles, "Latin American International Loan Defaults in the 1930s: Lessons for the 1980s?" Federal Reserve Bank of New York, Research Paper No. 8812, April 1988, 41–42. Stallings notes that suppliers' credits became significant only after World War II; see Barbara Stallings, *Banker to the Third World: U.S. Portfolio Investment in Latin America, 1900–1986* (Berkeley: University of California Press, 1987), 109–110.

[9] Frank Griffith Dawson, *The First Latin American Debt Crisis: The City of London and the 1822–1825 Loan Bubble* (New Haven, CT: Yale University Press, 1990), 237; Delamaide, *Debt Shock*, 49.

[10] Delamaide, *Debt Shock*, 49; Cleona Lewis, *America's Stake in International Investments* (Washington, DC: Brookings Institution, 1983), 17–24, 30, 35, 36–39, 45–48.

[11] Delamaide, *Debt Shock*, 49, and Lewis, *America's Stake*, 25–26, 35, 45–46.

[12] Barry Eichengreen and Richard Portes, "After the Deluge: Default, Negotiation, and Readjustment during the Interwar Years", in Barry Eichengreen and Peter Lindert (eds.), *The International Debt Crisis in Historical Perspective* (Cambridge, MA: MIT Press, 1989), 40–41.

[13] Debs, Roberts and Remolona, *Finance for Developing Countries*, 10; Delamaide, *Debt Shock*, 49.

[14] Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cote d'Ivoire, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia.

[15] World Bank, *Developing Country Debt: Implementing a Consensus* (Washington, DC: World Bank, 1987), 26.

[16] Jeffrey D. Sachs, "Introduction", in Jeffrey D. Sachs (ed.), *Developing Country Debt and the World Economy* (Chicago: Chicago University Press, 1989), 9. For instance, the net liabilities of Argentina, Brazil and Mexico to developed country international banks increased from US$56.6 billion in December 1979 to US$104.5 billion in December 1981; and almost as many net loans were made to the major debtors in 1981 and 1982 as in the entire period from 1973 to 1979.

Certainly, when Mexico's inability to service its debt triggered the debt crisis, there was an abundance of bad loans to be used in debt exchanges. However, to facilitate the process there needed to be a market upon which entities interested in initiating debt-for-development exchanges could acquire the debt.

II. THE SECONDARY MARKET IN DISCOUNTED DEBT

A form of secondary market for the discounted debt of less developed countries and their corporations had 'existed on a relatively small scale since well before the onset of the crisis in 1982'.[17] But the secondary market really began to grow after 1982.[18] I have written at length elsewhere about the development of this market.[19]

The market began as a swap market in which a US bank with one or two loans to Poland in its portfolio might exchange them with a German bank for some Latin American loans that the German bank no longer wanted. Each bank was refocussing its portfolio on regions of the world it knew best, or at least to which it had sizeable exposures. After some months, some brave and wise bankers began to actually sell loans and absorb the losses. In the words of Lee Buchheit:

> Fortunate indeed are those bankers who in 1983 sold off their Argentine exposure at a 15 or 20% discount although, at the time, this was accompanied by a good deal of hand-wringing, tooth-gnashing and piteous wailing about the cruelty of international lending.[20]

This secondary market provided the source of funds that were soon to be used in debt–equity exchanges and debt-for-nature exchanges.

III. DEBT–EQUITY EXCHANGES

Debt–equity agreements involve the sale of external debt by an investor to the debtor government in return for a discounted amount of local currency,

[17] United Nations Centre on Transnational Corporations, *Debt Equity Conversions: A Guide for Decision-Makers* (New York: United Nations, 1990).

[18] Ibid.

[19] R. P. Buckley, *Emerging Markets Debt: An Analysis of the Secondary Market* (Kluwer: London, 1999), 1–330; and R. P. Buckley, "A Force for Globalisation: Emerging Markets Debt Trading from 1994 to 1999", *Fordham International Law Journal* 30 (2007): 185–259.

[20] Lee C. Buchheit, "Return of the Living Debt", *International Financial Law Review* (May 1990): 28.