

DEBT-SWAPS FOR SOCIAL DEVELOPMENT

\$ 1.1-Million Debt Swapped for Health Research in Mexico

The project on debt-swaps of the Task Force, based at the Harvard Center for Population and Development, has facilitated \$ 1.1 million worth of debt swaps for health research in Mexico.

Two swaps, one utilizing funds from the Rockefeller Foundation, and the other making use of funds from the MacArthur Foundation, were arranged by Drs. Sunil Chacko, David Bell, Lincoln Chen and Adolfo Martinez-Palomo. The Mexican Health Foundation, led by Dr. Guillermo Soberon, a former Minister of Health, acted as an intermediary organization in both the swaps.

Utilizing \$ 700,000, the swaps yielded an extra benefit of the equivalent of \$ 400,000 for health research in Mexico.

What are debt swaps? Debt swaps for social purposes are essentially conversions of foreign debts of developing countries to local currency earmarked for specific purposes such as health, education or the environment.

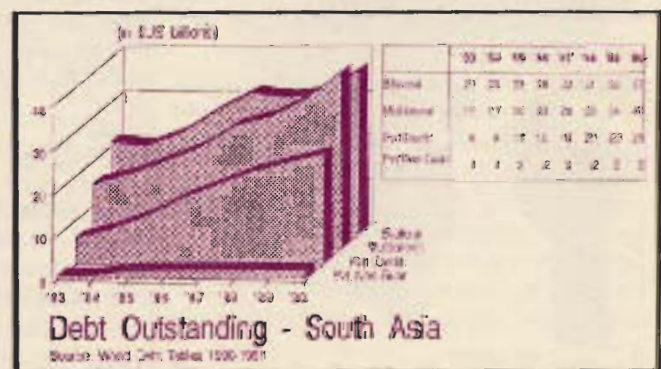
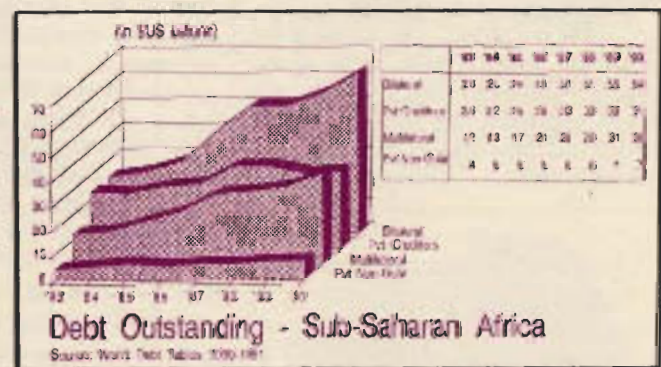
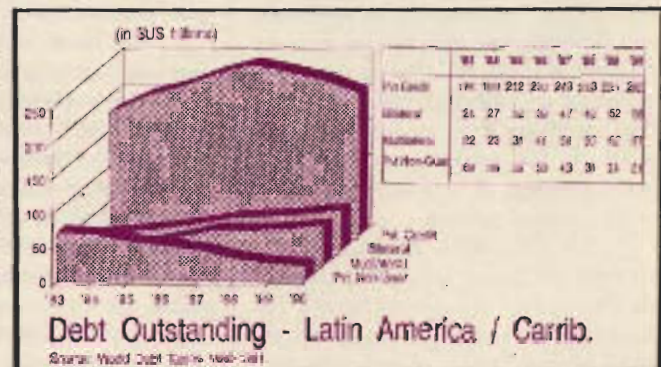
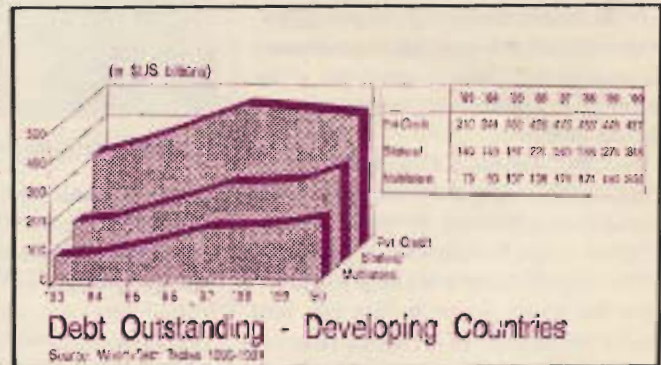
An NGO or any other agency that has foreign currency to contribute to social sector work in the debtor nation purchases commercial bank debt at discounted secondary-market prices

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and converts it to local currency through the central bank of the debtor nation. The local currency is then used for pre-arranged social purposes, helping the developing country in eliminating foreign debt without having to spend its own scarce foreign exchange.

The local currency may be used for direct operating expenses, or may in whole or in part be capitalized and the resulting flow of income used for operating expenses. Less commonly, commercial banks holding external debt may simply donate it, eliminating the need for purchasing the debt with foreign currency.

At present, only commercial bank debt is being sold in the secondary market. Ten percent of some government-to-government debt has become available for conversion to local currency investments in the social sectors as part of the "Paris Club Initiative." The Paris Club links industrialized lender countries. As part of its September 1990 initiative, 10 percent of government-to-government debt of some countries is available for conversion to local currency in debt-swaps for social purposes. Each project is to be worked out bilaterally between ministries of finance.



International Symposium on Debt-Swaps

Debt-swaps are an effective means of enhancing scarce resources in the social sectors in the third world, according to bankers and experts from international multilateral donor agencies.

Participating in an international symposium on debt-swaps in August this year at Cambridge, Massachusetts, these experts said that the benefits from debt-swaps were only in part financial. There are far greater benefits. For instance, they effect changes in the modalities of provision of support, especially the creation of local currency endowments that generate a steady stream of resources into the future, thus protecting the social sectors from the vagaries of government and donor funding, besides strengthening innovative non-governmental organizations.

The symposium, organized by the Task Force on Debt-Swaps, was co-chaired

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by Dr. Saburo Okita, former Japanese Foreign Minister, and Prof. David Bell, former Director of the U.S. Bureau of the Budget and former Administrator of USAID.

According to Dr. Okita, the total amount of debt swapped as at the end of 1990 was \$ 330 million, which he described as "rather small" compared to the total accumulated debt in developing countries. Citing the case of Bank of Tokyo, which has swapped debt in the Philippines and in some Latin American countries, Dr. Okita said he hoped that other Japanese banks would participate in the program as well.

Several participants said there was repeated evidence that debt-swaps helped

to build local competence in organizations for thinking through questions of financing and sustainability of programs benefiting critical areas in national development. "What we have learned in mobilizing flows of funds through debt-swaps, we can use to mobilize other funding flows as well, and for such reasons too, debt-swaps are well worth pursuing," they said.

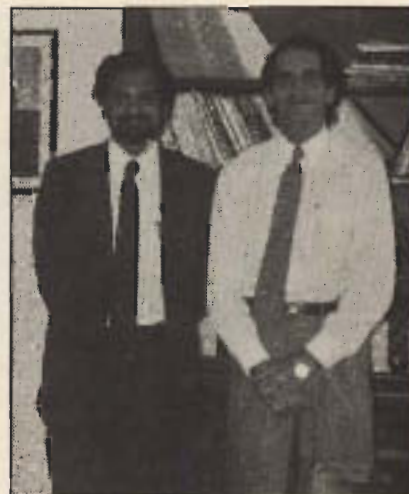
Dr. Joseph Cook of the Edna McConnell Clark Foundation said that by guaranteeing more local resources for an external donation, debt-swaps provide an extra incentive to donors seeking to make grants to developing countries. The amounts involved in social sector debts are so small as to have almost no impact on inflation or exchange rates.

There was wide agreement, based on the strong evidence presented and the analytical work undertaken, that debt swaps, if managed well, are a very positive means of strengthening weak social sectors in developing countries.

Drs. Lincoln Chen and Sunil Chacko of the Harvard Center for Population and Development Studies said that rising social sector needs stemmed from an annual increase of 93 million in the world's population, now totalling about 5.2 billion, and that this increase was taking place mostly in the developing countries. Hence, the funding needs of the social sectors, including population programs, are rising rapidly. With a billion people, mostly in the developing world, living on the equivalent of just one U.S. dollar per day, there is great need for enhanced support for third world development.

Mr. Sergio Fadl, Director-General in the Mexican Finance Ministry, and Dr. Guillermo Soberon, President of the Mexican Health Foundation, welcomed the group's recommendation that information on the successful Mexican experience with debt-swaps be communicated to a wider audience.

The group urged the Organization for Economic Cooperation and Development (OECD) and developing countries



The author (left) with Mr. Sergio Fadl, Director General, Mexican Ministry of Finance

to involve non-governmental organizations in all stages in the initiative, and not restrict it merely to officials in the ministries of finance. It was recommended that a "debt-for-social purpose" component be included in each LDC's country-debt financing package under the Brady Initiative.

The symposium participants appealed to the governments of Japan, the European countries, and the U.S. to provide more tax incentives to commercial banks to donate debt for social purpose swaps. The Bank of America, the Bank of Tokyo and the Deutsche Bank are some banks that have donated debt so far.

Secondary market prices of developing country debt are a reflection of the state of their economies. As the economies improve, the financial benefits of engaging in debt-swaps decrease. However, the other benefits such as the steady stream of resource that can be ensured through the creation of local currency endowments in developing countries can continue even if prices of debt rise significantly. The participants urged a rapid response by the private donor community to seize the significant opportunity afforded by debt-swaps for social development accompanying the debt crisis in the Third World.

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