Debt-for-AIDS swaps

A UNAIDS Policy Information Brief

Joint United Nations Programme on HIV/AIDS

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This paper was prepared by Stefan de Vylder, PhD in Economics,
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Contents

Acronyms

CI	Conservation International
ECLAC	Economic Commission for Latin America and the Caribbean
EURODAD	European Network on Debt and Development
GFATM	Global Fund to Fight AIDS, Tuberculosis and Malaria
MDG	Millennium Development Goal
NGO	Nongovernmental organization
OECD	Organisation for Economic Cooperation and Development
ODA	Official development assistance
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund

Preface

"The HIV/AIDS challenge cannot be met without new, additional and sustained resources," states the Declaration of Commitment on HIV/AIDS, adopted in June 2001 by all United Nations Member States. To help meet this challenge, the Declaration calls for "speedy and concerted action to address effectively the debt problems" and, more specifically, refers to "debt swaps for projects aimed at the prevention, care and treatment of HIV/AIDS".

Debt swaps exchange debt for some other asset or obligation. In the context of development, they normally involve countries negotiating cancellation of external debts in return for commitments on internal resource mobilization or some other government action. There has been considerable international interest in debt swaps and their potential to create a new and additional financing mechanism to help overcome long-standing barriers to development.

The impact of AIDS on many developing countries, including many of the most indebted, has been severe. In the worst cases, AIDS has caused development progress to be set back by decades. There is therefore emerging interest in examining whether debt swaps are potentially useful new instruments to apply to the problem of AIDS and development.

This policy information brief on debt-for-AIDS swaps is intended to provide further insights into debt swaps, along with examples of their use in the context of development projects, and their relative strengths and weaknesses as instruments for financing the scaling-up of HIV/AIDS programmes.

Department of Social Mobilization and Information
UNAIDS

Introduction

In many of the poorest countries in the world (in particular, in sub-Saharan Africa), there are two major obstacles to the realization of the Millennium Development Goals (MDGs): the HIV/AIDS epidemic and the debt crisis.

The two crises are mutually reinforcing, thereby creating a vicious circle. AIDS causes poverty and, without progress in the fight against HIV/AIDS, all MDGs, including the overriding goal of reducing poverty by 50% by the year 2015, will be impossible to reach in the worst-affected countries. But poverty, aggravated by the continuing need to channel scarce resources to meet the highly indebted countries´ debt-service obligations, also contributes to the spread of HIV, and makes it more difficult to finance and implement coherent national HIV/AIDS strategies.

It has long been recognized that debt relief, not least under the enhanced HIPC initiative[1], could release funds that could be used to scale up HIV/AIDS programmes by earmarking savings to finance the fight against the devastating epidemic. A 'win-win' strategy against the twin crises could thereby be designed, helping AIDS and debt-stricken countries to address two major development obstacles at the same time.

A toolkit for mainstreaming AIDS into poverty reduction and debt relief has been developed by UNAIDS, in cooperation with the World Bank (UNAIDS/The World Bank, 2001). The purpose of the present paper is more limited in scope: to discuss, against the background of the AIDS and debt crises indicated above, the pros and cons of one particular instrument for debt relief, so-called 'debt swaps', in order to finance a necessary expansion of HIV/AIDS programmes. The use of the debt-for-AIDS-swap mechanism in order to scale up the response to HIV/AIDS has sometimes been suggested by policy-makers, and it is also mentioned in the Declaration of Commitment on HIV/AIDS, unanimously adopted in June 2001 by 189 UN Member States.

This paper is meant to be an introduction to some key policy issues and does not attempt to provide comprehensive information about technicalities related to debt swaps. The specialized literature about debt management and debt-conversion schemes is full of highly technical terms and acronyms that are largely omitted in the present paper, and the interested reader is referred to the many handbooks, manuals and academic studies that have been produced over the past decades[2].

The paper begins with a brief, conceptual overview of various categories of swaps. The second part of the paper is a discussion of advantages and disadvantages with regard to swaps in general, followed by a concluding chapter about the relevance of swaps in the specific context of combating HIV/AIDS.

1. Definitions and categories of swaps

A debt swap can be defined as the cancellation of debt in exchange for something else. Formulated in slightly more technical terms, "A debt swap involves the voluntary exchange, by a creditor with its debtor, of debt for cash,

[1] The HIPC (Highly Indebted Poor Countries) initiative was launched by the World Bank and the IMF and agreed to by governments around the world in 1996. HIPC represents a coordinated approach among official creditors to bring down the external debt of low-income countries to sustainable levels.

[2] See Griffith-Jones and Mistry (1994) for an early and still very useful analysis of basic principles. Kaiser and Lambert (1996), Mercado (2003), Moye (2001) and UNAIDS/The World Bank (2001) are valuable and more practically-oriented overviews.

another asset or a new obligation with different repayment terms" (Moye, 2001, p. 1). Or, according to a definition used by UNDP, "A debt swap (or debt conversion) is defined as the cancellation of external debt in exchange for the debtor government's commitment to mobilize domestic resources (local currency or another asset) for an agreed purpose" (quoted in Mercado 2003, p. 3).

The rationale for such swaps is that the debt can be acquired at a discount. The creditor (whether it is a private company, a foreign bank, a foreign government or an international financial institution) does not expect to recover the full nominal value of the loan, and is therefore willing to accept less. The debtor, on the other hand, is prepared to give something in return for the cancellation of the debt in question.

If the debt is private, the debt can, in many cases, be purchased on the secondary market for non-performing debts that has developed for certain loans and debtor countries. If the debt is public—i.e., the creditor is a government or public institution—the price will have to be negotiated. The transactions involved in different kinds of debt-conversion schemes will be further discussed below.

The amount of local currency—normally in the form of cash or bonds—that the debtor country is willing to provide in exchange for the hard currency debt that is cancelled, is called the redemption price.

The redemption price typically falls somewhere in between the face value of the debt and the price of the debt on an actual or hypothetical secondary market for non-performing debts.

The proceeds in local currency from the debt-conversion can be managed in a number of different ways, depending on the nature of the swap.

A distinction is often made between public swaps (in which the parties are governments and where only bilateral or multilateral debt is being converted) and private swaps, which typically involve a private creditor and an international NGO. Naturally, other combinations—for example, an official government debt that is swapped for local currency with an NGO or UN organization implementing concrete projects in the debtor country—are also possible.

1.1 Debt-for-equity swaps

The quantitatively most important form of debt conversion since the outbreak of the debt crisis in the early 1980s has been the so-called 'debt-for-equity swap' in which a private, profit-seeking investor buys the debt on the secondary market or from a bilateral export credit agency. The debtor government then redeems the debt at a negotiated value in local currency (or domestic bonds), which is then used to invest in equity. The investor thus exchanges the country's foreign debt for ownership of some assets, with the expectation of a financial return on the assets thus acquired.

Beginning with a pioneering programme in Chile in 1985, debt-for-equity schemes rose to importance in the late 1980s and early 1990s when a number of countries (primarily middle-income countries in Latin America) used this instrument to reduce the value of their foreign debts. The debt-for-equity schemes often formed part of privatization programmes in countries such as Argentina, Chile, Mexico and the Philippines. Between 1985 and 1996, when debt-for-equity schemes began to lose their attractiveness, an estimated US$38 billion of nominal debt was swapped through various debt-for-equity schemes.

Today, as privatization programmes have lost momentum in the majority of middle-income countries, the volume of debt-for-equity swaps has been drastically reduced, and many countries have scaled down or terminated their swap programmes. The investors have also lost much of their initial interest as the debt situation has stabilized in a majority of middle-income countries, making prices on the secondary market [where such a market still exists] increase to levels that make swaps less interesting for the investor. Today, debt-for-equity swaps amount to just a small fraction of their value during the peak years but the situation may, of course, change, especially in countries where the debt situation deteriorates and the volume of non-performing debt is large.

1.2 Debt buy-backs

There is a special form of development aid through debt conversion whereby aid funds are used by the debtor country to buy back its own debt. In the 1980s, for example, a number of foreign donors agreed to help Bolivia to ease its debt situation by financing a buy-back—at 11% of the nominal value of the debt—of a large part of her commercial debt in hard currency (which Bolivia was no longer servicing). The debt that was purchased was handed over to the Bolivian Government—i.e., cancelled—but, as always in debt-swap schemes, no fresh funds were transferred to Bolivia. The real value of the aid given was the reduction achieved in future debt-service obligations and the improvement in the overall prospects for the Bolivian economy as a result of the 'cleaning' of the country from a considerable part of its old debt.

Example of debt-for-equity swap

Morocco is one of a few countries that operated a debt-for-equity programme after 1995. Although a debt-for-equity swap was first introduced in 1993 for the conversion of rescheduled debt owed to commercial banks, rising secondary market price for Morocco's debt limited the attractiveness of the initial programme.

In 1996, the Moroccan Government launched an offer to potential foreign investors for a debt-for-equity swap programme to convert FFr600 million face value of debt owed by the Moroccan Government to the French Government. A similar programme was subsequently established for debt owed to Spain.

The objective of the programme was to contribute to Moroccan economic development through increased French investment in Morocco. Eligible investments included capital investment to finance a new project, an existing project or purchase equity shares in Moroccan companies. The Moroccan Government evaluated investment proposals based on their contribution to job creation, local expenditures and exports.

The programme was reserved for foreigners and Moroccans residing overseas. While the investment proposal to the Moroccan Government required that the investor indicate the redemption price in Moroccan currency, the French Government required the investor to submit an offer indicating a purchase price and including a letter from the Moroccan Government approving the investment. The French Treasury then accepted the highest bids from eligible investors. The Moroccan Government is reported to have been pleased with the range of investment proposals generated by the programme.

Source: Moye (2001, p. 11).

In the present context, we will disregard all purely commercial swaps and limit our discussion to 'debt-for-development', or 'debt-for-aid', swaps in which the party financing the purchase of all or part of a debt sees the swap as a form of development assistance. This modality of swaps refers to a situation in which a developing country swaps a foreign debt in hard currency in exchange for a commitment by the debtor government to mobilize domestic resources, usually in the form of local currency, for an agreed purpose.

Debt buy-backs are examples of bilateral debt-reduction programmes—i.e., the transaction is negotiated between two governments or, as is often the case, between one debtor government and various governments and aid agencies in the creditor countries.

While debt buy-back schemes can be of considerable value for countries wishing to get rid of their 'debt overhang' and return to a normal situation as regards access to international capital markets, they are of limited relevance if the purpose of the swap is to increase funding to a specific priority area—in this case, combating HIV/AIDS.

Example of debt-for-nature swap

The first debt-for-nature swap was pioneered by a US biodiversity conservation organization, Conservation International (CI). In 1987, CI purchased a US$650,000 Bolivian debt from Citibank for US$100,000 (15% of face value), using a grant from a US foundation. In return for CI's retiring this debt, the Bolivian Government agreed to establish a local endowment account for the equivalent of US$250,000 in Bolivian currency (38%) to be used for managing the Beni Biosphere Reserve. The swap agreement also included a commitment by the Bolivian Government to introduce a policy reform aimed at strengthening the legal basis for national park protection in Bolivia.

Subsequent debt-for-nature swaps have typically included a debtor country NGO as one of the parties in the transaction.

Source: Rosen et al. (1999)

1.3 Debt-for-nature swaps

The first debt-for-development swaps in which funds were mobilized for a particular purpose were the 'debt-for-nature' swaps that gained some prominence in the latter half of the 1980s, and which are still carried out in a number of countries.

Typically, the agreements are made between at least three parties: the creditor (usually a foreign bank), the debtor country government, and an international development organization (an NGO working with environmental protection, or a UN agency). A fourth party that is usually involved is a developed-country government or international organization providing the funds.

The control over the counterpart funds in local currency generated by the swap could rest with either a domestic NGO, usually collaborating with an international NGO, a bilateral aid agency or a UN organization, or with an appropriate public institution, such as a national conservation authority, or with a new institution—a counterpart fund, or trust fund—with a board composed of majors stakeholders.

1.4 Debt-for-development swaps

Stimulated by the apparent success of environmental organizations in mobilizing additional resources through debt-for-nature swaps, a large number of NGOs, academic institutions and other non-profit organizations became actively involved in debt-for-development swaps under different names: debt-for-education swaps, debt-for-health swaps, debt-for-child-survival swaps, etc. Most of the actors have been international NGOs with funds of their own or with support from various bilateral and/or private donors. By the early 1990s, the majority of bilateral donors had developed criteria and guidelines for debt-reduction facilities, which included debt-conversion schemes of different kinds.

Various UN organizations also became involved in debt-for-development swaps, either to mobilize funds to finance their own programmes or as advisors/coordinators (UNICEF, UNDP, the World Bank, and others).

Examples of debt-for-development swaps

Between 1989 and 1994, UNICEF facilitated 14 different debt-for-child swaps by retiring US$193 million of debt at a cost of US$25 million. The swaps generated the equivalent of US$48 million of project funds that were used locally in a number of developing countries. These swaps were financed in addition to regular country programmes, through special fundraising campaigns.

In order to enhance sustainability, the projects chosen had a high local-cost content and a relatively short life span (three-to-four years) in order to guard against inflation or currency devaluation.

The UNICEF swap programme was terminated in 1995, reportedly because of the UNICEF headquarters' wish to maintain a stricter control over the funds raised by local UNICEF committees.

Source: ECLAC/UNDP 2003 and Moye (2001)

2. Can all debts be swapped?

2.1 Private commercial debt

All private debts can, in principle, be swapped, if the creditor and debtor agree. As soon as the creditor (typically a financial institution) realizes that it cannot expect to recover a particular debt, it may be willing to sell it below face value.

While the secondary market for non-performing debt is very thin today, with few buyers, sellers and transactions, any private creditor can be approached on an individual basis.

Most industrialized countries have today introduced legislation that provides a number of tax provisions in order to make it more attractive for private creditors to write off non-performing developing-world debt that is swapped. In some cases, commercial banks have even (largely for publicity reasons) accepted zero payment for credits swapped for development purposes.

2.2 Official bilateral debt

These claims usually result from soft development loans or, even more important today, from export credits extended or guaranteed by government export credit agencies.

All such debt can be subject to swaps. On the creditor side, it is a matter of political will to write off developing-country debt in the form of swaps or other kinds of debt relief.

Debt swaps account for only a minor share of all debt relief granted to developing countries, compared to the debt reductions continuously being agreed upon within the framework of the Paris Club agreements or under the HIPC programme. From the debtor country's perspective, debt swaps (which virtually always imply some conditions imposed on the country) are often seen as less attractive than other forms of debt relief whereby donor conditionality is either absent or attached to sometimes rather vague policy conditions (in the past, policy conditions associated with structural adjustment programmes; today, normally linked to the formulation of a poverty-reduction strategy approved by the World Bank).

2.3 Multilateral debt

Traditionally, multilateral debt has not been available for debt relief, including debt-for-development swaps. The status of 'preferred creditors' enjoyed by the Bretton Woods institutions and by regional development banks used to preclude the possibility of writing off such debt. The international financial institutions have, however, a long tradition of encouraging debt relief for commercial and bilateral debt and, through the World Bank's soft loan windows, the World Bank has provided its own funds for various debt buy-back schemes.

With the enhanced HIPC initiative, launched in 1999, new possibilities for writing off multilateral debt have been opened (for a discussion about AIDS, debt relief and HIPC, see, for example, UNAIDS/World Bank 2001). The modalities are, however, different from what is normally called debt conversion or debt swap, although it could be argued that multilateral and bilateral debt relief under HIPC represents a special kind of swap—namely an exchange of debt for policy conditionality.

Table 1 (largely taken from Rosen et al., 1999) summarizes the above-mentioned discussion about different kinds of swaps.

Table 1. Characteristics of private and public debt swaps

Characteristic	Typical private swap	Typical public swap
Parties to the transaction	A creditor country NGO, a debtor country NGO, a debtor country public institution (Finance Ministry, Central Bank)	The debtor and creditor country governments
Eligibility of debtor country	Creditor country NGO identifies countries and activities of special interest (e.g., conservation, health)	Creditor country sets criteria for participation (e.g., agreement with the Bretton Woods institutions)
Amount of debt converted	Generally small	Generally much larger
Recipient of funds in local currency	NGO or a counterpart fund/trust fund	A counterpart fund or public institution (e.g., Ministry of Health)
Oversight of fund use	International and domestic NGO	A board comprised of debtor and creditor country representatives
Debt-relief process	All debt is cancelled immediately as part of the initial transaction	Debt is cancelled gradually, based on debtor country's fulfilment of obligations
Source of hard currency funds	Funds raised by creditor country NGO or donation by commercial creditor	Budget of creditor country

Naturally, a UN organization such as UNICEF or UNAIDS can also be involved in both public and private swaps through, for example, participation in project implementation, representation on boards of trust funds or by providing technical assistance.

3. Potential advantages of swaps

3.1 Advantages for the debtor country

The country's total debt in hard currency is reduced, as are its future debt service obligations in hard currency. The impact on the country's balance of payments situation is positive.

Depending on the overall debt situation and the volume of debt swaps, swaps may reduce the country's 'debt overhang' and improve its standing in international financial markets.

The existence of debt-for-development schemes in a particular country can help to mobilize additional funds in the form of matching contributions from a wide variety of multilateral, bilateral and private sources. For example, many international NGOs—in particular, conservation organizations—have been quite successful in attracting extra funds, thanks to their debt-for-nature conversion schemes, and even some private creditors have made important contributions (largely for goodwill reasons) by donating part of their debt as a contribution to debt-for-development swaps.

A greater participation from civil society, which has been a condition in many debt-for-development swaps, has sometimes been achieved as a result of debt-for-development agreements.

3.2 Advantages for the creditor

For a commercial creditor, the possibility of a swap transaction makes it possible to recover at least part of its non-performing loan, and the intervention by aid donors to finance debt-conversion schemes actually increases all creditors' chances of recovering their loans. In some countries in Latin America, where debt buy-backs and debt swaps in the late 1980s and early 1990s were of more than marginal importance, debt prices on the secondary market increased substantially as a result of debt swaps.

If the creditor is a government, multilateral organization or bilateral aid agency, debt swaps can make it possible for the creditor and/or donor to condition the use of the funds that the debtor country saves through debt relief to particular areas and activities, such as child immunization, education, environmental conservation, or HIV/AIDS, to which the party representing the creditors accords higher priority than the debtor-country government. There is, however, no guarantee that earmarking actually increases the debtor country's total spending on the agreed-upon purpose, as the funds may simply replace ordinary budget expenditure for the same purpose. If, say, a sum of 1 million in local currency is mobilized through a swap and earmarked for HIV/AIDS control, the debtor government may reduce planned expenditure on HIV/AIDS by the same amount, thereby releasing resources for an entirely different purpose[3].

Debt relief, however granted, never represents an actual transfer of funds to the debtor country. Aid agencies in the rich countries can therefore use debt relief to inflate their spending on official development assistance (ODA) without any immediate cost to the state budget.

[3] This is the well-known phenomenon of the high degree of fungibility of foreign aid.

In particular, it should be observed that the OECD countries normally report the full value of non-performing debt that is forgiven as ODA. If, for example, a state-owned export credit agency has an outstanding, non-performing loan to a country that cannot be expected to service its debt in the foreseeable future, the cancellation of this debt represents a very small sacrifice for the creditor country; if sold on a secondary market for developing-world debt, the actual price might be less than 10% of the nominal value. In the actual reporting of ODA to OECD's Development Assistance Committee, however, the face value of the debt cancelled is registered as ODA, and the country's generosity is grossly exaggerated.

3.3 Advantages for non-profit development organizations

The most obvious advantage is the discount received or, formulated in another way, the mobilization of additional resources made possible. If a hard currency debt of 100 is acquired—by an NGO, say, or by UNAIDS—at a price of 20 and converted to local currency at a redemption price of 50, the organization in question can increase its funding of local costs by 250%, compared to a situation in which a donation in hard currency has to be exchanged without the swap discount.

The fact that local funds are earmarked for a particular purpose makes it possible for the non-profit organization to exert more influence over priorities in the debtor country. Again, while the *economic* rationale for the non-profit organization benefiting from the swap is to mobilize resources at a discount, the *political* rationale is to obtain resources in areas that are not included in government priorities.

The latter point is important and valid whether the debtor country organization is an NGO or a bilateral or multilateral aid agency. If expenditure priorities between the debtor country and the external party financing the swap were identical, there would be no reason to earmark funds in the form of 'debt-for-nature swaps' or 'debt-for-AIDS swaps'. The swap could simply take the form of debt relief with no conditionalities attached.

4. Potential disadvantages and problems

Swaps can be cumbersome, time-consuming and expensive to implement. There is usually a need to seek professional advice for the legal aspects of the deal, and transaction costs in a broad sense (time spent on identifying sellers and suitable projects, negotiations with all concerned parties, legal fees, the setting-up of suitable decision-making structures for the use of local counterpart funds, etc.) can be rather high.

Negotiations can be complicated. There are often a number of different actors, with different objectives, involved. On the debtor-country side, those involved may include, for example, the Finance Ministry, the Central Bank and/or a specialized debt-management institution, line ministries, NGOs, a special trust fund entrusted to manage the counterpart fund established as a result of the swap, and others. On the creditor/donor side, there can also be a number of stakeholders involved: a public or commercial creditor whose debt is being swapped, an aid agency financing the swap, an NGO or other non-profit organization responsible for project implementation, etc.

Given the number of stakeholders involved in many swap arrangements, there are a number of things that can go wrong.

Appendix 1 is a brief checklist, taken from a toolkit elaborated by UNDP, indicating the different steps that typically need to be taken in a debt-for-development swap.

Another drawback (common also in other modalities for foreign development assistance) is the danger of by-passing normal national budgetary procedures through the creation of a number of project 'islands' lying outside normal budgetary routines and control. This potential drawback can, of course, be avoided through a proper integration of all swap-financed programmes and projects into the national budget, but both the macroeconomic context and administrative procedures tend to be 'messier' in precisely those countries that are most attractive for debt swaps (all countries where debt-conversion schemes make sense are characterized by a debt crisis, expressed in non-performing loans that can be swapped at a discount, and the more difficult the external balance the larger the discount).

A somewhat related problem is corruption. Debt-conversion schemes are not, by definition, more prone to misappropriation of funds than other aid-financed activities, of course, but the somewhat ad hoc creation of new institutions that has sometimes accompanied the establishment of boards overseeing the use of counterpart funds has not always been conducive to transparency and accountability, and a common complaint in the literature on debt swaps is that procedures for reporting, monitoring and evaluation have been highly unsatisfactory.

4.1 Potential drawbacks for the debtor country

A swap is essentially the elimination of a foreign obligation in exchange for a domestic obligation, usually in the form of higher spending for a particular purpose. The external debt is reduced, but at the expense of increased expenditure in domestic currency, which, depending on a number of factors such as the redemption price, the exchange rate, the rate of inflation and others, may lead to higher inflation and/or a rising domestic debt.

Starting in the late 1980s, when the fight against inflation became an important objective of economic policies in Latin America, the potentially harmful macroeconomic effects of a large number of swap-financed activities were often mentioned in those Latin American countries where debt swaps had reached a considerable volume.

If the obligation is primarily a policy commitment, the swap entails a loss of national sovereignty in the sense that external conditions are imposed on the country. Or, as formulated by van Kesteren, referring to aid-financed swaps of public debt, "What the donor country basically acquires in return [...] is the authority to take decisions over a part of the debtor state's budget" (1994, p. 247). This threat to national sovereignty (although usually of small significance compared with policy conditionality from other actors, such as the Bretton Woods institutions and bilateral donors) has often been used by opponents of swaps, who have sometimes characterized debt swaps as a form of imperialism or neo-colonialism.

As emphasized earlier, a swap entails no transfer of liquid funds. If asked to choose between, say, a gift of US$100 million in hard currency and the same amount of nominal debt relief in one form or another, developing countries would probably prefer a gift in cash (which, of course, could be used for debt-service payments, if the country so decided).

By and large, debt-conversion funds compete with other forms of development aid. When swaps and other modalities of debt relief are reported as ODA, as is usually the case, they rarely represent *additional* development aid; the funds used are simply taken from the regular aid budget and become a bookkeeping exercise in the rich country's state budget rather than a genuine transfer of resources.

In some cases, debt relief of various kinds can be regarded as a transfer of public ODA funds to private creditors. Aid budgets can be used to 'bail out' commercial creditors or export credit agencies by granting excessive compensation for losses the creditors have incurred as a consequence of irresponsible lending to countries that are unable to meet their obligations. All kinds of debt relief thus introduce an element of moral hazard by giving incentives to exaggerate lending to countries and activities that lack creditworthiness.

For low-income countries eligible for debt relief under the HIPC initiative, debt swaps appear as a less attractive alternative than in the past; there is little margin for converting debt if up to 90% of a country's bilateral and multilateral debt can be reduced without any need to mobilize local counterpart funds.

5. Debt-for-AIDS swaps; potential strengths and weaknesses

5.1 Debt relief as an instrument for financing a scaling-up of HIV/AIDS programmes

There can be no doubt about the vital need to mobilize resources to combat HIV/AIDS. In a number of countries—primarily, but not exclusively, in sub-Saharan Africa—there is no problem more urgent than that of controlling the spread of HIV.

Debt relief in various forms can make a substantial contribution by allowing debt-stricken low-income countries to scale up their existing programmes to combat HIV/AIDS. In a number of countries, per capita funding for HIV/AIDS is US$1 per year, and sometimes even less. This represents, in the heavily indebted countries, only a small fraction of per capita debt service payments each year, and potential savings from debt relief, not least through the HIPC programme, often amount to many times the actual spending on HIV/AIDS programmes.

The 26 countries (most of which are low-income countries severely affected by HIV/AIDS) that have entered the HIPC programme—i.e., they had reached their so-called decision point (by March 2003), have already received debt relief that amounts to more than US$40 billion over time, and are saving around US$1.3 billion a year because of lower debt servicing costs (World Bank, HIPC Fact Sheet, March 2003). By comparison, rough estimates of current international flows to combat HIV/AIDS compared with funding requirements for key interventions[4] indicate that, in 2003, total aid-financed disbursements for HIV/AIDS amounted to around US$2.6 billion, compared with requirements of over US$6 billion, of which perhaps half represents requirements in the HIPC countries[5]. According to UNAIDS estimates, global funding needs are estimated to reach US$15 billion by the year 2007.

It is therefore clear that, while debt relief can make substantial contributions to the scaling-up of HIV/AIDS programmes at the country level, the debt relief envisaged under HIPC cannot alone finance all necessary interventions in the worst-affected countries. The HIPC process does, however, offer not only debt relief, but also excellent opportunities to influence the debtor countries in the policy dialogue so that they give more priority to HIV/AIDS control and channel increasing resources, including savings in debt service obligations, into the fight against HIV/AIDS[6].

In most non-HIPC developing countries where the HIV/AIDS epidemic calls for large

[4] Funding requirements for different types of key interventions are taken from UNAIDS (December 2002).

[5] Figures taken from UNAIDS (December 2002) and UNAIDS (June 2003). Rounded figures.

[6] See UNAIDS/The World Bank (2001) for an interesting discussion.

increases in spending, such as China, India and South Africa, the foreign debt situation is not alarming, and debt relief and debt swaps are not, as yet, on the agenda. By and large, these countries can also afford to finance their own HIV/AIDS programmes; what is lacking is often not the financial resources but the political will to tackle the problem.

In another group of countries with mounting HIV/AIDS problems, such as several of the new republics in Central Asia, debt relief is already, or will become, necessary, but probably largely outside the HIPC initiative. Given the rapidly deteriorating economic, health and HIV/AIDS situation in many of these countries, debt-for-development, including debt-for-AIDS swaps have undoubtedly a significant, but so far under-utilized, potential.

In most middle-income countries, funding requirements for HIV/AIDS are smaller than in sub-Saharan Africa, and the countries' possibilities of meeting their needs are obviously better.

In middle-income countries, the use of various debt-conversion schemes has also, as mentioned earlier, been reduced substantially since the peak years in the early 1990s. One reason for the decline is that the arguments against debt swaps—loss of national sovereignty, danger of inflationary pressures and/or increased domestic indebtedness, high transaction costs, weak monitoring and control over the use of counterpart funds, among others—have gained strength, not least in Latin America. Another, even more important reason for the decline in swap transactions is the fact that the debt situation has stabilized compared with the crisis years of the late 1980s and early 1990s, implying that the secondary market for many of these countries' foreign debt has been reduced or even disappeared, thereby eliminating the discount enjoyed by the foreign party engaging in debt swaps.

In several other middle-income countries where the debt crisis has not been overcome, governments are today looking for solutions other than debt swaps. Argentina, for example, with a foreign debt of around US$160 billion, has chosen to default on a large part of its commercial debt as a way out of the debt crisis.

To summarize the above discussion, we may conclude that the relevance of debt-relief in order to scale up HIV/AIDS programmes is high in a number of countries and regions, primarily in sub-Saharan Africa and parts of the former Soviet Union. As to which kind of debt relief generates the largest savings, it appears as if HIPC and various bilateral debt relief schemes at present represent appreciably larger amounts of savings than current debt-conversion schemes, although there is a considerable potential to use this latter instrument—in particular, if additional funding from sources such as the new Global Fund to Fight AIDS, Tuberculosis and Malaria can be mobilized on a larger scale.

5.2 Qualitative aspects and concluding remarks

It must finally be emphasized that the qualitative aspects of debt-for-AIDS swaps may be considerable, and may reach beyond their quantitative magnitude.

Debt-conversion schemes can, as discussed earlier, assume many different forms depending on circumstances, and there is no simple blueprint that can be universally applied. In general, however, involvement from civil society is a key ingredient. Cooperation between international and domestic NGOs is common in debt-for-development swaps, and specialized UN agencies (such as UNICEF and UNAIDS) can play an essential role as catalytic fundraisers and by providing technical assistance.

Twinning arrangements have often proved to be highly successful in past swaps—for example, in debt-for-nature swaps when international conservation organizations have established cooperation with NGOs or public conservation agencies in developing countries. Similar forms of cooperation have also been established in the fight against HIV/AIDS, but funding is often a problem. Debt-for-AIDS swaps have a considerable potential to create publicity and raise general awareness of the need to join forces in the fight against the HIV/AIDS epidemic and, as in the case of debt-for-nature swaps, it ought to be possible to raise matching contributions to finance HIV/AIDS programmes from both official and private donors. In all likelihood, a number of private creditors, such as commercial banks, could be prepared to cancel, not least for goodwill reasons, some of their developing-country debt in exchange for HIV/AIDS programmes.

When the debtor government has developed its own coherent HIV/AIDS programme, funds generated by swaps can, of course, be channelled to support and scale up such programmes. In other situations, the development of innovative and replicable programmes and projects can be of great help in the policy dialogue with a government that is not wholly committed to the fight against HIV/AIDS, or that lacks the technical knowledge about what does and does not work.

As regards the potential risks and disadvantages of using debt conversion to finance particular HIV/AIDS programmes and activities, the aforementioned drawbacks associated with debt-for-development swaps are, in general, equally valid in the case of debt-for-AIDS swaps. Swaps offer no panacea, only an additional instrument that certain countries, in collaboration with creditors, international organizations and bilateral donors, can use as part of their overall debt and AIDS strategies.

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Appendix 1

Debt swaps, step by step

This appendix is, with only minor alterations, reproduced from Mercado/UNDP (2003). A number of useful suggestions related to the actual implementation of debt swaps can also be found in Kaiser and Lambert (1996), and Rosen et al. (1999).

Step 1. Assessment of level of interest and political support for debt swaps

- Prepare informative materials and presentations describing debt-swap mechanisms, including examples of their implementation in other countries
- Organize meetings with the Finance Ministry, the national debt-management agency, and relevant line Ministry to identify potential debt to be converted and possible beneficiary projects and executing agencies

Step 2. Conduct an independent technical feasibility assessment

- Assess such factors as:
  - external debt profile
  - debtor government policy
  - macroeconomic and political context
  - potential funding sources for swap
  - financial and design issues for swap
- Identify possible interested creditor/donors

Step 3. Organize meetings with one or more creditor (donor) governments to verify level of interest in debt swap

- Prepare informative materials, including examples
- Organize meetings with representatives of the Ministries of Finance and Development Cooperation locally and make contacts with their head offices
- Present possible projects to finance and possible executing agencies

Step 4. Creditor and debtor governments enter formal negotiations on debt-swap transaction

- Debtor government presents proposal. Issues to be discussed include, for example:
  - definition of the debt-payment mechanism to be used
  - amount of debt eligible for redemption
  - payment schedule
  - projects to be funded
  - financial structure for channelling debt-swap proceeds
  - supervision and evaluation of uses of funds

Step 5. Creditor and debtor governments negotiate final details and enter into a debt-conversion agreement

Step 6. Creditor and debtor implement financial transaction

- Debtor deposits local currency or bonds in an interest-bearing account.

Step 7. Monitoring the agreement

- Set up an oversight committee to monitor implementation of agreement and use of proceeds. This sometimes takes the form of a bilateral committee (e.g., trust fund), which meets periodically to make decisions on the use of funds and reviews the general progress of projects.

The Joint United Nations Programme on HIV/AIDS (UNAIDS) brings together nine UN agencies in a common effort to fight the epidemic: the United Nations Children's Fund (UNICEF), the World Food Programme (WFP), the United Nations Development Programme (UNDP), the United Nations Population Fund (UNFPA), the United Nations Office on Drugs and Crime (UNODC), the International Labour Organization (ILO), the United Nations Educational, Scientific and Cultural Organization (UNESCO), the World Health Organization (WHO), and the World Bank.

UNAIDS, as a cosponsored programme, unites the responses to the epidemic of its nine cosponsoring organizations and supplements these efforts with special initiatives. Its purpose is to lead and assist an expansion of the international response to HIV/AIDS on all fronts. UNAIDS works with a broad range of partners – governmental and nongovernmental, business, scientific and lay – to share knowledge, skills and best practices across boundaries.

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Debt-for-AIDS swaps

A UNAIDS Policy Information Brief

In an effort to mobilize additional and sustained resources to meet the HIV/AIDS challenge in developing countries, the Declaration of Commitment on HIV/AIDS (unanimously adopted by the United Nations General Assembly in June 2001) calls for "…speedy and concerted action to address effectively the debt problems" and, more specifically, to create debt-relief mechanisms "such as debt swaps for projects aimed at the prevention, care and treatment of HIV/AIDS".

This policy information brief on debt-for-AIDS swaps provides an introduction to debt swaps, together with examples of their use in development projects and their relative strengths and weaknesses as instruments for financing the scaling-up of HIV/AIDS programmes.

Joint United Nations Programme on HIV/AIDS

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