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COMMENT

DEBT FOR NATURE SWAPS: AN INCREASINGLY ATTRACTIVE SOLUTION TO A PRESSING GLOBAL PROBLEM

INTRODUCTION

The tropical rain forests¹ are a crucial element in the world's delicate ecological balance. The ongoing studies of the organisms they contain indicate that the rain forests constitute an extensive reserve of plant and animal species with high potential value to mankind. The rain forests also play an important part in maintaining the water and atmospheric gas cycles that preserve the world climatic balances.

Nevertheless, the world's rain forests are being destroyed at a rapid pace by fire,² indiscriminate logging,³ and land clearing for agricultural purposes.⁴ This destruction has led to dramatic consequences, among which are the widespread elimination of plant and animal species,⁵ the lowering of river beds,⁶ soil impoverishment,⁷ and a worsening of the the "green house effect."⁸

¹ Tropical rain forests are closed-cover systems characterized by high quantities of nutrients locked in their biotic community as compared to the smaller quantities of nutrients found in their soil. Tropical rain forests also contain very high species diversity and relatively constant physical environmental conditions. See GOUDIE, *THE HUMAN IMPACT ON THE NATURAL ENVIRONMENT*, 292 (1986).

² See Stevens, *Research in "Virgin" Amazon Uncovers Complex Farming*, N.Y. Times, Apr. 3, 1990, at C12, col. 3.

³ *Id.*

⁴ *Id.*

⁵ Shabecoff, *Loss of Tropical Forests is Found Much Worse Than Was Thought*, N.Y. Times, June 8, 1990 at A1, col. 1.

⁶ World Resources Institute, *Tropical Forests: The Plan* at 7 (1985).

⁷ Bertrand, *Ecological Processes and Life Support Systems*, in *SUSTAINING DEVELOPMENT* 30 (Thibodeau & Field ed. 1984).

⁸ The "greenhouse effect" refers to the increasing concentrations of carbon dioxide

A complex array of local factors of varying significance in different countries combine to destroy rain forests. These factors include: unregulated commercial exploitation, social and political pressure on governments to clear land for agriculture, and failure to apply appropriate technologies that permit nondestructive use of natural resources.

Although individual instances of rain forest destruction may have local causes, the impetus for deforestation as a whole arises from international economic events. The economic development strategies of most Third World nations foresee rapid industrialization through substantial infusions of borrowed capital.⁹ When a borrowing nation lacks an internationally competitive industrial base, international lenders may expect loans to be repaid from accelerated exports of agricultural products and raw materials. Consequently, pressure builds to tap the wealth of the rain forest, mistakenly treated as inexhaustible.

The developing countries' extensive borrowing led to a more immediate, if not more dramatic, problem than global deforestation: the debt crisis. The debt crisis, a *de facto* recognition that sovereign borrowers were simply unable to service their foreign debt, resulted from a rapid deterioration of the developing countries' terms of trade.¹⁰ This started essentially as a borrower's problem, but it became a lender's crisis as it threatened the stability of the international financial system. Yet, a lender's options to resolve the crisis are considerably limited by the complexity and uncertainty of legal remedies for sovereign defaults.¹¹

and other gases that hold heat in the lower atmosphere, allowing temperatures to rise. See BROWN, STATE OF THE WORLD (1989). "The warming of the earth's climate is an environmental catastrophe on a new scale, with the potential to violently disrupt virtually every natural ecosystem and many of the structures and institutions that humanity has grown to depend on. . . . Conditions essential to life as we know it are now at risk." *Id.* at 8.

⁹ Escribde, *Les Jeux Sont Faits: Structural Origins of the International Debt Problem*, 25 VA. J. INT'L L. 281, 318 (1985).

¹⁰ "Terms of trade" refers to the acquisition power that a nation's exports yield as compared to the cost of a given package of imports. In the mid-1970s, the amount of industrial goods that developing countries could obtain for a given quantity of their commodities dropped dramatically; that is, their terms of trade placed them at great disadvantage vis-à-vis the industrialized countries. See MOFFAT, *ECONOMICS DICTIONARY* 299 (2d ed. 1983).

¹¹ See generally Note, *Default on Foreign Sovereign Debt: A Question for the*

Debt for nature exchanges are promising, though still unheralded,¹² banking transactions that seek to integrate a seemingly viable alternative to deforestation with a partial solution to the debt crisis. This comment describes the mechanisms of debt for nature exchanges and the benefits they bring to the various participants. It also identifies the requirements for their successful implementation and the prospects of their future expansion.

In seeking these limited objectives, Part I of this comment discusses the importance of the rain forest to the world's ecological balance; Part II discusses the magnitude of the ecological disaster that deforestation represents; Part III explores the links between the debt crisis and deforestation; Parts IV and V deal respectively with the scarcity of legal remedies for sovereign defaults and the viability of debt exchanges as an alternative non-legal solution; Part VI discusses the Costa Rican debt exchange program as a case model; and Part VII discusses the current support for debt for nature exchanges from the United States Congress and outlines some of the existing barriers to their further utilization. A better understanding of debt for nature exchanges, as well as the international context within which they have evolved, might contribute to their successful utilization and greater acceptance in the future.

I. THE IMPORTANCE OF THE RAIN FOREST

The tropical rain forests of the world comprise only about seven percent of its surface, yet they contain the largest known reserve of plant and animal species.¹³ The rain forests are home for ninety percent of the world's primates, eighty percent of the insects and over fifty percent of the plants.¹⁴ A typical four square-mile section of rain forest contains "1,500 species of flowering plants, 750 species of trees, 125 different mammals,

Courts?, 18 IND. L. REV. 959 (1985).

¹² Currently debt for nature exchanges amount to approximately \$100 million, or slightly less than .01 percent of a total Third World debt of \$1.2 trillion. For a break down of debt for nature transactions see Fuller, *Debt for Nature Swaps*, 23 ENVTL. SCI. TECHN. 1450 (1989) (Kathryn Fuller is president of the World Wildlife Fund (U.S.) and The Conservation Foundation).

¹³ Cerri, *La CEE en Croisade pour sauver les forêts tropicales*; Liberation (Paris), Aug. 17, 1989, at 6 (Paris, Fr.).

¹⁴ Jeffries, *Call of the Wild*, FAR E. ECON. REV., Jan. 19, 1989, at 38.

400 species of birds, 100 of reptiles, 60 of amphibians and 150 of butterflies."¹⁵ Life in the rain forests is so rich and diverse that "only a fraction [of rain forest resources] has ever been properly catalogued."¹⁶

The present and potential benefits that this vast cornucopia represents for mankind are, therefore, considerable. One fourth of all the drugs prescribed in the United States originate from rain forest plants.¹⁷ The forests' genetic pool may well contain hidden solutions to world hunger and cures to persistent diseases.¹⁸ However, virtually all large-scale commercial exploitation of the rain forests depletes their non-renewable resources.¹⁹ This trend may be reversed if, as demonstrated by organizations such as Cultural Survival,²⁰ sustainable forms of exploitation are

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* at 39.

¹⁸ Booth, *Study Offers Hope For Rain Forests*, Wash. Post, June 29, 1989, at A1, col. 1.

¹⁹ Sustainable forms of exploitation are those which "promote the maintenance and restoration of soils, vegetation, hydroelectrical cycles, wildlife, critical ecosystems, biological diversity and other natural resources essential to economic growth and human well-being. . . ." International Development and Finance Act of 1989, Pub. L. No. 101-1240, § 512 (b) (4), 1033 Stat. 2492 (codified as amended at 22 USC 2881).

²⁰ "Cultural Survival" is an organization affiliated with Harvard University that promotes rain forest products that can be commercially exploited without endangering the environment. The rationale behind this initiative is that hope for saving the rain forests lies not so much in forcing countries to halt exploitation of their natural resources, but in making renewable exploitation profitable. In the words of research director Jason Clay, "The idea is to stop saying no to everything in the Amazon and start offering a positive alternative." Christensen, *Saving Brazil's Rain Forests: New Products With a Cause*, San Francisco Chronicle, May 31, 1989, at C1.

Although many stumbling blocks make exports of renewable products from the rain forests a risky enterprise, marketing efforts in the last two years have brought some success. See McCabe, *Rain Forest Products, Growing Profits*, *ECONOMIST*, Sept. 9, 1989, at 15. One success story is the sale in New England of an ice cream ("Rain Forest Crunch") made with Brazilian wild nuts. Another is the sale by a British company of a line of cosmetics derived from rain forest plants. The latter includes lotions from fragrant roots, body oils from nuts, soaps from wild flowers, and a tanning agent extracted from red seeds used by Amazon Indians as body paint. In addition, there are plans of future promotion of rattan from Southeast Asia, vanilla from Madagascar, and medicinal extracts from most of the world's forests. See *Marketing the Rainforest, Renewable Products vs. Short Term Profits*, San Francisco Chronicle, Oct. 1, 1989, at 21. Support for renewable (i.e., "sustainable") exploitation of the rain forests has been given new impetus by a recent study that compares the market value of various renewable and non-renewable products. The study shows that profits from renewable products can be two to three times higher than those from products currently exploited through non-renewable meth-

encouraged. With the use of existing technology, small-scale sustainable exploitation is presently being achieved for fruits, nuts, and plant extracts used for cosmetics and pharmaceuticals.²¹

The rain forests also play an important role in maintaining fresh water supplies because of their capacity to store and return to the atmosphere billions of gallons of water.²² Although scientists are only beginning to analyze the interactions between rain forests and world climate, there is substantial consensus that the destruction of rain forests increases atmospheric carbon dioxide, accelerating global warming.²³

The rain forests are a crucial element in the world's delicate balance of life and their destruction affects all nations. In the search for means to preserve the rain forests, a first step is to assess the magnitude of the ecological disaster which can follow their destruction.

II. THE ECOLOGICAL DISASTER

Despite their importance to our survival, we are destroying rain forests at an alarming rate. Indiscriminate logging and land clearing for pasture and agriculture account for most of these losses.²⁴ Although figures on the pace of destruction conflict, all available statistics confirm the severity of the problem. The forests of Sri Lanka, India and Bangladesh, for example, have almost completely disappeared. It is predicted that if the destruction continues at its present rate, what forests remain in Southeast Asia may no longer exist in thirty years.²⁵

According to the World-Wide Fund for Nature, 200,000

ods. For example, the present annual value of the products, other than wood, found in a 2.5 acre section of Peruvian forest is approximately \$6,820. In contrast, a tree plantation of the same size yields \$3,184, while the yield of cattle grazing in a comparable area is estimated at \$2,960. *Valuation of an Amazonian Rain Forest*, NATURE, Vol. 339, June 29, 1989, at 655.

²¹ Seibert, *Hug a Tree, Kiss an Herb*, NEWSWEEK, May 1, 1989, at 50.

²² *Ein Aufstand mit Äxten und Kettensägen*, Der Spiegel, Feb. 17, 1989, at 137 (Hamburg, Ger.) (hereinafter *Äxten und Ketensägen*).

²³ Shabecoff, *supra* note 5, at B6, col. 1.

²⁴ Stevens, *supra* note 2.

²⁵ Jeffries, *supra* note 14, at 38. Latin America has already lost thirty-seven percent of its original rain forest, while Asia and Africa have lost forty-two percent and fifty-two percent respectively. Rubinoff, *Tropical Forest: Can We Afford Not to Give Them A Future?*, 12 Ecologist 253 (1982).

square kilometers (approximately 77,000 square miles) of rain forest are destroyed annually across the globe.²⁶ The figure often quoted for the Amazon forest alone is nearly 35,000 square kilometers (approximately 14,000 square miles) per year.²⁷ According to data received by the Brazilian Institute for Space and Research from weather satellites, by the end of the summer of 1989 there were nearly 7,000 active fires in the Amazon forest sending smoke as far as Venezuela and Argentina.²⁸ Biologists have compared the extent of ecological damage that would follow wholesale deforestation to that which occurred when the dinosaurs were obliterated.²⁹ United Nations Development Program officials have said that only a nuclear war could equal the long-term effects of loss of the rain forests.³⁰

Using rain forest land for agriculture or pasture has not led to a net gain in global productivity. First, more than half the world forests razed annually merely replace degraded agricultural soil.³¹ Second, because rain forest soil is relatively poor and the microclimate that keeps it alive is self-contained, a rain forest does not regenerate itself easily.³² This problem is particularly aggravated by the "slash and burn" method of agriculture practiced in most rain forest countries.³³ Because most nutrients

²⁶ Äxten und Kettensägen, *supra* note 22, at 137. According to "World Resources 1990-91," a study published by the World Resources Institute in collaboration with the United Nations, the rate of loss of rain forests measured for 1987 was nearly 50 percent greater than that estimated for 1980. The total destruction figure presented by the study is forty to fifty million acres of tropical rain forest annually. (The 1980 estimate was prepared by the United Nations Food and Agricultural Organization). Shabecoff, *Loss of Tropical Forests Is Found Much Worse Than Was Thought*, N.Y. Times, June 8, 1990, at A1, col 1.

²⁷ Fearnside, *A Prescription for Slowing Deforestation in Amazonia*, 31 Env't 16, 17, (1989). See generally Cohen, *While Trekking Through the Amazon Senators Learn not to Mimic Bananas*, Wall St. J., Apr. 4, 1989, at A19, col. 1; Desjardins, *Amazonie: le drame écologique; L'inexorable massacre de la forêt*, Figaro, Mar. 2, 1989, at 7 (Paris, Fr.).

²⁸ Äxten und Kettensägen, *supra* note 22, at 136.

²⁹ Jeffries, *supra* note 14, at 38.

³⁰ Äxten und Kettensägen, *supra* note 22, at 137.

³¹ Reid, *Sustainable Development: Lessons From Success*, 31 Env't, 7, 8 (1989).

³² Comment, *Deforestation in Brazil: Domestic Political Imperative-Global Ecological Disaster*, 18 ENVTL. L. REV. 537, 539 (1988).

³³ The "slash and burn" method consists of cutting, drying and burning forests to clear the land and release the nutrients. This results in a temporary enrichment of the soil, but once one or two crops are collected the soil is depleted and erosion sets in. See Bertrand, *Ecological Processes and Life Support Systems*, in SUSTAINING TOMORROW 30

are fixed in living organisms, once the plants are cut and burned, the remaining thin layer of soil and ashes has minimal productive value.³⁴ Pasture creation, on the other hand, far from being a land improvement, is "a form of ecological destruction."³⁵ Soil in the areas cleared for such purpose is said to be rendered "compacted and depleted of available phosphorous in about a decade."³⁶

In addition to soil depletion there is another problem of greater dimensions: the warming of the earth's atmosphere. Present deforestation practices aggravate the "greenhouse effect"³⁷ because more carbon dioxide is released from the massive burning of forest while fewer trees remain to remove carbon dioxide from the atmosphere.³⁸

Yet, the most serious consequence of rain forest destruction is the increasing elimination of plant and animal species and the reduction of the genetic pool for those remaining.³⁹ Scientists estimate that approximately 10,000 species of plants and animals, many of them not yet classified, vanish each year as a result of deforestation.⁴⁰ This involves the elimination of organisms that could become new sources of food, drugs or raw materials, or that can yield information and understanding useful for improving our quality of life. As expressed by Daniel Janzen, a biologist doing research on the Amazon forest, "[I]t is as if the nations of the world had decided to burn their libraries without even looking to see what was in them."⁴¹

The scientific consensus is that deforestation is not just a regional problem, but a global one affecting many issues related

(Thibodeau & Field ed. 1984).

³⁴ *Id.*

³⁵ Fearnside, *supra* note 27, at 18.

³⁶ *Id.*

³⁷ See *supra* note 8.

³⁸ Scott, *The Disappearing Forests*, FAR E. ECON. REV., Jan. 12, 1989, at 34. See also, Davis, *Vast Environmental Changes on Earth Are Recorded in NASA Shuttle Photos*, WALL ST. J., Mar. 15, 1989, at B4, col. 5.

³⁹ Cerri, *La CEE en croisade pour sauver les forêts tropicales*, Liberation, Aug. 17, 1989, at 6 (Paris, Fr.).

⁴⁰ Scott, *supra* note 38, at 34. Because of animal dependency on plants, it is estimated that 10 animal species disappear for each plant species that is eliminated. See Jeffries, *supra* note 14, at 39. See also Swire, *Tropical Chic*, NEW REPUBLIC, Jan. 30, 1989, at 20.

⁴¹ *Tropical Forests: An Endangered Species*, World Press Rev., May 1989, at 36.

to life on earth. Thus, the rapid destruction of the rain forests has been called, appropriately, "a catastrophe that compromises all biological equilibrium on the planet."⁴²

III. UNDERLYING FORCES OF DEFORESTATION: THE LINK WITH THE DEBT CRISIS

In most instances, the immediate causes of deforestation are peculiar to each individual country possessing a rain forest. The spectrum of local forces at play includes landless peasants struggling to survive,⁴³ land speculation schemes,⁴⁴ unregulated exploitation of raw materials and mineral resources,⁴⁵ harnessing

⁴² Desjardins, *Amazonie: le drame écologique; L'inexorable massacre de la forêt*, Figaro Mar. 2, 1989, at 7 (Paris, Fr.).

⁴³ Breck, *Rain Forests for Rent?*, Newsweek, Dec. 5, 1988, at 12. The efforts in Brazil to unionize rubber tappers and nut farmers by one particular popular leader, Chico Mendes, culminated in his murder at the hands of *pistoleiros*, paid gunmen, on contract from rubber barons and land speculators. The plight of the indians and the traditional settlers, widely exposed as a result of Chico Mendes' death, presents a stark contrast with the quick fortunes made by outside tycoons. This constant struggle is representative of the social forces underlying the rain forest exploitation policies of Brazil. For an incisive analysis of that struggle see Hecht & Cockburn, *Land, Trees and Justice, Defenders of the Amazon*, Nation, May 22, 1989; see also REVKIN, *THE BURNING SEASON: THE MURDER OF CHICO MENDES* (1990).

⁴⁴ Lutzenberger, *The Systematic Demolition of the Tropical Rain Forest in the Amazon*, 12 Ecologist 248 (1982). In Brazil, for example, land speculation in the Amazon region is promoted by the Government's recognition of clearing land for pasture as an "improvement," thus qualifying it for title. As a result of this policy, "every wild settler cuts down as much forest as he can, often more than the area he can cultivate with crops As soon as they get title or sufficient proof of property, more often than not they sell to big outfits and move on." *Id.* at 249. See also Cockburn, *Amazon Symbiosis: Social Justice and Environmental Protection*, Wall St. J., Dec. 29, 1988, at A7. In describing the link between the development strategies adopted by Brazil's previous military regimes and deforestation, Cockburn wrote:

What the generals started was a land boom, in which cattle have been an incidental decoration. The big entrepreneurs, followed by small-timers by the thousands, chopped down trees because they were offered land concessions, seventy-five percent of the capital cost of development, loans at negative interest rates, tax breaks of up to 100% for seventeen years.

Id.

⁴⁵ In Southeast Asia, large-scale Japanese consumption is the force behind the extensive exploitation of timber and other raw materials. *Tropical Forests*, *supra* note 41, at 37. "Already Thailand has gone from an exporter to an importer of timber, and the Philippines' timber trade is down to a trickle." Scott, *supra* note 38, at 34. Commercial logging is also one of the main forces of forest destruction in the Ivory Coast, Nigeria and Ghana. The damage done by the logging companies themselves is compounded by other factors: "Logging roads, pushed deep into the interior of previously isolated regions,

hydroelectric energy,⁴⁶ and road construction.⁴⁷

However, most of the local factors leading to deforestation are linked, in varying degrees, to international economic events. Developing countries continuously struggle to repay the extensive loans provided by multinational banks. Those repayment burdens have forced the borrower countries to expand their economic base through relentless exploitation of their natural resources.⁴⁸ In the words of Peter Seligmann, President of Conservation International, "[T]he global environmental crisis has been accelerated by tremendous pressures on the developing world to service its debt."⁴⁹

The debt crisis is a composite of the difficulties experienced by several developing countries in maintaining their foreign debt payments and the efforts of the lenders to avoid sovereign defaults.⁵⁰ An understanding of the basic elements of the debt crisis is important in studying debt for nature exchanges because efforts to solve the crisis have provided both the mechanisms and the political will that have made these exchanges possible.

The debt crisis originated with rising oil prices in 1973. Between 1973 and 1982, for example, the less developed countries (LDCs) had to disburse an additional \$260 billion just to cover

open them up to landless colonists, scotching any chances the degraded forests had of recovering from the logging." *The Vanishing Jungle, Ecologists Make Friends with Economists*, *ECONOMIST*, Oct. 15, 1988, at 26.

⁴⁶ The Balbina Dam, for example, built to the northwest of Manaus, Brazil, has submerged millions of square kilometers for a meager production of 250 megawatts, an amount of electricity totally insufficient for the local demand. Dawney, *L'offensive des Verts indigne le Brésil*, *Figaro*, June 7, 1989, at 13 (Paris, Fr.).

⁴⁷ For an analysis of destruction in Brazil due to highway construction see Comment, *Deforestation in Brazil: Domestic Political Imperative, Global Ecological Disaster*, 18 *ENVTL. L.*, 537, 544-546 (1988) (authored by Michael S. Giaimo); *Brazil and the Amazon, It's Our Forest to Burn If We Want To*, *ECONOMIST*, Mar. 11, 1989.

⁴⁸ Many of the settlers of the Amazon forest, for instance, have been forced out from southern Brazilian states by the spread of large-scale mechanized soya farming. Soya is an export commodity used "to pay interest on Brazil's \$115-billion foreign debt." Cohen, *Amazon Tug-of-War Reaches Fever Pitch*, *Wall St. J.*, Apr. 7, 1989, at A12.

⁴⁹ Truell, *What Do Monkeys in Bolivia Have to Do With the Debt Crisis?*, *Wall St. J.*, Jan. 20, 1988, at A1, col. 3. See also, *U.S. Says Third World Loans Pose Environmental Danger*, *Investor's Daily*, Apr. 26, 1988, at 23.

⁵⁰ See Meessen, *Back to the Market: The Debt Problem in Legal Perspective*, 12 *FORDHAM INT'L L.J.* 1 (1988); Clark & Gianni, *Are There Solutions to the Debt Problem?* *INT'L FIN. L. REV.*, Sept., 1988, at 9; Corrigan, *A Balanced Approach to the LDC Debt Problem*, *FED. RES. BANK N.Y.Q. REV.*, Spring 1988, at 1.

their oil imports.⁵¹ A subsequent world recession and an increase in dollar interest rates triggered massive borrowing by these countries to cover their current account deficits.⁵² To compound the problem, world recession meant a fall in commodity prices, the main source of foreign exchange earnings for the LDCs.⁵³ Finally, a further rise in dollar interest rates, which by 1981 had reached a high of twenty-one percent, meant a greater increase in the debtor countries' remittances abroad.⁵⁴

The international banking community, itself the recipient of "recycled petrodollars,"⁵⁵ was eager to cover the deficits left by the LDCs' net transfer of resources to the oil-producing and industrialized countries. The LDCs, on the other hand, were willing to borrow more money in order to avoid, or at least postpone, the difficult political and economic decisions called for. Thus, according to the World Bank, between 1974 and 1982 international lending to the LDCs multiplied four times in nominal terms and doubled in real terms.⁵⁶

These external factors of the debt crisis must be viewed in conjunction with development strategies adopted by the LDCs. Such strategies envisioned growth through significant infusions of borrowed capital.⁵⁷ Given the internal economic bottlenecks

⁵¹ Eskridge, *Les Jeux Sont Faits: Structural Origins of the International Debt Problem*, 25 VA. J. INT'L L. 281, 288 (1985).

⁵² *Id.* at 294-97.

⁵³ *Id.* at 297.

⁵⁴ *Id.* at 298-301.

⁵⁵ Meessen, *supra* note 50, at 1.

⁵⁶ IBRD (World Bank), *World Development Report 1988*, at 27 (1988).

⁵⁷ Since the late 1950s, the growth strategies of the LDCs have evolved around three main models of economic development: modernization, dependency, and global interdependency. See Eskridge, *supra* note 51, at 352.

The modernization model purports that by following the historical path of the already developed economies, that is, by imitating the same basic steps they took toward industrialization, the developing countries eventually will attain the status of mass-market societies. The characteristics of such societies would be "sustained and diversified industrialization, self-perpetuating growth, and middle-class mores and democratic institutions." *Id.* at 353. The path to industrialization, however, contains economic traps that act as barriers to full utilization of resources. Among these traps are illiteracy, overpopulation, inadequate infrastructures, and a low rate of capital formation. An often-chosen alternative to solve these traps is to provide massive inflows of external capital as a means to "break the vicious cycle of poverty." *Id.* at 354.

The dependency model posits that underdevelopment is a permanent state of affairs fixed by capitalist domination of world markets. The industrialized countries are interested in perpetuating this relationship because they require subordinate markets and

in these countries—that is, abysmal income disparities, unstable political systems, inadequate infrastructures—it is not surprising that extensive borrowing failed to generate sustainable growth.⁵⁸ In the absence of viable alternatives, pressure to meet debt service payments led to further exploitation of natural resources without adequate protective measures or long-term planning.

The plight of the LDCs was such that even an increase in their export of commodities and raw materials to the developed world was insufficient to maintain debt payments. Beginning with Mexico in 1982, and continuing with Venezuela, Argentina, Bolivia, Poland and others, country after country has faced this problem and taken measures to protect their decreasing balance of payments. On the other hand, the specter of sovereign defaults became more visible on the lenders' horizon, threatening to disrupt the "stability and solvency of major international financial institutions."⁵⁹

International lenders confronted with this problem must realize that the legal remedies available for sovereign defaults are not only scarce but also complex to pursue. The nature of these remedies is such that other alternatives for rescuing nonperforming sovereign loans are attractive to banks. An ac-

areas of investment for their surplus capital. As a way out of this paradigm, the developing countries adopted import-substitution strategies hoping to generate self-sustained growth. One problem with this option is that most of the items produced under these policies are luxuries, and most of the modern sectors producing them rely on imported technologies. There is, for this reason, "only a relatively weak multiplier effect on the local economy." Makgetla, *External Influences on Third World Debt*, 12 HASTINGS INT'L & COMP. L. REV. 591, 604 (1989).

The interdependency model incorporates the realities of modern relationships among states and recognizes the susceptibility of the industrialized countries to the plight of the less developed. This model takes into account the role of global factors such as the advent of multinational corporations and the continuing erosion of traditional frontiers as a result of modern transportation, communications and financial systems. The interdependency theory recognizes the intricate balance of social and economic structures and incorporates, as a result, such global concerns as world hunger and the environment. Nevertheless, structural inequalities included in the earlier models are still present. The debt problem, for instance, is seen as the result of the LDCs' "participating in a financial system increasingly stacked against them." Eskridge, *supra* note 51, at 384.

⁵⁸ See Breck, *supra* note 43, at 12. To highlight Brazil's dilemma, it has been observed that it is difficult for a country not to exploit its land richness, not to produce low cost energy or not to create new agricultural zones when half its territory is empty and it must create two million new jobs and make debt payments of \$12 billion per year. Dawney, *supra* note 46, at 13.

⁵⁹ Makgetla, *supra* note 57, at 591.

count of the inadequacies of legal remedies available to international lenders is therefore important for studying debt exchanges.

IV. THE NATURE OF LEGAL REMEDIES FOR SOVEREIGN DEFAULTS

International lenders encounter several barriers when seeking legal remedies for defaults on their overseas portfolios. In the United States, where most of the direct or syndicate lending to developing nations originates, international financial institutions seeking redress for such defaults must act within the framework of established international law. These lenders must also contend with the possible adverse position of foreign courts and legislatures.⁶⁰

The distinguishing feature of most international loans is that they are made to sovereign entities whose actions are governed by a separate body of law. This is true of loans made directly to a public bank or institution, as well as of loans made to private or semi-private banks. Because the ability of these borrowers to remit hard currency payments abroad often depends on each country's central or government bank, and thus on the government itself, such international lending falls within the category of "sovereign risk."⁶¹

Sovereignty is the normative principle that a state has "exclusive authority over the exercise of government power within its borders."⁶² In the United States, the legal precepts emanating from this principle are embodied in the "act of state doctrine,"⁶³ which prohibits review of acts of a sovereign entity by

⁶⁰ An adverse decision by a foreign court would not be reviewable in a United States court because it would fall within the act of state doctrine. See *infra* note 90 and accompanying text.

⁶¹ "Sovereign risk" refers to the likelihood that a foreign country, borrowing convertible currency, will pay its obligations on schedule and fully comply with other terms of the loan agreement. An international lender who accepts a given sovereign risk will ultimately depend on the borrowing country's capacity to pay as well as its eagerness to maintain a favorable credit rating. See HANER & EWING, COUNTRY RISK ASSESSMENT, THEORY AND WORLDWIDE PRACTICE 113 (1985).

⁶² Note, *Extraterritorial Jurisdiction and International Banking: A Conflict of Interests*, 43 U. MIAMI L. REV. 449, 456 (1988).

⁶³ The act of state doctrine "precludes the courts of this country from inquiring into the validity of governmental acts of a recognized foreign sovereign committed within its

the courts.⁶⁴ Because the theoretical basis of the "act of state doctrine" stems from the notions of comity and sovereign immunity,⁶⁵ the two concepts are briefly described here. These descriptions provide a background for a further analysis of the "act of state doctrine," as well as for a brief assessment of the enforceability of favorable judgments that lenders might obtain.

A. Comity

Comity is "the degree of deference that a domestic forum must pay to the act of a foreign government not otherwise binding on the forum."⁶⁶ While not a rule of law per se, comity is a customary rule of practical convenience that fosters mutual respect between nations and encourages reciprocity and the preservation of international law.⁶⁷

An international lender invoking comity as a means to enforce a court decision against a foreign sovereign will encounter several limitations. First, comity is accorded as a courtesy and not as a matter of right, because "[n]o domestic forum has an absolute obligation to enforce foreign interests when they are fundamentally adverse to their own. . . ."⁶⁸ Second, where a lender has obtained a favorable decision from a court in a foreign nation, comity is accorded only if the laws and public policy of the forum state are not violated.⁶⁹ Finally, comity cannot be invoked to resolve conflicts between foreign and domestic laws. Such conflicts of laws usually appear in cases where a sovereign borrower defaults due to foreign payment restrictions imposed

own territory." BLACK'S LAW DICTIONARY 32 (5th ed., 1979).

⁶⁴ See *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 401 (1964). For a comprehensive analysis of the modern view of the act of state doctrine see Halberstam, *Sabbatino Resurrected: The Act of State Doctrine in the Revised Restatement of U.S. Foreign Relations Law*, 79 AM. J. INT'L L. 68 (1985).

⁶⁵ See Ebenroth & Teitz, *Winning (or losing) by Default: The Act of State Doctrine, Sovereign Immunity and Comity in International Business Transactions*, 19 INT'L LAW 225 (1985).

⁶⁶ *Laker Airways v. Sabena*, 731 F.2d 909, 937 (D.C. Cir. 1984).

⁶⁷ See Note, *Extraterritorial Jurisdiction and International Banking: A Conflict of Interests*, 43 U. MIAMI L. REV. 449, 458 (1988). Comity was first recognized by the Supreme Court in *Hilton v. Guyot*, 159 U.S. 113 (1895).

⁶⁸ See Note, *supra* note 67, at 458. See also *Laker Airways v. Sabena*, 731 F.2d at 937.

⁶⁹ Note, *Allied's Flawed Application of the Act of State Doctrine: Impropriety of the Doctrine in International Finance*, 20 CORNELL INT'L L.J. 253, 256 (1987).

by a government. These defaults are not uncommon in developing countries.⁷⁰

B. *Sovereign Immunity*

Another significant barrier for an international lender seeking legal remedies against sovereign debtors is the doctrine of sovereign immunity, which "precludes domestic courts from exercising personal jurisdiction over foreign states."⁷¹ As stated by Chief Justice Marshall in *The Schooner Exchange v. McFaddon*,⁷² sovereign immunity "is necessarily exclusive and absolute. It is susceptible of no limitation not imposed by itself."⁷³ Historically, unless the party consented, "foreign states enjoyed absolute immunity from being sued in American courts."⁷⁴

Absolute immunity later yielded to a restrictive theory of immunity by which courts could exercise jurisdiction on sovereign matters that involved private or commercial acts. Sovereign immunity, however, was still granted for all public acts by a state.⁷⁵ Because suits concerning public acts by a state usually had sensitive foreign policy implications, the State Department had the task of recommending whether a matter fell within the domain of purely private or commercial acts and was therefore within the jurisdiction of the courts.⁷⁶ However, international loans to a sovereign entity were still considered public acts of the recipient state and were consequently protected by sovereign immunity.⁷⁷

The State Department discretion ceased in 1976 when Con-

⁷⁰ See Zamora, *Recognition of Foreign Exchange Controls in International Creditors' Rights Cases: The State of the Art*, 21 INT'L LAW. 1055, 1056 (1987).

⁷¹ Note, *Default on Foreign Sovereign Debt: A Question for the Courts?*, 18 IND. L. REV. 959, 965 (1985).

⁷² 11 U.S. (7 Cranch) 116 (1812).

⁷³ *Id.* at 136.

⁷⁴ Note, *supra* note 71, at 965.

⁷⁵ *Id.*

⁷⁶ See, e.g., *Isbrandtsen Tankers, Inc. v. President of India*, 446 F.2d 1198 (2d Cir.), *cert. denied*, 404 U.S. 985 (1971), where the court held that if the State Department formally suggested immunity the judiciary would not interfere.

⁷⁷ See, e.g., *Victory Transport, Inc. v. Comisaria General*, 336 F.2d 354, 360 (2d Cir. 1964), *cert. denied*, 347 U.S. 934 (1965). See also Nichols, *The Impact of the Foreign Sovereign Immunities Act on the Enforcement of Lender's Remedies*, 1982 U. ILL. L. REV. 251, 253 (1982).

gress enacted the Foreign Sovereign Immunities Act (hereinafter FSIA).⁷⁸ The FSIA "provided a statutory means for obtaining service upon, and *in personam* jurisdiction over, a foreign state. . . ."⁷⁹ Generally the FSIA grants immunity to acts of a sovereign state except when (a) the foreign state has waived immunity, (b) the action arises out of a purely commercial activity of the foreign state, or (c) foreign-owned property in the United States was obtained in violation of international law.⁸⁰

Since the adoption of the FSIA, international lenders have used successfully the waiver and commercial transactions exceptions to meet their jurisdictional burden.⁸¹ According to the FSIA, a sovereign borrower can waive immunity either implicitly, as when the foreign state agrees to arbitration in the United States, or explicitly, as is customarily stated in most loan agreements.⁸² Courts routinely accept explicit waivers,⁸³ but are divided regarding implicit ones, particularly if arbitration or choice of law clauses allow access to courts outside the United States. The consensus is that implicit waivers are "neither certain nor predictable, two qualities which lenders like their remedies to have."⁸⁴

Sovereign borrowing from international financial institutions falls within the FSIA definition of commercial activity. Consequently, courts have subject matter jurisdiction over most international loans originating in the United States.⁸⁵ However,

⁷⁸ Pub. L. No. 94-583 Stat. 2892 (1976) (codified as amended at 28 U.S.C. §§ 1602-11 (1982)).

⁷⁹ Comment, *Applying an Amorphous Doctrine Wisely: The Viability of the Act of State Doctrine After the Foreign Sovereign Immunities Act*, 18 Tex. Int'l L.J. 547, 550 (1983).

⁸⁰ 28 U.S.C. §§ 1605(a)(1),(2),(3) (1982). The exceptions also cover certain actions arising out of personal injury or death.

⁸¹ See generally Kahale, *State Loan Transactions: Foreign Law Restrictions on Waivers of Immunity and Submissions to Jurisdiction*, 37 BUS. LAW. 1549 (1982); McCormick, *The Commercial Activity Exception to Foreign Sovereign Immunity and the Act of State Doctrine*, 16 L. & POL. INT'L BUS. 477 (1984); Note, *Foreign Sovereign Immunity and Commercial Activity*, 83 COLUM. L. REV. 1440 (1983).

⁸² See Ryan, *Defaults and Remedies Under International Bank Loan Agreements With Foreign Sovereign Borrowers—A New York Lawyer's Perspective*, 1982 U. ILL. L. REV. 89, 113 n. 111 and accompanying text (1982).

⁸³ *Id.* at 112 n.109.

⁸⁴ *Id.* at 112.

⁸⁵ The commercial exception of the FSIA reads in relevant part:

A foreign state shall not be immune from the jurisdiction of courts of the United

in addition to subject matter jurisdiction, courts must also have personal jurisdiction over the sovereign defendant.⁸⁶ International lenders usually meet this requirement either by previous consent,⁸⁷ which is usually stipulated in the loan agreement, or by the use of "long-arm" statutes in the forum state.⁸⁸

C. Act of State

The act of state doctrine embodies "the reluctance of the courts to pass judgment on the actions of foreign sovereigns."⁸⁹ In an action against a sovereign debtor, proper jurisdiction will not necessarily render the case amenable to the courts. Where the default results from compliance with the domestic laws of a sovereign nation, courts are likely to invoke the act of state doctrine and abstain from addressing the merits of the case.⁹⁰ The

States in any case. . . (2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States. . .

18 U.S.C. § 1605 (a).

When the lending transaction is carried outside the United States, the required direct effect must be sufficient to meet the "minimum contacts standard established in *International Shoe Co. v. Washington*, 326 U.S. 310 . . . (1945) and *McGee v. International Life Insurance Co.*, 355 U.S. 220. . . (1957)." See Ryan, *supra* note 80, at 115, n.126, quoting *Decor by Nikkey Int'l, Inc. v. Federal Republic of Nigeria*, 497 F. Supp. 893, 903-04 (S.D.N.Y. 1980), *aff'd sub nom. Texas Trading and Milling Corp. v. Federal Republic of Nigeria*, 647 F.2d 300 (2d Cir. 1981).

⁸⁶ See Ryan, *supra* note 82, at 116. The FSIA prohibits *quasi in rem* jurisdiction over a sovereign state. 28 U.S.C. § 1610(d)(2) (1976).

⁸⁷ *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1971) (parties may contract for the adjudication of a dispute arising out their contract in a specific jurisdiction).

⁸⁸ In New York, a state court may exercise personal jurisdiction over a non-citizen who, either directly or through an agent, "transacts any business within the state." N.Y. Civ. Prac. L. & R. § 302 (a)(1) (McKinney 1990). See Ryan, *supra* note 82, at 117. See also Homburger, *The Reach of New York's Long-Arm Statute: Today and Tomorrow*, 15 BUFFALO L. REV. 61 (1965).

⁸⁹ Note, *supra* note 69, at 967.

⁹⁰ The act of state doctrine was first articulated by the United States Supreme Court in *Underhill v. Hernandez*, 168 U.S. 250 (1897), where a United States citizen sued the government of Venezuela for unlawful detention and assault. Recognizing the defendant, who had usurped power through a coup d'état, as the *de facto* President of Venezuela, the court held that "[e]very sovereign State is bound to respect the independence of every other sovereign State and the courts of one country will not sit in judgment of the acts of the government of another done within its own territory." *Id.* at 252.

act of state doctrine, as it relates to remedies for defaults on international loans, was first considered by the federal judiciary in *Allied Bank Int'l v. Banco de Credito Agricola de Cartago*.⁹¹ As agent of a syndicate loan involving thirty-nine banks,⁹² Allied Bank International sued one of three public Costa Rican banks that had signed promissory notes in favor of the lenders. The defendant bank failed to make repayments on the loan following a Costa Rican Government decision suspending foreign exchange remittances abroad.⁹³ The District Court denied Allied's motion for summary judgment and dismissed the action. On appeal, the Second Circuit applied the act of state doctrine and upheld the District Court decision. The court observed that a decision in favor of the lenders would "constitute a judicial determination that defendants must make payments contrary to the directives of their government."⁹⁴

The international banks were alarmed by the implications of this decision. They feared more defaults as sovereign borrowers adopted new foreign exchange controls in response to economic pressures. Amidst this concern, plaintiffs petitioned for a rehearing and enlisted the assistance of the United States Government, which filed an *amicus curiae* brief. Upon rehearing, the Circuit Court vacated its earlier decision, found the act of state doctrine inapplicable, and remanded to the District Court for

See generally Bazylar, *Abolishing the Act of State Doctrine*, 134 U. PA. L. REV. 325 (1986); Note, *The Act of State Doctrine and Foreign Sovereign Defaults on United States Bank Loans: A New Focus for a Muddled Doctrine*, 133 U. PA. L. REV. 469 (1985); Note, *The Resolution of Act of State Disputes Involving Indefinitely Situated Property*, 25 VA. J. INT'L L. 901 (1985); Henkin, *Act of State Today: Recollections in Tranquility*, 6 COLUM. J. TRANSNAT'L L. 175 (1967).

⁹¹ 566 F. Supp. 1440 (S.D.N.Y. 1983), *rev'd*, 757 F.2d 516 (2d Cir.) *cert. dismissed*, 106 S. Ct. 30 (1985). For a detailed discussion of this case see Note, *The Act of State Doctrine and Allied Bank*, 31 VILL. L. REV. 291 (1986). See also Note, *Allied's Flawed Application of the Act of State Doctrine: Impropriety of the Doctrine in International Finance*, 20 CORNELL INT'L L. J. 253 (1987); Rendell, *The Allied Bank Case and its Aftermath*, 20 INT'L LAW. 819 (1986); Zaitzeff & Kunz, *The Act of State Doctrine and the Allied Case*, 40 BUS. LAW. 449 (1985).

⁹² *Allied Bank*, 757 F.2d at 516. The District Court obtained personal jurisdiction by consent, as stipulated in the promissory notes. In addition, the notes were payable in United States dollars in New York which would have placed the defendants under the state's long-arm statutes. Rendell, *The Allied Bank Case and Its Aftermath*, 20 INT'L LAW. 819, 821 (1986).

⁹³ See Rendell, *supra* note 92, at 822.

⁹⁴ *Allied Bank*, 566 F. Supp. at 1444.

summary judgment in favor of Allied Bank.⁹⁵ The Circuit Court held that the act of state doctrine was "applicable to this dispute only if, when the decrees were promulgated, the situs of the debt was Costa Rica."⁹⁶ The court concluded that the facts of the case indicated otherwise: the Costa Rican banks had conceded jurisdiction in New York, payment was in United States dollars in New York, and the syndicate agent was located in the United States, where some of the negotiations also were conducted.⁹⁷ Based upon these facts, the court held that the defendants could not invoke the protection of the act of state doctrine.⁹⁸

D. *Enforceability of Judgments*

The *Allied Bank* decision created a favorable precedent for international lenders initiating default actions against sovereign debtors or against private debtors that alleged governmental restrictions.⁹⁹ However, enforcing the judgments still remains a major obstacle for the lenders.

Since reciprocal enforcement of a United States judgment

⁹⁵ *Allied Bank*, 757 F.2d at 519.

⁹⁶ *Id.* at 521.

⁹⁷ *Id.*

⁹⁸ *Id.* at 522. The court also found that the Costa Rican government directives were "inconsistent with the orderly resolution of international debt problems," and that the restrictions on payments of foreign obligations were "similarly contrary to the interests of the United States, a major source of private international credit."

⁹⁹ Courts have imposed various limitations on the act of state doctrine: (a) that the acts of the sovereign must be done "within its own territory," *Underhill v. Hernandez*, 168 U.S. 250 (1897); (b) that the executive branch does not object to a judicial examination of the sovereign's act, *Bernstein v. Van Heyghen Freres Societe Anonyme*, 163 F.2d 246 (2d Cir.), *cert. denied*, 332 U.S. 772 (1947); and (c) that it not be a private commercial act of the sovereign state, *Alfred Dunhill of London, Inc. v. Republica de Cuba*, 425 U.S. 682 (1975). There is also an important legislative exception, the "Hickenlooper Amendment," which bars application of the act of state doctrine in cases of confiscation of property by a foreign sovereign "in violation of the principles of international law." Hickenlooper Amendment to the Foreign Assistance Act of 1964, 22 U.S.C. § 2370(e)(2) & Supp. IV (1987). See generally Comment, *The Act of State Doctrine: A History of Judicial Limitations and Exceptions*, 18 HARV. INT'L L. J. 677 (1977); Dellapenna, *Suing Foreign Governments and Their Corporations: Choice of Law*, 87 COM. L. J. 8 (1982); Note, *Adjudicating Acts of State in Suits Against Foreign Sovereigns: A Political Question Analysis*, 51 FORDHAM L. REV. 722 (1983); Note, *Rehabilitation and Exoneration of the Act of State Doctrine*, 12 N.Y.U. J. INT'L L. & POL. 599 (1980); Note, *Limiting the Act of State Doctrine: A Legislative Initiative*, 23 VA. J. INT'L L. 103 (1982).

by a court in the defendant's country is unlikely, the only viable alternative would be execution on the defendant's property within the United States.¹⁰⁰ Yet this option may be precluded if (a) the defendant removes the property from the jurisdiction in anticipation of an adverse judgment or (b) the property itself is immune from legal action.¹⁰¹

In the first instance, however, a bank litigating against a sovereign debtor may prevent the debtor from removing the property from the jurisdiction by attaching it before the judgment. This option is available on any action brought in a federal district court if allowed by state law.¹⁰² However, the outcome depends on who acts first, the lender or the borrower. The reason is that the assets of foreign financial institutions are usually very liquid, thus easily transferable, and prudence dictates their removal overseas by the defendant at the first sign of litigation.¹⁰³

In the second case, a foreign debtor's immunity from attachment is subject to exceptions similar to the jurisdictional exceptions provided in the FSIA.¹⁰⁴ Nevertheless, certain assets enjoy absolute immunity and thus are out of the lenders' reach. Absolute immunity covers assets such as transfers to a sovereign state from multilateral organizations,¹⁰⁵ property destined for military purposes,¹⁰⁶ and the funds of central banks held for

¹⁰⁰ See Nichols, *The Impact of the Foreign Sovereign Immunities Act on the Enforcement of Lenders' Remedies*, 1982 U. ILL. L. REV. 251, 257.

¹⁰¹ *Id.*

¹⁰² Fed. R. Civ. P. 61, 66. See *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1937). New York law allows attachment of property before judgment in cases where (a) the debtor is an out of state resident, (b) the debtor is likely to transfer property from the state, or (c) the cause of action is based on a federal or state judgment that falls within the Uniform Foreign Money-Judgments Recognition Act. N.Y. Civ. Prac. L. & R. § 6201 (McKinney 1990).

¹⁰³ See, e.g., *Libra Bank Ltd. v. Banco Nacional de Costa Rica*, 570 F. Supp. 870 (S.D.N.Y. 1983), a case arising out of the same Costa Rican government directive to suspend foreign exchange payments as *Allied Bank*. *Libra Bank* obtained a judgment against the defendant, but when it tried to execute it the defendant had already transferred its assets out of New York. See Note, *Default on Foreign Sovereign Debt*, *supra* note 71, at 978.

¹⁰⁴ See *supra* note 78 and accompanying text.

¹⁰⁵ 28 U.S.C. § 1610(a) (1987). The code grants immunity to assets owned by organizations such as the IMF and the World Bank.

¹⁰⁶ *Id.* at § 1611(b)(2).

their own account.¹⁰⁷

V. DEBT EXCHANGES: AN ATTRACTIVE ALTERNATIVE TO JUDICIAL REMEDIES

The complexity of issues involved in litigating sovereign defaults, as well as the uncertainty of recovering judgments, help explain why non-judicial remedies are far more attractive to international lenders. In the aftermath of the debt crisis, the international financial community has tried a number of alternatives with varying degrees of success. Among these alternatives are debt restructuring agreements,¹⁰⁸ debt for equity swaps,¹⁰⁹ and, the focus of this comment, debt for nature swaps.¹¹⁰

Debt restructuring agreements are mechanisms that make present obligations less burdensome for the debtors by allowing them to stretch their principal payments.¹¹¹ In some circumstances, the restructuring even includes advancing new funds to allow the debtor to cover interest payments.¹¹² These agreements are usually negotiated in conjunction with austerity measures to be implemented by the debtor.¹¹³

A second approach, more attractive to the debtors, is debt for equity swaps.¹¹⁴ Debt for equity swaps are transactions that allow foreign investors to purchase "troubled loans," defined as

¹⁰⁷ *Id.* at § 1611(b)(1). Funds held for a bank's own account are funds used or held in connection with that bank's expenses, as distinguished from funds used to finance commercial transactions. See Ryan, note 82, at 127-28.

¹⁰⁸ See generally, Buchheit, *The Changing Tactics of Sovereign Debt Restructuring*, INT'L FIN. L. REV., Nov., 1987, at 35.

¹⁰⁹ See Chamberlin, Gruson & Weltchek, *Sovereign Debt Exchanges*, 2 U. ILL. L. REV. 415, 418-19 (1988); Shepherd & Clock, *Regulatory Aspects of Developing Nation Debt-Equity Swaps*, 12 FORDHAM INT'L L. J. 43 (1988); Stuber, *The Brazilian Debt-Equity Swap Program*, 12 HASTINGS INT'L & COMP. L. REV. 613 (1989).

¹¹⁰ See Burton, *Back to Nature the Financial Way*, Banker, Dec. 1988, at 22; *Conservation Groups Help to Bail Out the Big Banks*, 65 BUS. & SOC'Y REV. 34 (1988); *Using Red Ink to Keep Tropical Forests Green*, U.S. NEWS & WORLD REP., Mar. 6, 1989, at 48; *Capital Conservation*, FORBES, Apr. 17, 1989, at 208.

¹¹¹ See Meissner, *Crisis as an Opportunity for Change: A Commentary on the Debt Restructuring Process*, 17 INT'L L. & POL. 612 (1985).

¹¹² This new lending to finance part of the debtor's interest payments is termed "involuntary" lending. See Kuczynski, *The Outlook for Latin American Debt*, 66 FOREIGN AFF. 129, 131 (1987).

¹¹³ See Henriot & Jameson, *International Debt, Austerity, and the Poor*, in REKINDLING DEVELOPMENT: MULTINATIONAL FIRMS AND WORLD DEBT 13, 23 (Tavis, ed., 1988).

¹¹⁴ See *supra* note 107.

loans on which the debtor is experiencing payment difficulties, at a substantial discount.¹¹⁵ The participating country agrees to convert the face value of the debt to its own currency and to disburse these funds to the investor.¹¹⁶ The investor is thereby allowed to use cheaply obtained debt as "a discounted currency substitute" to finance projects inside the debtor country.¹¹⁷

A secondary market, in which dubious Third World obligations are traded at substantial discounts makes these debt exchanges possible.¹¹⁸ The size of the discount for each sovereign debt corresponds to the perceived risk that the loans will never be fully repaid. As is usual for instruments actively traded, prices fluctuate on a day-to-day basis.¹¹⁹ The following list of prices for acquiring one dollar of debt, quoted for September, 1989, indicates the range of the discounts: Argentina, 19 cents; Brazil, 30 cents; Chile, 63 cents; Ecuador, 17 cents; Peru, 5 cents; Philippines, 50 cents; Poland, 38 cents.¹²⁰

Debt for equity swaps led, in turn, to the creation of debt for nature swaps. The principal difference between the two mechanisms is the specific objective for which each transaction is authorized by the central bank. In a debt for nature swap or exchange, a debtor is able to exchange a portion of its foreign debt for either bonds or cash in its own currency, or for an agreement to set aside land, all for the specific purpose of carrying out conservation projects.¹²¹ These transactions are attractive to all the parties involved because, while supporting conservation measures, they "enable a nation to reduce its foreign debt, and a bank to get troubled loans off its books permanently."¹²²

The debt is usually purchased by non-government conserva-

¹¹⁵ Wallenstein & Silkenat, *Investment Funds and Debt-Equity Swaps: Broadening the Base of A New Financial Tool*, 12 FORDHAM INT'L L. J. 9 (1988).

¹¹⁶ Main, *A Latin Debt Plan that Might Work*, FORTUNE, Apr. 24, 1989, at 212.

¹¹⁷ Chamberlin, Gruson & Weltchek, *supra* note 109, at 419.

¹¹⁸ See Truell, *Foreign Debt Loans Buoyed by U.S. Debt Strategy*, Wall St. J., July 19, 1989, at C1, col. 5.

¹¹⁹ *Secondary Debt Market: Bargain Basement*, ECONOMIST, Mar. 18, 1989, at 87.

¹²⁰ SWAPS, The Newsletter of New Financial Instruments, Vol. 3, No. 10, Oct. 1989, at 12. See also, *Secondary Debt Market, A Bargain Basement*, ECONOMIST, Mar. 18, 1989, at 87.

¹²¹ Burton, *Back to Nature the Financial Way*, BANKER, Dec., 1988, at 22.

¹²² *A Debt Swap to Aid Nature*, N.Y. Times, Jan. 12, 1989, at D1, col. 3.

tion groups with funds raised privately for that purpose.¹²³ The Bolivian debt for nature agreement of July, 1987, the first such exchange completed, serves to illustrate the various steps required in this type of transaction.¹²⁴ Washington-based Conservation International purchased \$650,000 worth of Bolivian debt through the offices of Citicorp Investment Bank, using a \$100,000 grant it received from a California foundation.¹²⁵ The cost was, therefore, slightly over fifteen cents for a dollar of debt. In turn, the Bolivian Government agreed to set aside 3.7 million acres of rain forest in areas adjacent to the existing Beni Biosphere Reserve.¹²⁶ It also agreed to place the expanded reserve lands under legislative protection, as opposed to a previous administrative decree, and to establish a trust fund for management purposes in the local equivalent of \$250,000.¹²⁷

Contrary to fears that debt for nature exchanges may lead to the surrender of local sovereignty to foreign institutions, the Bolivian exchange involved no transfer of land title to outsiders.¹²⁸ The Bolivian Government retains ownership of the reserved areas and administers them in partnership with the Bolivian Association for the Conservation of Nature, a private organization. However, Conservation International does maintain a role as coordinator and advisor.¹²⁹

¹²³ See, e.g. Umaña, *Costa Rica's Debt for Nature Swaps Come of Age*, Wall St. J., May 26, 1989, at A11, col. 4.

¹²⁴ *Beautiful Barter in Bolivia*, ECONOMIST, July 18, 1987, at 26.

¹²⁵ *Id.*

¹²⁶ *Id.* The Beni Biosphere Reserve is located 150 miles North-East of La Paz. See Shabecoff, *Bolivia to Protect Lands in Swap for Lower Debt*, N.Y. Times, July 14, 1987, at C2, col. 3.

¹²⁷ See *supra* note 117, at 442.

¹²⁸ The International Development and Finance Act of 1989, signed by President Bush on December 19, 1989, contains a special provision forbidding foreign assistance organizations from acquiring title to land through debt for nature exchanges. International Development and Finance Act of 1989, Pub. L. No. 101-240, 103 Stat. 2492 (codified as amended at 22 U.S.C. 2882). (The Act was sponsored by Senators Joseph Biden, Richard Lugar and Clairborne Pell). In his statements to the Senate, Senator Biden explained: "No one in their [sic] right mind would seriously propose that the United States try to claim ownership of any land through a debt for nature exchange. But there are always some who will raise ridiculous scenarios to oppose environmental initiatives, so this provision was included to avoid any question on this issue." 135 CONG. REC. S8464 (daily ed. July 20, 1989).

¹²⁹ Shabecoff, *Bolivia to Protect Lands in Swap for Lower Debt*, N.Y. Times, July 14, 1987, at C2, col. 3.

Similar debt for nature transactions have been completed in Ecuador, Costa Rica, Madagascar, the Philippines and Zambia.¹³⁰ The first Costa Rican debt for nature exchange is explored here as a model for examining these transactions in more detail. The exchanges concluded thus far in Costa Rica contain valuable lessons, both in terms of government support and in the implementation mechanisms Costa Rica has developed, from which other countries may benefit. It is important to bear in mind, however, that these lessons must be adjusted to needs and conditions specific to other countries, leaving ample room for creative and flexible adaptations.

VI. COSTA RICA AS A CASE MODEL

Costa Rica's experience in implementing debt for nature exchanges is an excellent case model for several reasons. First, with a population of three million, and a foreign debt of \$3.7 billion, Costa Rica has one of the highest debt per capita ratios in the world.¹³¹ Costa Rica's economy and the foreign exchange

¹³⁰ Negotiations are now in progress for debt for nature swaps in the Dominican Republic, Argentina and Mexico. Telephone interview with Randall K. Curtis, Director of Debt Exchanges at The Nature Conservancy, Latin American Division, Washington, D.C. (Feb. 2, 1990).

In the initial Ecuadorean deal, signed in December, 1987, Ecuador's Fundacion Natura obtained authorization from the Central Bank to exchange up to \$10 million in debt for local currency bonds. The World Wildlife Fund (WWF-US), drawing on private donations, bought the first \$1 million of debt for \$355,400 from Banker's Trust and transferred it to Fundacion Natura. Pursuant to a Consolidation Agreement, the Central Bank issued bonds for an equivalent amount in local currency at the official exchange rate. At maturity, Fundacion Natura will receive the cash value of the bonds. In the meantime, the interest earned from the bonds will be used to establish and administer parks and reserves as well as to train personnel. A second \$9 million deal was completed in April, 1989. With assistance from WWF, the Nature Conservancy and the Missouri Botanical Garden purchased Ecuadorean debt at 11 7/8 cents on the dollar. As in the previous transaction, the Central Bank issued bonds with a nine year maturity for the equivalent in local currency. The interest on the bonds is destined to support conservation efforts in the Galapagos Islands as well as for preservation zones in the Andean and Amazon regions. See Sevilla, *El Canje de Deuda por Conservación en America Latina y el Caribe*, Programa de Naciones Unidas para el Medio Ambiente (United Nations Environmental Program), Quito, Ecu., Feb. 1989, at 14-21. See also Chamberlin, Gruson & Weltchek, *supra* note 109, at 443-45; U.S. Conservation Groups and Banks Collaborate on Mammoth \$9 Million Ecuadorean Debt for Nature Swap, Nature Conservancy Press Release, Apr. 5, 1989; Weisskopf, *Ecuador Gets Aid for Debt, Environment*, Wash. Post, Apr. 6, 1989, at 20, col. 6.

¹³¹ Umaña, *Costa Rica Swaps Debt for Trees*, Wall St. J., Mar. 6, 1987, at 31, col. 4.

earnings it needs to repay its debt depend almost exclusively on agriculture and commodity exports.¹³² Second, Costa Rica possesses probably the richest concentration of plant and animal life in the world.¹³³ Third, Costa Rica has created a comprehensive national park system that covers twelve percent of the nation's territory. An additional fifteen percent of its land falls within other categories of protection such as indian and wildlife reserves.¹³⁴ Finally, parallel to this geographic protection, Costa Rica has developed a framework of administrative and legal institutions that have proven valuable in negotiating and implementing debt exchange agreements.¹³⁵

The first Costa Rican debt for nature exchange was approved by its government in August, 1987 and completed in February, 1988.¹³⁶ A brief account of the procedure followed in this transaction will serve to identify the mechanisms that were used as well as the various actors involved:

a) The Central Bank of Costa Rica (hereinafter The Central Bank) approved the exchange of foreign debt for local currency bonds pursuant to a proposal presented by the Fundacion de Parques Nacionales (hereinafter National Parks Foundation), a Costa Rican private organization.¹³⁷ The National Parks Foundation proposal delineated, *inter alia*, the projects to be funded, the estimated costs, and the amount of foreign debt to be re-

¹³² *Deficits and Debt Disturb the Peace*, EUROMONY, Mar., 1990 (Special Supp.), at 2.

¹³³ Costa Rica's forests are said to contain 208 species of mammals, 850 species of birds, 160 species of amphibians, 220 species of reptiles, 130 species of fresh water fish, 9,000 species of vascular plants and an estimated 35,000 species of insects. Umaña, *Costa Rica's Fight for the Tropics*, BRITANNICA BOOK OF THE YEAR, 126, 135 (1990).

¹³⁴ *Id.* at 135.

¹³⁵ *Id.* at 138. See also Tripoli, *Costa Rica Halts Assault on Its Fragile Tropical Forests*, CHRISTIAN SCI. MONITOR, Jan. 4, 1989, at 12.

¹³⁶ *Conservation Groups Help to Bail Out the Big Banks*, 65 BUS. & SOC. REV. 34, 35 (1988). The second exchange was completed in January, 1989. It involved an additional purchase of \$5.6 million worth of debt at 14 cents for a dollar. Passel, *Saving Costa Rica*, N.Y. TIMES, Feb. 8, 1989, at D2, col. 1. Further deals also were completed with donations from the Dutch and Swedish governments. Umaña, *Costa Rica's Debt for Nature Swaps Come of Age*, WALL ST. J., May 26, 1989, at A11, col. 4. As of February, 1990, the Costa Rican government had authorized debt for nature exchanges amounting to a total of \$86 million of foreign debt redemptions. Telephone interview with Alvaro Umaña, Costa Rica's Minister for Energy, Mining and Natural Resources (Feb. 7, 1990).

¹³⁷ Fundación de Parques Nacionales, *Oferta Canje Deuda Externa, Presentada Ante el Banco Central de Costa Rica* (1989) (on permanent file at PACE Y.B. INT'L L.).

deemed to fund those projects.¹³⁸

b) The Central Bank, the National Parks Foundation, the Ministry of Natural Resources, Energy and Mining, and a private bank, the Banco Cooperativo de Costa Rica, all entered into a "Debt for Nature Agreement." This Agreement established the characteristics and amount of the bonds and the commission (twenty-five percent) charged by the government. It also designated Banco Cooperativo as the agent bank to administer the exchange on behalf of the National Parks Foundation.¹³⁹

c) Upon completion of the target amount from private donations,¹⁴⁰ the National Parks Foundation proceeded to purchase the debt in the secondary market. A total of \$5.4 million worth of debt was acquired at a rate of seventeen cents on the dollar.¹⁴¹

d) Using Banco Cooperativo as agent, the National Parks Foundation exchanged the debt instruments for Central Bank bonds. The bonds pay twenty-five percent annual interest and mature two years later than the original debt.¹⁴² The bonds themselves are non-negotiable, but can be used as collateral to obtain local loans. The proceeds of the entire transaction are then used to fund environmental projects chosen by the donors

¹³⁸ *Id.*

¹³⁹ Ministerio de Industria, Energía y Minas, *Acuerdo Entre el Banco Central de Costa Rica, la Fundación de Parques Nacionales, el Ministerio de Industria, Energía y Minas y el Banco Cooperativo Costarricense, Para la Constitución de un Fondo de Conservación de Recursos Naturales* (1987) (on permanent file at PACE Y.B. INT'L L.). For later debt for nature swaps, however, the Costa Rican government increased its commission to seventy percent. Chamberlin, Gruson & Weltchek, *supra* note 109, at 445 n. 115.

¹⁴⁰ Funds for Costa Rican debt for nature swaps have been donated by, among others, The Nature Conservancy, World Wildlife Fund, Conservation International, Asociacion Ecologica La Pacifica, Pew Charitable Trust, The MacArthur Foundation, The J.S. Noyes Foundation, Swedish Society for the Conservation of Nature, and the Organization for Tropical Studies. Cody, Environment and Natural Resources Policy Division, Congressional Research Service Report for Congress, *Debt for Nature Swaps in Developing Countries: An Overview of Recent Conservation Efforts*, at 30 (1988). Despite new United States tax regulations favoring such donations, only one United States bank has thus far donated debt from its Third World portfolio. *Cf. Fleet Norstar Donates Latin Debt to Conservancy*, Wall St. J., Feb. 9, 1988, at 57, col. 4.

¹⁴¹ Cody, *supra* note 140, at 31.

¹⁴² Sevilla, *El Canje de Deuda por Conservación en America Latina y el Caribe*, Programa de las Naciones Unidas para el Medio Ambiente (United Nations Environmental Program), Quito, Ecu., Feb. 1989, at 14-21.

in coordination with the National Parks Foundation.¹⁴³

Costa Rica's successful experience with several debt for nature swaps illustrates that the initiative and the administrative structure needed to obtain the maximum benefit from these transactions must come from debtor countries. Only the debtor countries can decide the conditions on which they are willing to let outside organizations utilize their financial systems and influence what would otherwise be sovereign matters.¹⁴⁴ The administrative structures are also important for pragmatic reasons. Debt for nature exchanges would not be nearly as fruitful if the task of implementing them fell to competing administrative agencies lacking clear guidelines for conservation programs.

In this respect, Costa Rica's former President Oscar Arias provided unsurpassed leadership. Under his tutelage, the nation's administration of environmental protection was elevated to a ministerial level with its own resources and a well-defined agenda.¹⁴⁵ President Arias also supported legislative action aimed at conservation, and favored an increasing use of easily adaptable technology for tapping natural resources.¹⁴⁶

¹⁴³ See Fundación de Parques Nacionales, *Informe de Donaciones Correspondientes a 1988*, San José, Costa Rica, 1989, at 11-24 (on permanent file at PACE Y.B. INT'L L.). The money made available by debt for nature swaps in Costa Rica has been used to sponsor a number of conservation projects ranging from a \$2 million land acquisition (Megapark Project) to training programs costing less than \$1,000 each.

Among the projects currently funded are:

1. Tortuguero National Park. The Tortuguero beaches are nesting grounds for various endangered species of marine turtles. The Parks Foundation now has a protection program that includes scientific research, purchase of beaches, and education programs to increase awareness by adjacent populations (including an annual "turtle festival").

2. Grandoca Land Management Project. This project aims to slow deforestation and to support sustainable development through organization of plant nurseries, land tilting and creation of a national park.

3. Talamaca Complex. These are two national parks located on the border with Panama. These parks contain the greatest biological wealth in the region, with many interlocking habitats that include paramos, swamps, oak forests and fern groves. Funds are allocated to build conservation facilities and to help prevent poaching and deforestation. *Id.*

¹⁴⁴ Cf. Chamberlin, Gruson & Weltchek, *supra* note 109, at 447.

¹⁴⁵ This is the Ministry of Natural Resources, Energy and Mines. See Fuller & Williamson, *Debt for Nature Swaps: A New Means of Funding Conservation in Developing Nations*, in INT'L ENV'T REPORTER (Bureau of Nat'l Affairs, ed.), May 11, 1988, at 302.

¹⁴⁶ See Sun, *Costa Rica's Campaign for Conservation*, 239 SCIENCE 1366, 1367 (Mar. 18, 1988). On the subject of appropriate technology for the developing countries see Salam, *What the Third World Really Needs*, 44 BULLETIN OF THE ATOMIC SCIENTISTS 8

The recipient country's legal and administrative support is important for still another reason: It helps the international conservation organizations in their fund-raising activities. In order to avoid accusations of foreign domination these organizations must relinquish control of the donated funds, yet they must also "be able to vouchsafe to domestic donors and tax authorities the continuing responsible use of these funds."¹⁴⁷

The importance of allaying any fears of foreign domination in the recipient countries can hardly be exaggerated. Brazil provides the best example of the critical role such fears can play.¹⁴⁸ Brazil, a country with one of the highest foreign debts in the world (\$115 billion)¹⁴⁹ and holding the largest tract of rain forest of any nation,¹⁵⁰ could well be a leader in debt for nature transactions. Yet no such transaction has been negotiated thus far.

Debt for nature exchanges have been pictured by segments of the Brazilian government and press as schemes by the industrialized nations "intended to hold back its [Brazil's] development."¹⁵¹ Former President José Sarney specifically said that debt for nature swaps will not be considered in Brazil and warned that such international concern for its Amazon programs could lead to "a new colonial system."¹⁵² President Sarney's Foreign Minister made further assertions to the effect that what the international ecologists intended was to make Brazil an ecological reserve.¹⁵³ Thus, emotions ran high and the issue became ripe political capital for a number of public figures. One of these,

(Nov. 1988); *The Slow March of Technology*, *ECONOMIST*, Jan. 13, 1990, at 79. For an exposition of the environmental benefits of alleviating the debt problem of the developing countries see Arias, *For the Globe's Sake, Debt Relief*, *N.Y. Times*, July 14, 1989, at A29, col. 1.

¹⁴⁷ von Moltke, *Debt for Nature: An Overview*, World Wildlife Fund Press Release, at 1, col. 2.

¹⁴⁸ See Cohen, *U.S. Complaints on Amazon Destruction Spur Brazil's Resentment and Defiance*, *Wall St. J.*, Feb. 17, 1989, at A10, col. 1; Brooke, *Brazil Wants Foreign Aid to Fight Pollution, But No Strings*, *N.Y. Times*, Mar. 31, 1989, at A9, col. 1.

¹⁴⁹ Main, *A Latin Debt Plan that Might Work*, *FORTUNE*, Apr. 24, 1989, at 205.

¹⁵⁰ Brazil's forest basin has a surface of 1.9 million square miles. See Brooke, *Brazil Announces Plan to Protect the Amazon*, *N.Y. Times*, Apr. 7, 1989, at A5, col. 1.

¹⁵¹ *It's Our Forest to Burn If We Want To*, *ECONOMIST*, Mar. 11, 1989, at 42.

¹⁵² Brooke, *Brazil Wants Foreign Aid to Fight Pollution, But No Strings*, *N.Y. Times*, Mar. 31, 1989, at A9, col. 1.

¹⁵³ Moran, *Un Anthropologue étonné: Le Plus Grand Gaspillage de l'Histoire Humaine*, *L'Humanité*, Apr. 14, 1989 (Paris, Fr.).

the mayor of the western city of Ariquemes, demonstrated his contempt for United States conservation initiatives by saying that while Americans burned Vietnam's forests with napalm and other bombs, they now wanted to clear their consciences by blocking the development of Brazil.¹⁵⁴

These sensitivities over sovereignty may be difficult to dispel, particularly because Brazil's development plans consider the Amazon "the natural hinterland for its expansion."¹⁵⁵ However, there is hope that the new administration of President Collor de Mello may decide to take advantage of debt for nature exchanges as it sees the benefits that some of Brazil's neighbors have obtained without compromising their own sovereignty.¹⁵⁶

VII. THE OUTLOOK FOR DEBT FOR NATURE EXCHANGES

Since the first transaction took place in 1987, Congress has given debt for nature exchanges considerable attention and support. A specific example of that support is the International Development and Finance Act of 1989,¹⁵⁷ signed by President Bush on December 19, 1989. The Act authorizes multilateral development banks and United States relief agencies to use American foreign aid to carry out debt for nature exchanges.¹⁵⁸

¹⁵⁴ Brooke, *supra* note 152. See also *Mobilisation Internationale Pour la Protection de la Nature: Brésil, le sort de la forêt amazonienne suscite un âpre débat*, *Le Monde*, Mar. 9, 1989, at 3 (Paris, Fr.).

¹⁵⁵ Cohen, *U.S. Complaints on Amazon Destruction Spur Brazil's Resentment and Defiance*, *Wall St. J.*, Feb. 17, 1989, at 10, col. 1.

¹⁵⁶ Brazil has also been under pressure from other Latin American countries to improve its conservation efforts. Shortly before President Sarney was to announce his own rain forest plan, a group of leading Latin American intellectuals issued an open letter accusing him of "ecocide" and asking him to stop massive deforestation of the Amazon. Among the signers were Nobel laureate Gabriel Garcia Márquez of Colombia, Carlos Fuentes of Mexico and Mario Vargas Llosa of Peru. Serrill, *A Dubious Plan for the Amazon*, *Time*, Apr. 17, 1989, at 67.

¹⁵⁷ Pub. L. No. 101-240, 103 Stat. 2492 (codified as amended at 22 U.S.C. 2881).

¹⁵⁸ The Act directs the multilateral development banks to create a department that will:

(A) be responsible for environmental protection and resource conservation, including support for restoration, protection and sustainable use policies; (B) develop and monitor strict environmental guidelines and policies to govern lending activities; and (C) actively promote, coordinate and facilitate *debt for nature exchanges* and the restoration, protection and sustainable use of tropical forests, renewable natural resources, endangered ecosystems and species in debtor countries.

Id. at § 512 (a)(1) (emphasis added).

The International Development and Finance Act is comprehensive legislation that sets clear environmental guidelines for relief and development projects around the globe.¹⁵⁹ It encourages the recipient countries to adopt sustainable forms of exploitation, defined as those that "promote the maintenance and restoration of soils, vegetation, hydrological cycles, wildlife, critical ecosystems (tropical forests, wetlands and coastal marine resources), biological diversity and other natural resources essential to economic growth and human well-being. . . ." ¹⁶⁰

These guidelines are expected to have a sizable impact on world conservation efforts. Not only will they make more funds available for debt for nature exchanges, but they are also likely to prevent funding of environmentally destructive development projects by international relief organizations.¹⁶¹

Although the International Development Finance Act establishes a positive United States policy toward debt for nature exchanges, their increased utilization faces several limitations. One such limitation lays in potential changes in the secondary market itself. Debt for nature exchanges can continue only as long as banks are willing to sell their loans. Yet, because every loan redeemed leaves fewer loans outstanding, the debt leverage of the Third World will improve as the number of debt exchanges increases. This improved debt leverage will lower sovereign risk. As a result, the secondary market prices may either be too high, and thus unattractive to the conservation groups, or it may disappear altogether.¹⁶² However, there is no indication that these changes will occur in the near future. The sheer magnitude of

¹⁵⁹ The Act calls on the Secretary of the Treasury to direct the multilateral banks to "support and encourage the approval of multilateral development bank loans which include provisions that foster and facilitate the implementation of a sound and effective environmental policy in the borrowing country. *Id.* at § 512 (a)(2).

¹⁶⁰ *Id.* at § 512 (b)(4).

¹⁶¹ The Grand Carajás Project in Brazil, for example, a complex of pig iron smelters funded by the World Bank, will require the burning of thousands of acres of forest a year for the production of charcoal. The steel production, 90 percent of which is to be exported, "will not be profitable if it had to include systematic reforestation." Ruellan, *Le Projet du Grand Carajás au Brésil, un Saccage Lucratif des Forêts*, *Le Monde Diplomatique*, Sept. 1989, at 3 (Paris, Fr.).

For a broad study of the destructiveness of development projects funded by international relief organizations see GRAHAM HANCOCK, *THE LORDS OF POVERTY* (1989).

¹⁶² See *A Debtor's Dream*, *ECONOMIST*, Sept. 10, 1988, at 81.

the Third World debt, \$1.2 trillion,¹⁶³ makes the secondary market a necessary outlet for dubious loans and assures that market's continued existence.

Fund raising is another limiting factor. Although government participation is now increasing, as the International Development and Finance Act of 1989 and contributions from the Dutch and Swedish governments demonstrate,¹⁶⁴ the bulk of the funding to purchase LDC debt comes from private institutions. The main participants in fund-raising activities thus far are the private international conservation organizations. However, these organizations have their own size and personnel limitations as well as competing projects to attend. Furthermore, as the number of countries willing to participate in debt for nature exchanges increases, the available share of donations decreases, and otherwise attractive conservation projects must go unfunded.

The other logical candidates to supplement these fund-raising activities are the major international lenders. Lenders can donate portions of their non-performing loans either to the international conservation groups or, within the framework of debt for nature agreements, directly to LDCs. With the single exception of one regional bank's donation of Costa Rican debt, however, such options have been universally rejected by lenders.¹⁶⁵

There are two important reasons for this rejection. First, banks do not want to promote the notion that they are willing to forgive foreign debt. Their shareholders are unlikely to support such actions because of their negative balance sheet impact. Banks also fear that loan forgiveness may disrupt the fragile repayment agreement already reached with some debtors and perhaps even promote further defaults. Second, there are few finan-

¹⁶³ *Conservation Groups Help to Bail Out the Big Banks*, 65 Bus. & Soc. Rev. 34 (1988).

¹⁶⁴ Umaña, *Costa Rica's Debt for Nature Swaps Come of Age*, Wall St. J., May 26, 1989, at A11, col. 4.

¹⁶⁵ This was a \$254,000 donation from the Fleet National Bank of Rhode Island. See *Fleet/Norstar Donates Latin Debt to Conservancy*, Wall St. J., Feb. 9, 1988, at A57, col. 4. Contrary to original press coverage, however, this donation was not done for tax relief purposes. According to Fleet's President William J. Penn, "Fleet's earnings position was such that a charitable deduction was not required for purposes of its financial statements." Dionne, *Treasury Agrees to Construe Revenue Ruling on Debt for Nature Swaps Liberally*, 1988 Tax Notes, at 308.

cial incentives for banks to make debt donations. This is still the case despite a 1987 Internal Revenue Service Ruling declaring that banks could deduct from taxes the full face value—not just the fair market value, as previously held—of any debt donated to a charitable organization.¹⁶⁶ Banks still conclude that it is more attractive to sell their high risk debt in the secondary market than to donate it in order to take advantage of the allowed tax deductions.¹⁶⁷

Finally, donors and other supporters of these exchanges want assurances that debt for nature agreements contain sufficient safeguards to deter violations by the recipient countries. Donors fear that once a government has had portions of its foreign debt cancelled it might withdraw its support for specific environmental projects, particularly in the face of mounting political or economic pressure. In view of the usually low status that developing countries give to their own agencies in charge of conservation and the general lack of local environmental protection laws, those fears are not unreasonable.

Although a recipient country can always raise issues of sovereignty to foreclose internal remedies sought by the sponsors, several interlocking factors still protect debt for nature exchanges. Recipient countries, for example, continue to receive direct funding for other projects long after the debt exchange transaction is concluded. Consequently, countries may have more to lose in the long run by violating their agreements than whatever short-term gains they may obtain from such conduct. On the other hand, sponsors of debt for nature exchanges rely on long-term working relationships with local nongovernmental conservation organizations. These organizations usually have active constituencies and dedicated staff members who, together

¹⁶⁶ Rev. Rul. 87-124, 1987 C.B. 205. The Treasury Department clarified that the Ruling will be interpreted liberally, and that either foreign currency or foreign currency-denominated bonds may be exchanged for the LDC debt. See Dionne, *supra* note 158, at 307. But see Halperin, *Revenue Ruling 87-124: Treasury's Flawed Interpretation of Debt for Nature Swaps*, 43 U. MIAMI L. REV. 721 (1989) (too many legal contortions required to justify the interpretation given by the Treasury.)

¹⁶⁷ According to the present United States tax laws, a lender donating debt worth one dollar will get a maximum tax credit of 34 cents. If the lender sells the debt in the secondary market for 35 cents, however, it will get the 35 cents cash plus a 22 cents tax credit (on the loss of 65 cents), for a total of 57 cents. See Burton, *Back to Nature the Financial Way*, *BANKER*, Dec. 1988, at 23.

with the international groups, present a wide-ranging public opinion barrier to government violations. The local environmental groups also can seek redress through various areas of national law (for example, tort, contract or property law), which are less readily available to international groups.

IX. CONCLUSION

Debt for nature exchanges represent a unique opportunity to alleviate two of the most fundamental problems of the world today: Third World debt and the destruction of rain forests. These exchanges allow the recipient countries to attain sustainable utilization of their natural resources and to pursue conservation projects they could not otherwise afford. Furthermore, even if direct reduction of foreign debt is minimal, the conversion of hard currency obligations to local currency relieves economic pressures on the debtors. Reduction of economic pressure will, in turn, improve the possibility of repayment for the rest of the debt, a direct benefit to international lenders for whom judicial remedies for sovereign defaults are highly costly and uncertain.

Of all the actors involved in debt for nature exchanges, the recipient countries play the most important role. These countries must take the initiative by establishing legal and administrative structures that will lend credibility to their conservation objectives. Such structures are important not only for an efficient implementation of the programs themselves, but also because sponsoring international organizations require assurances that once they relinquish control of the funds no deviations from the initial goals will occur.

Debt for nature exchanges are essentially banking transactions. Yet, the mere availability of banking mechanisms does not guarantee their efficient use. The international financial community can play an active role in these exchanges even if debt donation is not a viable option for them. The advisory services that some banks have rendered to conservation groups could be expanded to provide technical data to debtors and to assist in identifying debt exchange opportunities. In addition, multinational banks could pursue the elimination of negative pledges in their syndication loans as well as in their restructuring agreements, thereby freeing new portions of debt to enter the secondary market.

Even under the most favorable circumstances, debt for nature exchanges themselves are at most only a small step in solving the extensive problems of the Third World. Their existence, however, has great significance in changing perceptions of these problems and in making new kinds of solutions available. Debt exchanges improve the ratio between expenditures and true impact in the recipient country. They can also provide the foundation for better conservation policies within these countries, and they may lead to the adoption of debt repayment strategies compatible with the preservation of the rain forests.

Most importantly, debt for nature exchanges may make the industrialized world aware of the intricate relationship between the economic plight of developing countries and the destructive exploitation of their natural resources.

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