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NORTH CAROLINA JOURNAL OF
INTERNATIONAL LAW AND
COMMERCIAL REGULATION

Volume 16 | Number 1

Article 8

Winter 1991

The Feasibility of Debt-For-Nature Swaps

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Recommended Citation

Nina M. Dillon, *The Feasibility of Debt-For-Nature Swaps*, 16 N.C. J. INT'L L. & COM. REG. 127 (1991).
Available at: <http://scholarship.law.unc.edu/ncilj/vol16/iss1/8>

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The Feasibility of Debt-For-Nature Swaps

Cover Page Footnote

International Law; Commercial Law; Law

The Feasibility of Debt-For-Nature Swaps

I. Introduction

Since the early 1980s economists have been warning the Western financial community of the potentially grave threats posed by the "Third World Debt Crisis."¹ Nevertheless, Third World debt, especially that of Latin American countries, has continued to increase at phenomenal rates.² The International Monetary Fund, in its *World Economic Outlook*, estimates that the external debt of developing nations will rise by nine percent during 1990-1991.³ Recent reports estimate that Brazil's foreign debt is nearly \$120 billion—approximately 1.4 percent higher than it was one year previously.⁴ The total debt of the leading Latin American nations is estimated at \$390 billion.⁵

Tragically, the rate of tropical deforestation in Latin America has paralleled the region's astronomical borrowing patterns. Every day, 140,000 acres of tropical forest are cut for timber, burned for cultivation, or clearcut for cattle grazing.⁶ Some Latin American countries, under intense pressure to meet foreign debt obligations,

¹ Weinert, *Swapping Third World Debt*, 65 FOREIGN POL'Y 85 (1986).

² The World Bank estimated total Third World or "LDC" (less developed country) debt at \$142 billion in 1974. THE AMERICANA ANNUAL 291 (1981). By 1980, this figure had increased to \$376 billion. *Id.* According to a survey recently conducted by the World Bank, Third World debt has now risen to over \$1.3 trillion. THE WORLD ALMANAC 75 (1990).

³ *International Finance—Mideast Crisis, Third-World Debt Issues for Bank-Fund Meeting*, 1990 Daily Rep. for Executives, Sept. 24, 1990, at A-1. It is estimated that the total amount of external debt of developing nations will reach \$1.35 trillion by the end of 1991. *Id.*

⁴ N.Y. Times, Jan. 19, 1990, at 48, col. 5. Brazil's debt represents the largest owed by any Third World country. *Id.*

⁵ See THE WORLD ALMANAC, *supra* note 2, at 75. The breakdown by country is as follows: Brazil—\$120 billion; Mexico—\$107 billion; Argentina—\$60 billion; Venezuela—\$35 billion; Chile—\$21 billion; Peru—\$19 billion; Colombia—\$17 billion; Ecuador—\$11 billion. *Id.*

⁶ THE NATURE CONSERVANCY, INTERNATIONAL PROGRAM, PROTECTING THE WORLD'S REMAINING TROPICAL HABITATS (1989). If deforestation continues at current rates, almost all pristine habitat will be obliterated in thirty years. *Id.* The Nature Conservancy postulates that possibly three-fourths of the millions of plant and animal species that populate the world are located in a small band of tropical forest close to the equator. *Id.* Many of these plant and animal species have yet to be discovered. *Id.* Although the Nature Conservancy's estimate may be high, more conservative estimates are also extremely alarming. As early as 1981, the Council on Environmental Quality and the State Department estimated that 50% of the world's tropical forest reserves would be depleted by the year 2000. 1 THE GLOBAL 2000 REPORT TO THE PRESIDENT: ENTERING THE 21ST CENTURY 36 (G. Bar-

often implement policies that contribute to deforestation.⁷ The urgency of this situation has spurred environmental groups to devise innovative ways to curb deforestation. Debt-for-nature swaps are clever proposals which seek simultaneously to alleviate foreign debt and deforestation concerns. This Comment will explore the feasibility of debt-for-nature swaps. First, it will describe what a debt-for-nature swap is and explain how one works. Second, it will analyze the recent Revenue Ruling which purports to provide commercial lenders with an incentive to participate in debt-for-nature swaps. Third, it will focus on some of the incentives and disincentives that a debt-for-nature swap provides to the parties involved in the swap. Finally, it will assess the overall feasibility and effectiveness of debt-for-nature swaps.

II. The Mechanics of a Swap

A debt-for-nature swap is an agreement whereby a portion of a debtor nation's foreign debt is retired in exchange for that country's pledge to institute environmental protection programs. Although the specific provisions of each debt-for-nature swap are unique and can be quite complex, there are two basic ways in which a swap may be structured. In the first and most commonly used method, a private conservation organization purchases Third World debt, usually at a substantial discount, from a private bank.⁸ The conservation organization then negotiates with the debtor nation's central bank to redeem the debt and issue local-currency bonds equivalent to the total debt.⁹ These bonds are issued in the name of a local conservation organization, which is charged with the responsibility for overseeing environmental protection programs in an area designated by the conservation organization. The conservation program may also be financed in part by the interest paid on the bonds.¹⁰

The debt-for-nature swap engineered by Conservation Interna-

ney ed. 1981). A Boston Globe report projected that deforestation is occurring at a rate of 26 million acres per year. Boston Globe, Oct. 18, 1987, at 24, col. 4.

⁷ See Copeland, *Buying Debt, Saving Nature*, NEWSWEEK, Aug. 31, 1987, at 46 ("Countless species of plants and animals will die in the greatest extinction since the end of the age of the dinosaurs. . . . But biology lectures carry little clout with poor countries desperate for cash to pay huge foreign debts."). See also Cevallos, *Ecuador: Environmental Damage Blamed on Foreign Debt*, Inter Press Service, Nov. 20, 1989 (Mr. Gonzalo Oviedo stated that Ecuador's mangrove forests were "ravaged when former President Leon Febres Cordero's government encouraged prawn exports to bring in much-needed foreign exchange to pay for Ecuador's foreign debt.").

⁸ See generally Note, *Revenue Ruling 87-124: Treasury's Flawed Interpretation of Debt-For-Nature Swaps*, 43 U. MIAMI L. REV. 721, 723 (1989). The purchaser is able to obtain the discount because the bank realizes it may be fortunate to recover any of the money it loaned to the impoverished country. *Id.*

⁹ *Id.*

¹⁰ *Id.* See also Work & Smith, *Using Red Ink to Keep Tropical Forests Green*, U.S. NEWS & WORLD REP., Mar. 6, 1989, at 49.

tional with the Bolivian government provides an illustrative example of how a swap actually works. In 1987, Conservation International¹¹ initiated the transaction by purchasing \$650,000 of Bolivian commercial bank debt for \$100,000 from an affiliate of Citibank.¹² A written contract was then executed between Conservation International and the Bolivian government. Conservation International agreed to extinguish the \$650,000 debt obligation owed to it by Bolivia, provided that Bolivia establish an endowment fund of local currency equivalent to \$250,000 to cover the operating costs of managing the Beni Biosphere Reserve¹³ in the northeastern region of Bolivia.¹⁴ The agreement also designated Conservation International as an official adviser to the Bolivian government in the design, planning, and establishment of the means of administering the protected areas.¹⁵ In addition, the contract specified that the areas covered by the agreement be granted the highest legal protection status accorded under Bolivian law.¹⁶

A similar transaction between Conservation International and Costa Rica sheds further light on the financial intricacies involved in a debt-for-nature swap. Conservation International transferred \$50,000 to Fundacion de Parques Nacionales (FPN), a Costa Rican conservation organization.¹⁷ At the time of the transfer, Costa Rican debt was selling at seventeen cents on the dollar.¹⁸ Because the Costa Rican central bank retained a 25% redemption fee, the initial \$50,000 was converted into \$215,000 local currency.¹⁹ The local currency was then used to purchase monetary stabilization bonds with a three to five year maturity date.²⁰ The bonds were placed in an endowment fund earning at least 23% interest.²¹ Interest on the bonds is to be paid quarterly and will amount to about \$50,000 per year for at least three years.²² Conservation International may start redeeming the bonds for 25% of their value after four years. The remaining principal will continue to accrue interest until all the bonds have been cashed.²³ In a deal orchestrated by the Nature

¹¹ Conservation International is a private, nonprofit organization dedicated to the protection of the environment.

¹² CONSERVATION INT'L, THE DEBT-FOR-NATURE EXCHANGE, A TOOL FOR INTERNATIONAL CONSERVATION 13 (1989).

¹³ The Beni Biosphere Reserve is a protected area established by an administrative decree issued by Bolivia's National Academy of Sciences. *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ CONSERVATION INT'L, LA AMISTAD DEBT CONVERSION ACTIVITY SUMMARY.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* This high interest rate compensates for the inflation/devaluation rate. *Id.*

²² *Id.*

²³ *Id.*

Conservancy, Fleet/Norstar Financial Group of New York donated \$250,000 of outstanding debt to Costa Rica. In exchange, Costa Rica agreed to add 25,000 acres of tropical forest to the Braulio Carrillo National Park.²⁴

The second method of structuring a debt-for-nature swap is to have the private bank negotiate directly with the central bank of the debtor nation to exchange Third World debt for bonds or currency of the debtor nation.²⁵ The private bank then donates the bonds or currency to a conservation organization, which uses the funds for environmental protection programs in the debtor nation.²⁶

Regardless of what form the swap takes, some of the potential benefits of these transactions are immediately apparent: the private bank is able to remove a portion of delinquent debt from its books;²⁷ conservation organizations move toward fulfillment of their conservation goals;²⁸ and the debtor nation not only is permitted to pay back part of its debt in local currency, but is also able to ensure the preservation of some of its natural resources in the process.²⁹ Although the magnitude of the debt-for-nature swaps has been small in comparison to the overall Third World debt figures, the dollar amounts and acreage involved are nevertheless impressive.³⁰ Thus far, about \$26 million has been used for debt-for-nature swaps.³¹

²⁴ Lenssen, *Debt-For-Nature Swaps*, WORLD WATCH, Dec. 1988, at 376.

²⁵ See generally Lamp, *A Tax Blueprint For LDC Swaps*, 39 TAX NOTES 1215 (1988).

²⁶ *Id.* at 1216. Typically, the U.S. conservation organization donates its gift from the bank to an affiliated conservation organization in the debtor nation. *Id.*

²⁷ In addition, the bank might also be eligible for favorable tax treatment. See *infra* notes 32-50 and accompanying text.

²⁸ Because the conservation organization usually purchases the foreign debt at a substantial discount, its actual spending power is increased once the debt is swapped for the foreign country's local currency. See Lamp, *supra* note 25, at 1216. For example, if the less developed country's (hereinafter LDC) debt is selling at a 50% discount, a conservation organization could spend \$100 for \$200 face value of LDC debt. *Id.* The actual exchange rate at which the foreign government will agree to reacquire the \$200 of its debt is then negotiated. *Id.* Although this exchange rate is not likely to be at full value (i.e., \$200 in local currency), the conservation organization nevertheless ends up with a material increase in its spending power. For example, if the foreign country, in the hypothetical above, agreed to a 90% exchange rate, the conservation organization would end up with \$180 in local currency for its initial \$100 investment. *Id.*

²⁹ See generally THE NATURE CONSERVANCY, SWAPPING DEBT FOR NATURE (1989).

³⁰ Recent examples include: redemption of \$650,000 in Bolivia in exchange for the setting aside of 3.7 million acres of tropical forest; retirement of \$11 million of Costa Rican debt in exchange for protection of national parks on the mainland and on the Galapagos Islands; and the commitment by the World Wildlife Fund to swap \$2 million of the Philippines' external debt in return for conservation training funds. Work & Smith, *supra* note 10, at 49. In addition, both Sweden and the Netherlands have participated in swaps. See CONSERVATION INT'L, *supra* note 17. Most recently, the Dominican Republic entered into an agreement to convert up to \$80 million into local currency to be used for conservation programs. *Largest Debt-For-Nature Program Announced in Dominican Republic*, PR Newswire, Mar. 2, 1990 (available on Nexis). This agreement will retire 10% of the Dominican Republic's debt. *Id.*

³¹ Kelash, *Development Swaps Said to Top \$132 Million*, AM. BANKER, May 8, 1990, at 30. Debt-for-nature swaps fall within the larger category of debt-for-development swaps. This

III. Tax Consequences

Naturally, conservation organizations would prefer that private banks donate rather than sell discounted LDC debt; the United States Treasury Department's liberal interpretation³² of Revenue Ruling 87-124³³ attempts to encourage banks to do just that. It is important to note that the Ruling applies only to that debt which a private bank donates (i.e., as in the second alternative in Part II, above).³⁴

Revenue Ruling 87-124 sets out the following situation:

FACTS

X, a United States commercial bank, holds a United States dollar denominated debt (the Obligation) of the central bank (Central Bank) of foreign country FC. The Obligation evidences a loan of \$100 that X made to the Central Bank. X's adjusted basis in the Obligation, as determined under section 1011 of the Internal Revenue Code of 1986, is \$100. Under the laws of FC, the Obligation cannot be held by an FC entity. . . .

The local currency of FC is the LC. On July 1, 1987, the free market exchange was \$1 = 10 LCs.

FC has a program (the Program) whereby a holder of United States dollar denominated debt of FC can negotiate with the Central Bank to deliver the FC debt to the Central Bank for LCs if the holder agrees to invest the LCs in . . . a manner approved in advance by the government of FC. The Program controls the LCs by . . . channeling the LCs to their designated use in FC. . . . The amount of LCs the Central Bank will give the holder in exchange for the debt varies according to how the LCs are used.

In accordance with a prearranged plan pursuant to the Program, the following transaction occurred on July 1, 1987:

[X delivered the debt instrument to the Central Bank and] the Central Bank credited an account of Z, a United States corporation that is a charitable organization [as defined by the Internal Revenue Code] with 900 LCs. Under the terms of the Program, Z can use the 900 LCs only in FC for charitable purposes [as defined in the Internal Revenue Code]. . . .

latter category includes any transaction in which a country's foreign debt is retired in exchange for the country's promise to institute domestic development programs.

³² See Letter from C. Eugene Steuerle, Treasury Deputy Assistant Secretary for Tax Analysis, to Sen. John H. Chafee, Senate Finance Committee member (Mar. 29, 1988) (hereinafter Steuerle Letter), reprinted in 39 TAX NOTES 402 (1988).

³³ Rev. Rul. 87-124, 1987-2 C.B. 205. Revenue Rulings are Treasury Department opinions. They provide an interpretation of substantive tax law for "the purpose of promoting uniform application of the tax laws for the guidance of taxpayers." See B. BITTKER & L. STONE, FEDERAL INCOME TAXATION 1148-49 (5th ed. 1980). Although Revenue Rulings are less authoritative than Treasury Regulations, they are considered persuasive authority by most courts when cited as precedent by taxpayers in substantially similar circumstances. *Id.*

³⁴ Where a bank sells a portion of LDC debt to a conservation organization at a discount, the tax consequences for the bank are the same as they would be for any other transaction in which the bank takes a loss. See Lamp, *supra* note 25, at 1215. The loss that a bank recognizes on the exchange is, of course, deductible. *Id.*

HOLDING

Under the facts described above, the federal income tax consequences to X . . . are as follows:

(1) X recognizes a loss on the exchange of the Obligation for the 900 LCs to the extent of the excess of its adjusted basis in the Obligation (\$100) over the fair market value of the 900 LCs.

(2) If X and Z otherwise satisfy all the requirements of the code in relation to charitable contributions, X is entitled to a charitable contribution deduction equal to the fair market value of the 900 LCs at the time of the contribution.³⁵

Revenue Ruling 87-124 thus separates a debt-for-nature swap into two parts, enabling a commercial bank to claim both a tax deductible loss for the difference between the face value of the loan at the time it was made and its fair market value at the time of the donation,³⁶ and a deductible charitable donation equal to the fair market value of the proceeds generated by the swap.³⁷

On March 29, 1988, Eugene Steuerle, Deputy Assistant Treasury Secretary for Tax Analysis, issued a letter that was promptly hailed as a liberal clarification of Revenue Ruling 87-124.³⁸ The letter responded to specific questions posed by Senator John H.

³⁵ Rev. Rul. 87-124, 1987-2 C.B. 205. The Ruling also discusses two other fact patterns pertaining to debt-equity swaps, a conceptually similar debt reduction mechanism. In a debt-equity swap, the "donating" bank receives an interest in a local business venture—the construction of a high-rise hotel, for example. See Comment, *Debt Equity Swaps in Developing Countries: Toward a Workable System*, 9 B.C. THIRD WORLD L.J. 39, 42 (1989). Debt-equity swaps tend to be controversial because the primary impetus behind their execution is viewed as foreign financial interest rather than provision of local aid to the debtor nation. See *Mini-Debt-For-Nature Swap to Break the Ice in Dominican Republic*, INST'L INVESTOR, Dec. 11, 1989, at 8. See also Marton, *The Debate Over Debt For Equity Swaps*, INST'L INVESTOR, Feb. 1987, at 177 ("In nine out of ten swaps, it is one big rip-off [because] the investment would have come in anyway, and the central bank is saddled with paying an unnecessary subsidy to provide the local currency."). The debt-equity fact scenarios in Rev. Rul. 87-124 are inapposite to debt-for-nature swaps.

³⁶ Thus, in the example above, the bank would have a tax deductible loss of \$10. See Lamp, *supra* note 25, at 1217.

³⁷ The bank would have a charitable deduction of \$90. *Id.* In order to claim this charitable deduction, however, the donation and the conservation organization to which the donation is made must meet the requirements of I.R.C. § 170, which defines a charitable contribution as:

(c) . . . a contribution or gift to or for the use of—

.....

(2) A corporation, trust, or community chest, fund, or foundation—

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes . . . ;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified . . . by reason of attempting to influence legislation and which does not participate in or intervene in (including the publishing or distributing of statements) any political campaign

I.R.C. § 170(c)(2) (1988).

³⁸ See Note, *supra* note 8, at 724 (characterizing Steuerle's letter as evidence of the Treasury Department's intention to construe Rev. Rul. 87-124 liberally). See also Dionne,

Chafee.³⁹ Steuerle stated that the issuance of bonds, rather than local currency, as used in the facts of Revenue Ruling 87-124, to the U.S. charity by the central bank of the foreign country would be consistent with the principle underlying Revenue Ruling 87-124.⁴⁰ Steuerle's favorable opinion with respect to bonds was viewed by environmental groups as significant to the effectiveness of debt-for-nature swaps.⁴¹

Steuerle also interpreted the requirement that the donation be made "to or for the use" of charities created or organized in the United States⁴² to mean that: "[a] U.S. charity may work in cooperation with a [foreign entity] . . . without jeopardizing the charitable deduction, provided that the U.S. charity has such control and discretion regarding contributions as to ensure that the contributions will be used to carry out the U.S. charity's charitable functions and purposes."⁴³ Such an interpretation represents a tacit endorsement of the form of debt-for-nature swaps which use local conservation organizations in the debtor's own country.⁴⁴

Revenue Ruling 87-124 addresses charitable contributions generally. Although the Ruling is clearly applicable to debt-for-nature swaps, it does not mention them specifically. In October of 1987, Senator Chafee introduced a bill which was specifically designed to provide incentives for charitable contributions of debt to conservation groups.⁴⁵ The bill sought to amend the Internal Revenue Code explicitly to incorporate the tax incentives created by Revenue Rul-

Treasury Agrees to Construe Revenue Ruling on Debt-For-Nature Swaps Liberally, 39 TAX NOTES 307 (1988) ("the Treasury interpretation is liberal"). As one commentator put it:

A tax attorney might advise, on a technical level, that the letter has no official status [like the Revenue Ruling it interprets] and that one relies on it at one's peril. However, it's a good bet that everyone will accept the letter as authoritative, especially since the rationale advanced seems sound.

Lamp, *supra* note 25, at 1217.

³⁹ Senator Chafee, a Republican from Rhode Island, is a member of the Senate Finance Committee. Chafee posed three hypothetical fact scenarios and requested Steuerle's advice about whether Rev. Rul. 87-124 would be applicable to them. See Steuerle Letter, *supra* note 32, 39 TAX NOTES at 402.

⁴⁰ *Id.* The stated principle underlying the Ruling is that "when there are two paths available to the charitable donor, the tax consequences turn on which path he chooses; so long as there is substance to what he does, there is no requirement that he choose the more expensive way." *Id.* (citing *Palmer v. Commissioner*, 62 T.C. 684, 693 (1974)).

⁴¹ Barbara J. Bramble, Director of the National Wildlife Federation, remarked in one instance that "interest paid on the bonds [issued pursuant to a debt-for-nature swap] has doubled the Ecuadorian park service budget in the past six months." See Dionne, *supra* note 38, at 309.

⁴² See I.R.C. § 170(c)(2)(A) (1988).

⁴³ See Steuerle Letter, *supra* note 32, 39 TAX NOTES at 402 (citing Rev. Rul. 75-65, 1975-1 C.B. 79; Rev. Rul. 66-79, 1966-1 C.B. 48; Rev. Rul. 63-25, 1963-2 C.B. 101).

⁴⁴ Such provisions in swaps may be more attractive politically because vesting control of the conservation effort in the hands of a local charity helps dispel the impression that debt-for-nature swaps are yet another example of industrialized nations seeking to manipulate a debtor nation's internal affairs.

⁴⁵ S. 1781, 100th Cong., 1st Sess., 133 CONG. REC. 14,063-66 (1987).

ing 87-124.⁴⁶ Although the bill was never passed,⁴⁷ it is nonetheless significant because members of Congress thereby acknowledged that debt-for-nature swaps are "an imaginative way to help developing nations implement and maintain conservation programs [and are] an example of taking a very bad situation [the Third World Debt Crisis] and salvaging a little good out of it."⁴⁸ This acknowledgment may provide the key to enactment of future legislation designed to make debt-for-nature swaps more attractive to commercial banks in the future.⁴⁹ As the tax law currently stands, however, there are several ambiguities which are impeding the banks' willingness to engage in more swaps. The primary tax law obstacle concerns the valuation of both the deductible loss and the donation.⁵⁰

Finally, despite Revenue Ruling 87-124 and Mr. Steuerle's favorable interpretation of the Ruling, the tax consequences for a bank that enters into a debt-for-nature swap remain speculative.⁵¹ Because each swap is unique, there is a belief that most swaps would be subject to a case-by-case determination by the Internal Revenue Service.⁵² Although any bank contemplating a swap could obtain a private letter ruling⁵³ prior to finalizing the transaction, "prospective

⁴⁶ See Rev. Rul. 87-124, 1987-2 C.B. 205.

⁴⁷ Steuerle's clarification letter apparently made the need for the legislation superfluous. See Dionne, *supra* note 38, at 310 (Executive Vice President and General Counsel for the World Wildlife Fund stating that "the [Steuerle] letter makes it possible for us to rely on the ruling arranging debt-for-nature swaps with bank-donated debt without the need for specific legislation").

⁴⁸ 133 CONG. REC. at 14,064.

⁴⁹ *But see* Loudon, *Tax Breaks For Third World Become Subject of Scrutiny*, 44 TAX NOTES 17 (1989) ("Still reeling from the savings and loan debacle, legislators are beginning to . . . focus . . . their attention on how tax breaks affect the treatment of loans made to less developed countries."). Even absent legislation, however, the ability of conservation organizations to devise ways to exploit Internal Revenue Code provisions to their advantage should not be underestimated. See *Conservation Groups Use Innovative Financial Strategy to Benefit Caribbean Environment*, Business Wire, Dec. 27, 1989. Recently, the Nature Conservancy used I.R.C. § 936 (implemented to promote corporate investment in Puerto Rico and other U.S. territories) to generate funds for conservation. The Nature Conservancy and the Puerto Rican Conservation Trust, a local conservation organization authorized to receive the investments of § 936 companies, plan to use the income derived from their joint venture to engineer several debt-for-nature swaps. *Id.*

⁵⁰ See CONSERVATION INT'L, *supra* note 12, at 25.

[O]verly optimistic readings of Rev. Rul. 87-124 initially led some nonprofit organizations to believe that the combined value of the bad loan loss deduction and charitable contribution deduction available to a donor could exceed the donor's adjusted basis in the donated debt even where the debt had depreciated in value, [but] tax experts . . . since have cautioned that such a windfall probably would be disallowed by the I.R.S.

Id.

⁵¹ See Lamp, *supra* note 25, at 1220 (noting that "[although] the U.S. Treasury has done much to make debt for charity swaps possible without violating traditional tax rules, [t]he remaining tax uncertainties may deter some donations of LDC debt for charity swaps").

⁵² See Dionne, *supra* note 38, at 310.

⁵³ A private letter ruling is an I.R.S. opinion which interprets the tax law based on a specific set of facts. Private letter rulings have no precedential value and may be relied

bank-donors are reluctant to incur the time and expense involved in obtaining [such a] ruling simply to give away a portion of their assets."⁵⁴

IV. Practical Considerations

Quite apart from the tax considerations, the decision to enter into a swap may also be affected by powerful practical and political considerations. As previously stated, there are three primary parties to a debt-for-nature swap: the commercial bank, the debtor nation, and the conservation organization. Factors which influence the decisions of each of these organizations shall be discussed in turn.

A. The Bank

Banks derive one obvious benefit from participation in debt-for-nature swaps: removal of excessive and unproductive foreign debt from their balance sheets. In addition to the accounting benefits, banks also receive at least a token return on their LDC loans. Because the loss is taken for a good cause, disgruntled shareholders may be mollified in the process.⁵⁵ The potential benefit with regard to the shareholders might in reality, however, prove to be a double-edged sword. If the loss taken by the bank is large enough to diminish shareholder dividends, it is quite possible that shareholder magnanimity would give way, especially by those who do not recognize the importance of environmental preservation in the Third World.

Banks have, in fact, steadfastly refused to donate debt outright to conservation organizations.⁵⁶ Perhaps they fear that donating large amounts of one country's debt will jeopardize collection of their other outstanding loans.⁵⁷ The banks nevertheless continue to play an important role in debt-for-nature swaps because their willingness to sell the debt at deep discounts is one of the factors that makes debt-for-nature swaps so attractive to conservation organizations.⁵⁸ One problem with which conservation groups may have to

upon only by the taxpayer to whom the letter is issued. These rulings are very important in large transactions and a favorable ruling is often a condition precedent to the consummation of a business transaction. See B. BITTKER & L. STONE, *supra* note 33, at 1149.

⁵⁴ See Dionne, *supra* note 38, at 308.

⁵⁵ Snow, *Nature-For-Debt Swaps Make Conservation Hit Parade*, WorldPaper, Aug. 1988, at 15.

⁵⁶ *Id.* at 309 (Barbara J. Bramble, Director of the National Wildlife Federation, stated it has had "no luck" in obtaining LDC donations, and expectations are that if debt ever were donated, it would be by "the smaller banks . . . , either for goodwill or as part of their exit strategy.").

⁵⁷ See Lenssen, *Debt-For-Nature Swaps*, WORLD WATCH, Dec. 1988, at 376.

⁵⁸ See Lamp, *supra* note 25. Ironically, "the sudden interest of well-endowed conservation groups [in debt-for-nature swaps] has some New York banks reconsidering the size of the discounts they'll offer." See Snow, *supra* note 55, at 15. The Nature Conservancy listed its total support and revenue at \$168,554,000 for the fiscal year ending June 30, 1989. 1989 *Financial Summary*, NATURE CONSERVANCY MAGAZINE, Nov. 1989, at 27.

contend is the growing temptation for banks actually to cancel some of their foreign debt.⁵⁹ This would diminish the leverage on which conservation groups depend.⁶⁰

B. Debtor Nations

Like banks, debtor nations receive obvious benefits from participation in debt-for-nature swaps: reduction of their foreign debt obligation and improved conservation programs. Nonetheless, while the commodity that the foreign nations give up in exchange seems benign, debt-for-nature swaps have proven to raise serious political questions for the debtor nations involved. "No developing country, facing pressing social needs in schools, housing, health care, and so forth, can afford to commit major proportions of its currency solely to conservation."⁶¹ Brazilian Interior Minister Joao Alves recently echoed these very sentiments: "We understand the Amazon's ecological value, but we have to create 1.7 million new jobs each year and [we therefore] must tap its resources."⁶² Furthermore, debt-for-nature swaps not only place a valuable resource off limits to a developing country, but they do so in return for a reduction in foreign debt that is negligible, at best.⁶³ Debtor nations who sacrifice their pristine land will continue to face enormous foreign debt payments, and, more significantly, they will have placed a potentially lucrative resource off limits.

Aside from the economic concerns that debt-for-nature swaps create for debtor nations,⁶⁴ there is a good deal of justifiable resentment in the Third World towards the industrialized world: "The big aggressors on the world environment are the industrial nations, which have given us acid rain, most of the greenhouse effect and depletion of the ozone layer."⁶⁵ The imposition of environmental protection programs, however well-intentioned, could be considered by

⁵⁹ See Snow, *supra* note 55, at 15. The Bank of Boston recently wrote off 50% of its Latin American debt. *Id.*

⁶⁰ See *supra* note 28.

⁶¹ Kidder, *Debt-For-Nature Swap: A Good Pickle*, Christian Science Monitor, Oct. 2, 1989, at 12. The author noted further that "Costa Rica, having swapped down its debt by five percent, may already have reached the debt-for-nature limit." *Id.*

⁶² Work & Smith, *supra* note 10, at 49.

⁶³ See Kidder, *supra* note 61, at 12.

⁶⁴ Opponents of debt-for-nature swaps originally predicted that the flood of local currency generated by the swaps would produce a harmful inflationary impact. This concern, however, has by and large "receded" as an issue. See 12 U.N. DEP'T OF PUBLIC INFORMATION, DEVELOPMENT FORUM.

⁶⁵ *Id.* See also Snow, *supra* note 55, at 15 (A Third World ambassador stated at Washington briefing that "we're not going to just save [the tropical forests] for your rich folks."); Sirohi, *Environment: Industrialized North Asked To Do More*, Inter Press Service, Nov. 7, 1989 (A Brazilian official noted that "developing countries have also a keen interest that the industrialized countries themselves, whose behavior is the main threat to [the] world environment, quickly adopt very strong and decisive actions aiming at a curbing of their present excessive levels of consumption of energy.").

many as meddlesome, or, worse yet, imperialistic.⁶⁶

Even if the government of the debtor nation agrees to a swap, there exists a further complication involving the rights of indigenous citizens. Debt-for-nature swaps are increasingly causing agitation among embittered Amazon Indians who believe the primary focus should be on returning control of the land to them.⁶⁷ "If you look at half a dozen of these swaps you see significant problems There has always been a lack of consultation with grass-roots people, especially indigenous groups."⁶⁸ Environmentalists agree that greater involvement by indigenous land groups is a good idea from an environmental standpoint: "[I]nstead of having [fifteen] park rangers controlling a huge area, you'd have thousands of tribal people patrolling it."⁶⁹ Thus, future swaps ideally should incorporate the interests of indigenous land groups into the agreement.

C. Conservation Organizations

Although it would seem that conservation organizations have nothing to lose and everything to gain in a debt-for-nature swap, the fact that each swap is a highly complex and time consuming transaction necessarily draws heavily on the conservation organizations' limited resources.⁷⁰ Most conservation organizations engage in numerous and diverse projects.⁷¹ To the extent that debt-for-nature swaps monopolize these resources, the organizations' other projects must necessarily suffer.

Conservation organizations must also contend with a threat which could potentially nullify the entire transaction; that is, "the [debtor nation] still may exercise its power of eminent domain over its own resources by nationalizing the enterprise."⁷² It would not be hard to envision a scenario in which the intense pressure of domestic economic strife would tempt a debtor nation's government to exploit

⁶⁶ Nevertheless, in a recent worldwide survey conducted by WorldPaper, 66% of the respondents disagreed with the statement that debt-for-nature swaps are a form of "eco-colonialism." *Bicycles, Yes—Cheap Shoes, No*, WorldPaper, Sept. 1990, at 8.

⁶⁷ See Dumanoski, *Amazon Lobbyists Come to United States*, Boston Globe, Oct. 22, 1989, at 24. A spokesperson for the Indians stated that environmentalists "concentrate just on the trees and the butterflies." *Id.* The Amazon delegation proposed that environmentalists adopt a policy of "indigenous stewardship, which would allow [environmental] organizations to help return areas of the Amazonian rain forest to our care and control." *Id.*

⁶⁸ See Day, *Indians, Environmentalists Meet*, Christian Science Monitor, May 21, 1990, at 6 (quoting an anonymous banker).

⁶⁹ Bowen, *Tribes Seek Debt Swaps for Amazon Land Rights*, Fin. Times, May 15, 1990, at 7.

⁷⁰ See Lenssen, *supra* note 57. For example, Conservation International's Bolivian swap took two years to complete. CONSERVATION INT'L, *supra* note 12, at 14.

⁷¹ Conservation International, for example, is very active in developing and implementing programs for the protection of marine life. See generally TRÖPICUS, Winter 1990, at 4-5.

⁷² See Note, *supra* note 8, at 735. According to the United Nations General Assembly, a foreign nation always retains sovereignty over its natural resources. *Id.* at 736 (citing G.A. Res. 1803, 17 U.N. GAOR Supp. (No. 17) at 15, U.N. Doc. A/5344/Add. 1 (1962)).

land that was subject to swap restrictions. In this regard, the United Nations has endorsed the Charter of Economic Rights and Duties of States (CERDS),⁷³ which specifically lists natural resources as one of the assets over which a state may freely exercise full sovereignty.⁷⁴ Although paragraph two of CERDS provides for compensation in the event of expropriation,⁷⁵ this provision would be of little consolation to the conservation organization because monetary compensation can never adequately redress irreparable damage to the environment. Although the risk of expropriation is potentially insurable,⁷⁶ the cost of such insurance is often prohibitive. Despite the threat of expropriation, the conservation groups do not appear inhibited as debt-for-nature swaps continue to grow in number.⁷⁷ The participating conservation organizations evidently recognize that nationalization is a risk with which they must live if they are to fulfill their conservation mission.⁷⁸

Finally, experience from the swaps that have already been implemented demonstrates that protection programs may be undermined by illegal logging operations.⁷⁹ To protect lands covered under a swap, local conservation organizations have been forced to assemble staffs equipped with airguns and radio communications networks.⁸⁰

V. Current Legislative and Executive Proposals

On June 27, 1990, President Bush submitted the "Enterprise for the Americas Initiative Act of 1990" to Congress.⁸¹ The Bush plan

⁷³ Charter of Economic Rights and Duties of States, G.A. Res. 3281, 29 U.N. GAOR Supp. (No. 31) at 50, U.N. Doc. A/9361 (1974).

⁷⁴ *Id.* at 52.

⁷⁵ *Id.*

⁷⁶ Institutions such as the U.S. Overseas Private Investment Corporation and the World Bank's Multilateral Investment Guarantee Agency sell political risk insurance. See *supra* note 10.

⁷⁷ See Regis, *Debt-For-Nature Swaps Seen Growing In Next Few Years*, Reuters, Sept. 19, 1989.

⁷⁸ Although the conservation organizations could conceivably include some sort of penalty provision in their donation agreements with debtor nations, it is unlikely such a provision would prove an effective deterrent to nationalization. See CONSERVATION INT'L, *supra* note 12, at 28. There is no guarantee to a conservation organization that the debtor nation would honor such an agreement in the event of nationalization, and it is unlikely the conservation organization will possess the financial resources to enforce the provision. *Id.* Furthermore, the payment of a penalty to the conservation organization would provide little consolation in the face of deforestation of land which could never be replaced.

⁷⁹ See, e.g., de Castro, *Philippines: Symbolic Choice for Asia's First Debt-Swap Project*, Inter Press Service, Oct. 1, 1990.

⁸⁰ *Id.* Even with a well-staffed program, enforcement officers are sometimes confronted by gun-wielding loggers. *Id.* In one instance, a logger forced his way past the initial enforcement checkpoint, but later was apprehended by local police who had received radio notification from one of the park's staff members. *Id.*

⁸¹ See *Bush Sends Legislative Proposal to Congress to Implement Initiative for Latin America*, 7 Int'l Trade Rep. (BNA) 1444 (Sept. 19, 1990). The Enterprise for the Americas Initiative was still alive in Congress at press time. See H.R. 964, 102d Cong., 1st Sess., 137 CONG. REC. H1023 (Feb. 19, 1991).

calls for the United States to contribute approximately \$100 million over five years to the multilateral Enterprise for the Americas Investment Fund for the purpose of boosting the Latin American Economy.⁸² Contributions to the Fund will be sought from other countries, as well.⁸³ The initiative also involves the establishment of an "Enterprise for the Americas Facility."⁸⁴ The facility, operated by the Treasury Department, would administer debt reduction programs for countries that satisfy certain criteria.⁸⁵ According to the terms of the initiative, the United States will sell, on a case-by-case basis, a portion of a qualifying nation's outstanding debt in order to facilitate debt-for-nature and other debt-for-development swaps.⁸⁶

Legislation has recently been introduced in the United States Congress which seeks authorization for the United States to begin entering into debt-for-nature swaps. According to House Report 5088, the "Western Hemisphere Debt for Nature Conservation Act" would waive a portion of a nation's debt obligation provided that nation institutes environmental protection programs.⁸⁷ The bill provides specific guidelines for the exchange of local currency and the management of trust funds established in furtherance of the conservation programs.⁸⁸

VI. Conclusion

The underlying concept of a debt-for-nature swap is appealing. These swaps illustrate that the preservation of an endangered natural resource that is vital to all nations can be attained in a manner that causes little pain to the commercial banks who, absent such an exchange, stand a real possibility of being denied any payback on their outstanding loans. Nevertheless, a close look at debt-for-nature swaps reveals that the disincentives associated with them appear sufficiently grave to dissuade any one of the three necessary parties from consummating a swap. Before labeling debt-for-nature swaps "feasible" or "infeasible," however, it is necessary to focus realistically on exactly what it is we wish them to accomplish. Will debt-for-nature swaps reduce Third World debt? Undoubtedly, they will not significantly reduce such an enormous sum. Any reduction in the

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ For example, in order to be eligible to participate in the initiative, Latin American countries which owe a substantial portion of their debt to commercial banks must first negotiate a financing plan with those banks. In addition, participating countries "must have in effect International Monetary Fund/World Bank economic reform programs." *Id.*

⁸⁶ *Id.*

⁸⁷ See H.R. REP. NO. 5088, 102d Cong., 1st Sess. (1990). See also *International Finance—Mulford Says House Bills Not Adequate to Implement Latin America Initiative*, Daily Rep. for Executives, July 19, 1990, at 10.

⁸⁸ *Id.*

Third World debt derived from debt-for-nature swaps would be trifling.⁸⁹ For the same reason, debt-for-nature swaps will not provide a miraculous means by which the commercial lending industry can stave off the onslaught of the "Third World Debt Crisis" that will inevitably culminate in massive loan defaults. Critics of debt-for-nature swaps contend that these transactions potentially could delay real solutions to the Third World debt crisis.⁹⁰ "What's needed is negotiated, comprehensive settlement—not something that nibbles away at the problem."⁹¹

What debt-for-nature swaps do offer is hope in the fight to save an irreplaceable resource: the natural environment. Legislation should be passed which provides greater incentives to commercial banks to participate in debt-for-nature swaps. Not only would such legislation aid an international conservation effort, it would also provide a step toward the solution of the Third World debt crisis. Even in the event that political problems involved in swapping Third World debt for protection of tropical forests prove insurmountable, the underlying concept could be applied in different contexts.⁹²

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⁸⁹ See Kidder, *supra* note 61, at 12.

⁹⁰ Flint, *When Nations Try to Swap Their Way Out of Debt*, Boston Globe, Aug. 19, 1990, at A14 (quoting Harvard economist Jeffrey Sachs).

⁹¹ *Id.*

⁹² For example, there have been recent suggestions that debt-for-nature swaps might be used as a way to protect valuable land on which failed savings and loan institutions are located. See Parrish, Los Angeles Times, Nov. 10, 1989, at D-1, col. 2. Also, Harvard University has established a fund which converts Ecuadorean national debt into educational grants for Ecuadorean students. See *Harvard and Ecuador in "Debt-For-Education" Swap*, Reuters, July 10, 1990.