Debt Swaps Basic Theory…

- Not new mechanism/not easy mechanism
- Very widely implemented (public and private sector)
- Requires multidisciplinary approach, including diplomacy

Arguments against Debt Swaps

- Put national sovereignty at risk!
- Creates inflation!
- Legitimizes “illegitimate” debt!
- Negatively affect the balance of payments!
- Does not solve the debt problem!
**Arguments in favour of Debt Swaps**

- Good way to get rid of “bad” debts
- Creates resources for conservation
- Creates a favourable “cooperation” climate
- Does not have the negative side effects of “debt forgiveness”

**Basic starting point**

- All debts are not good for swapping operations
- Every swap is an *Ad Hoc* operation
- Good will/political will is a prerequisite
- Must be a win/win situation

**Swap potential Analysis**

<table>
<thead>
<tr>
<th>Debt that would be serviced</th>
<th>Low Inflation</th>
<th>High Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Very desirable</td>
<td>II Desirable but monetary impact needs to be regulated for large operations</td>
</tr>
<tr>
<td>II</td>
<td>Desirable only if spending priority changes are essential to justify program due to efficiency gain</td>
<td></td>
</tr>
<tr>
<td>III</td>
<td>Only desirable if conditions in both II and III are met</td>
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</table>

**The mechanics of debt swaps**

1. NGO identifies conservation program and seeks government approval of debt swap
2. NGO secures hard currency funding to obtain debt
3. NGO purchases debt or bank donates debt
4. NGO and Central Bank negotiate debt swap agreement
5. Central Bank payments to beneficiary

Figure 2. Generic commercial debt swap with third party assistance