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INFORMATION MEMORANDUM FOR THE ACTING ADMINISTRATOR

FROM: DGC, John E. Mullen

SUBJECT: Recent Statutory Enactments On Debt for Development: Modifications to A.I.D. Debt for Development Guidelines

I. SUMMARY

This memorandum summarizes recent statutory enactments and regulatory changes regarding the A.I.D. Debt for Development Initiative. The subject enactments are contained in the Fiscal Year 1990 Foreign Assistance Appropriations Act (P.L. 101-167) (the "Appropriations Act"), enacted on November 21, 1989; and the International Development and Finance Act of 1989 (P.L. 101-240), enacted on December 19, 1989.

The above enactments express strong congressional support for the A.I.D. Debt for Development Initiative, as well as for other U.S. Government efforts to reduce debt burdens of developing countries. The enactments reflect positive congressional action to remove obstacles to effective use of the Initiative. As discussed further below, the cumulative effect of these enactments for A.I.D. has been: (1) to relieve nongovernmental organizations (the Debt for Development "intermediaries") receiving A.I.D. grants from the previous requirement to return to the U.S. Treasury interest earned on local currencies received from the exchange of A.I.D.-financed debt, and to allow such intermediaries to establish endowments with such local currencies; (2) to provide permanent, specific authority to A.I.D. to finance Debt for Development transactions involving natural resources ("Debt for Nature" exchanges); and (3) to require A.I.D. to take the initiative in stimulating Debt for Nature exchanges, especially in sub-Saharan Africa.

As an immediate consequence of these enactments, the A.I.D. Debt for Development Guidelines have been modified to remove the requirement, previously contained in Sections D(10) and D(11) of those Guidelines, to return to the U.S. Treasury interest received by intermediaries on Debt for Nature and other Debt for Development exchanges. A.I.D. also may now approve proposals by nongovernmental organizations to establish endowments with local currencies received from such debt exchanges and to use the interest earned on such endowments either to expand the endowment or for ongoing program purposes, without further appropriation by Congress. This endowment authority is novel and highly significant, because it allows establishment of long-term funding mechanisms for A.I.D. nongovernmental organization grantees.

Finally, as a result of recent enactments, A.I.D. for accounting and other purposes will no longer regard the local currencies received in exchange for debt retirement as grant "advances." Instead, a Debt for Development dollar advance will be liquidated upon the purchase of the debt, which will effectuate the terms of the agreement between the intermediary and the debtor government providing for prompt retirement of the debt in exchange for development resources (such as local currencies, environmental set-asides, or policy commitments) needed for additional project purposes. The use of such resources by the intermediary for agreed-upon purposes will be subject to quarterly reporting requirements.

The above statutory and regulatory changes, reflected in modified Debt for Development Guidelines described in Part V of this memorandum, should significantly enhance the attractiveness of the Debt for Development mechanism, both to intermediaries and debtor countries.

II. BACKGROUND

In February 1989, A.I.D. announced a new Debt for Development Initiative to finance certain programs of nongovernmental organizations by means of debt exchange transactions. (The Debt for Development Guidelines issued by A.I.D. at that time are Attachment A to this memorandum.) Through this new financing mechanism, nongovernmental organizations (such as private voluntary organizations, cooperatives and universities) serving as Debt for Development "intermediaries" use A.I.D. grant dollars to buy developing country debt at a discount price. The intermediaries subsequently exchange the debt for local currencies needed for development activities. Debt for Development transactions achieve a dual purpose: they reduce debt burdens of aid-recipient countries, and they obtain a favorable rate of exchange for A.I.D. funds provided to nongovernmental organizations for foreign assistance purposes.

During the past year, A.I.D. has gained useful experience with the Debt for Development mechanism. A Debt for Development transaction will provide $1 million to the World Wildlife Fund for biological diversity and other nature preservation activities in Madagascar. Another Debt for Development transaction will provide $2,050,000 to the International Foundation for Education and Self-Help (IFESH) for self-help development efforts in Nigeria, Niger and Guinea. Additional proposals are pending in other countries.

A significant obstacle to wider utilization of the Debt for Development mechanism has been the requirement regarding use of interest earned on local currencies obtained by intermediaries through debt exchange transactions. Sections D(10) and D(11) of the A.I.D. Debt for Development Guidelines have required that all such interest be remitted to A.I.D., for the account of the U.S. Treasury. This rule, which has been required by general principles of law governing appropriated funds, has reduced the value to intermediaries of Debt for Development transactions, especially where the debtor country will make installment rather than lump sum payments of local currencies to intermediaries in exchange for release of its debt obligations. In accordance with recent enactments, this rule has now been changed.

III. AUTHORITY IN THE FY 1990 APPROPRIATIONS ACT

Section 584 of the FY 1990 Appropriations Act provides:

> "In order to enhance the continued participation of nongovernmental organizations in economic assistance activities under the Foreign Assistance Act of 1961, including debt-for-development and debt-for-nature exchanges, a nongovernmental organization may invest local currencies which accrue to that organization as a result of economic assistance provided under the heading "Agency for International Development" and any interest earned on such investment may be used, including for the establishment of an endowment, for the purpose for which the assistance was provided to that organization."

Section 584 authorizes nongovernmental organizations to retain, for program purposes, interest earned on local currencies received through an A.I.D.-financed debt exchange (or as a result of other economic assistance activities), and to establish endowments with such funds.

As background to Section 584, the Senate Appropriations Committee Report (S.Rep't 101-131) on the FY 1990 foreign assistance appropriations bill emphasizes the magnitude of the international debt problem and describes the damaging effect of the previous interest repayment rule on those Debt for Development exchanges targetted to nature preservation:

> "The Committee notes that there is approximately $1,200,000,000 in outstanding debt by developing countries. This debt places enormous pressures on many of these countries to consume their natural resources in an uncontrolled manner. This process not only causes serious and irreversible ecological damage, but also precludes the economic opportunities provided by the sustainable use of natural resources. While the Committee does not expect debt-for-nature exchanges to significantly reduce the debt burden, it can be a powerful tool in generating additional resources for environmental protection.
>
> "A.I.D. has been hindered in the execution of debt-for-nature exchanges by the requirement that interest bearing accounts set up from Federal funds have their interest returned to the U.S. Treasury. Thus, A.I.D. has been prohibited from participating in the most effective, and least inflationary, of debt exchanges by this requirement. Accordingly, the Committee has included bill language authorizing A.I.D. to provide funds to nongovernmental organizations for debt-for-nature exchanges, and allowing those NGO's to retain interest earned on the proceeds of any such exchange pending their disbursement for an approved natural resource protection program."

The House Appropriations Committee's Report (H.Rep't 101-165) on the appropriations bill states more general support for certain debt exchanges:

> "The Committee continues to support debt-for-nature swaps as a small but creative and promising contribution to the overall debt problem in the developing world. . . . The Committee is . . . encouraged by specific debt for environmental strategies originating in developing countries, such as a proposal by the government of Costa Rica, suggesting debt relief for energy efficiency and conservation in that country."

Section 584 and the Appropriations Committee reports reflect strong congressional support for the debt exchange mechanism and for the A.I.D. Debt for Development Initiative. In authorizing retention of interest earnings and establishment of endowments, Congress has removed a principal obstacle to wider utilization of the debt exchange mechanism.

IV. INTERNATIONAL DEVELOPMENT AND FINANCE ACT PROVISIONS

Titles IV through VII of the International Development and Finance Act ("IDF Act") set guidelines and impose certain requirements for United States policy on international debt issues, especially regarding Multilateral Development Bank (MDB) transactions. These provisions will be described in a separate Information Memorandum.

A. Debt for Development: With regard to Debt for Development, Section 531 of the IDF Act states the sense of the Congress that Debt for Development exchanges "serve a useful purpose" by providing "highly indebted developing countries with a creative method of reducing external debt burdens" and by enabling banking institutions to strengthen overall loan portfolios through reduction of high external debt burdens. Section 531(b) directs "each appropriate Federal banking agency" to "adopt uniform guidelines" supportive of Debt for Development transactions.

B. Debt for Nature: Title VII of the IDF Act, which is separately titled the "Global Environmental Protection Assistance Act of 1989" ("Global Environment Act") enacts into permanent law, as a new chapter 7 of part I of the Foreign Assistance Act, detailed authority and guidelines on Debt for Nature exchanges. A copy of this new Act is Attachment B to this Memorandum.

The Global Environment Act specifically authorizes A.I.D. to provide grant assistance to nongovernmental organizations to purchase discounted commercial debt of developing countries for use in a Debt for Nature exchange. It authorizes Debt for Nature exchanges with those countries that are "fully committed" to the long-term viability of the nature project, that have prepared (or have provided for the preparation of) a long-term plan, and that have a governmental or nongovernmental entity capable of overseeing long-term project viability. The Act defines broadly the environmental purposes that may be achieved by such an exchange. For example, such efforts may include (1) protection efforts for the world's oceans and atmosphere, animal and plant species, and parks and reserves; (2) development of natural resource management, local conservation and training programs; and (3) promotion of regenerative approaches in farming, forestry, fishing, and watershed management.

Significantly, the Global Environment Act authorizes grantees (as well as subgrantees) of Debt for Nature grants to retain interest earned on the proceeds of a Debt for Nature exchange, and the Act allows establishment of endowments with such proceeds and interest. Unlike the similar authority provided for all Debt for Development grants in the FY 1990 Appropriations Act, discussed above, the Debt for Nature authority provided in the Global Environment Act is permanent because it has been included in the Foreign Assistance Act.

Finally, the Global Environment Act directs A.I.D. to take the initiative in developing Debt for Nature proposals. The Act directs A.I.D., in cooperation with nongovernmental organizations, to "seek to identify those areas, which because of an imminent threat, are in particular need of immediate attention to prevent the loss of unique biological life or valuable ecosystem," and it directs A.I.D. to "encourage as many eligible countries as possible" to propose Debt for Nature exchanges in order to "demonstrat[e] to a large number of governments the feasibility and benefits of sustainable development."

C. <u>Pilot Program in Sub-Saharan Africa</u>: The Act directs A.I.D., in cooperation with nongovernmental conservation organizations, to "invite the government of each country in sub-Saharan Africa to submit a list of those areas of severely degraded national resources which threaten human survival and well-being and the opportunity for future economic growth or those areas of biological or ecological importance within the territory of that country." A.I.D. is directed to "assess the list submitted by each country" and to "seek to reach agreement" with that country for the "restoration and future sustainable use of those areas."

The Act specifically authorizes A.I.D. to make grants to nongovernmental organizations to purchase discounted commercial debt of an eligible sub-Saharan country "in exchange for commitments by that government to restore," or for "commitments to develop plans for sustainable use" of, natural resources identified by the country in the list submitted to A.I.D. The Act reiterates the authority of Debt for Nature grantees to retain interest earned on proceeds of a Debt for Nature exchange in sub-Saharan Africa, and to establish an endowment with such proceeds and interest.

Though A.I.D. has previously had authority to award Debt for Nature (as well as other Debt for Development) grants under general provisions of the Foreign Assistance Act, the Global Environment Act provides specific authority and detailed guidelines for administration of a Debt for Nature program, especially in sub-Saharan Africa. The Act is most significant in providing permanent authority to Debt for Nature grantees to retain interest on proceeds of debt exchanges, and to establish endowments.

V. MODIFICATIONS TO A.I.D. GUIDELINES

In accordance with the new statutory authority provided in the Appropriations and IDF Acts, the A.I.D. Debt for Development Initiative Guidelines have been revised by deleting the text of Section D(10), titled "Interest Earned on Local Currencies Obtained from the Debt Exchange." Section D(11), regarding "Installment Payments in Exchange for Debt Retirement," has also been revised by deleting the last sentence of the first paragraph, which reiterates the interest repayment requirement.

In place of the above provisions, the following new text has been provided for Section D(10);

> Subject to agreement by A.I.D. and any special rules to be issued by A.I.D., the intermediary may earn and retain interest or other forms of income on the principal amount of local currencies obtained by the intermediary through debt exchange transactions, and the intermediary may use such principal and income either directly for approved program purposes or to establish an endowment for long-term financing of such program purposes. During the life of the project, the intermediary shall make quarterly reports to A.I.D. of the amount of such local currencies earned, retained or used for project purposes.

In addition, in response to enquiries and suggestions of interested parties since A.I.D. issued its original Guidelines for the Debt for Development Initiative in February 1989, the Guidelines will be modified in order to: (1) clarify that parties eligible to participate in Debt for Development activities include educational institutions, such as universities, which are not instruments of the aid-recipient governments; and (2) advise that in reviewing proposals by debtor governments to make debt exchange local currency payments in installments rather than in a single lump sum, A.I.D. and the intermediary organizations should consider the risk of nonpayment by the debtor country and whether insurance or other guarantees against nonpayment should be provided to reduce the risk of loss.

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Clearances:
AA/LEG, RRandlett (draft)
AA/PPC, RBrown (draft)
PPC/EA, ECostello (draft)
PFM/FM/C, MUsnich (draft)
GC/LP, RLester (draft)

Attachment A

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

SHOWING MODIFICATIONS TO GUIDELINES

February 15, 1989

A.I.D. ANNOUNCES DEBT FOR DEVELOPMENT INITIATIVE

In response to the debt crisis facing many developing countries, the U.S. Agency for International Development (A.I.D.) is initiating a new Debt for Development mechanism to finance development assistance activities of non-governmental organizations. Through this new Initiative, A.I.D. will support certain programs of nongovernmental organizations in developing countries through debt exchange transactions that will both reduce the host countries' debt burdens and obtain a favorable rate of exchange for foreign assistance funds provided to such organizations.

I. INTRODUCTION TO THE A.I.D. INITIATIVE

A. Summary

With the Debt for Development Initiative, A.I.D. will use foreign assistance funds to finance the purchase, by intermediary organizations, of debt currently owed by developing countries to foreign creditors. A.I.D. will finance the purchase of debt at the discount price at which such debt is currently bought and sold on the secondary market.

Instead of seeking to collect the full face value of debt acquired through the Debt for Development Initiative, however, A.I.D. will provide for the retirement of the debt in exchange for resources that the debtor country will provide for use in development activities. For example, debt acquired with A.I.D. funds could be retired in exchange for local currencies to be used in A.I.D.-financed health and nutrition programs in the debtor country. By converting foreign assistance dollars into local development resources (such as local currencies) through the debt exchange market, A.I.D. will be able to reduce the debt burden of developing countries while also obtaining local development resources at a favorable rate of exchange.

and universities that are not instruments of the aid recipient country's government.

Resources received through Debt for Development transactions will be used for A.I.D.-financed projects of non-governmental organizations, such as private voluntary organizations (PVOs), ~~and~~ cooperatives, These organizations will play a central role in the Debt for Development Initiative by serving as intermediaries between A.I.D. and the current owners ("holders") of developing country debt, as well as between A.I.D. and the debtor countries, for the purpose of acquiring and retiring debt. Intermediary organizations will then be responsible for managing the use of resources acquired through the debt exchange for development activities approved by A.I.D.

B. Background on the International Debt Market

Many developing countries face serious difficulties in repaying high volumes of debt owed to foreign governments and private commercial lenders. Payments of principal and interest on debt consume a large proportion of the foreign currencies earned by developing countries. Heavy debt burdens also limit opportunities for obtaining new credit, thus impeding development efforts.

In recent years a private commercial market has developed for the debt obligations of nations ("sovereign debt"), which can be bought or sold like other commercial property. Because of the increasing risk that many heavily indebted countries will be unable to repay either all or part of their debt, debtholders have become willing to sell the debt for an amount less than the debt's face value. Debtholders may wish to sell this debt, even at a "loss" resulting from the discount price, in order to capture the debt's current value and to reduce the volume of non-performing loans in their loan portfolios.

Parties wishing to invest, conduct other forms of business, or support development activities in developing countries may find it attractive to purchase the debt of developing countries at current discount prices. After buying the debt, the new debtholders exchange or swap the debt for assets (such as local currencies or equity shares in local enterprises) provided by the debtor country. The value of the assets received in this exchange may be less than the debt's face value but greater than the debt's purchase price. Thus the buyer ultimately gains a more valuable asset in the debtor country through the mechanism of the debt exchange than through direct acquisition with dollars or use of conventional currency exchange markets.

Developing countries also benefit from debt exchange transactions, because these countries retire a certain amount of foreign debt while gaining new participants in their economies (for example, new investors in private enterprises). Debtor nations generally cannot take advantage of the discount sale price of their debt by purchasing their own loans directly, because the terms of most loan agreements bar such purchase. Therefore, most debt exchange transactions require purchase of the loan asset by a third party serving as intermediary between the lender and the borrowing country.

C. Participation by A.I.D. in the Debt Exchange Market

The new international debt market presents A.I.D. with an opportunity to achieve several objectives, consistent with the purposes of the U.S. foreign assistance program. Through the new Debt for Development Initiative, A.I.D. will participate in this market by using foreign assistance funds to finance the purchase of loans owed by developing countries to foreign creditors. Instead of collecting such loans, A.I.D. will provide for their retirement in exchange for local assets needed for foreign assistance activities of nongovernmental organizations in debtor countries.

A.I.D. will finance all debt exchange transactions through intermediary organizations, such as private voluntary agencies and cooperatives. A.I.D. will issue grants to intermediary organizations to purchase debt. Intermediaries will subsequently convert this debt into local assets, which the intermediaries will use for either newly initiated or ongoing development projects approved by A.I.D. Participation by intermediaries in Debt for Development will strengthen the development programs of these organizations while simultaneously advancing the other stated objectives of the Debt for Development Initiative.

A.I.D. will finance debt exchange transactions yielding various types of host country assets needed for development activities. For example, debt could be exchanged directly for local currencies needed to finance development activities, such as education and health programs, in the debtor country. Intermediaries could also exchange A.I.D.-financed debt for host country programs, such as commitments to conserve natural resources or protect endangered species ("debt for nature"), in a manner similar to the recent debt exchange agreement between the Government of Bolivia and a private organization (Conservation International) to protect tropical rain forest in Bolivia. A wide range of A.I.D.-financed programs of nongovernmental organizations will be eligible for financing with resources obtained through the Debt for Development Initiative.

Each activity of a nongovernmental organization financed through a Debt for Development transaction must be approved by A.I.D. in accordance with standard Agency rules and procedures applicable to funding of nongovernmental organization activities. Both new and ongoing activities of nongovernmental organizations will be eligible for financing, either in whole or in part, through A.I.D. Debt for Development transactions.

D. Illustrative Transaction

Each Debt for Development transaction will be accomplished through a series of agreements and transactions involving the debtor country, the debtholder, A.I.D., and an intermediary organization. The A.I.D. Debt for Development Guidelines, which follow in Part II, will govern these transactions. The following hypothetical transaction shows in abbreviated form the steps needed to complete a typical Debt for Development exchange.

Example: A private voluntary organization dedicated to preservation of endangered species (in this hypothetical example, the organization will be called "Preservation International") has received a commitment by A.I.D., or is preparing to submit a proposal to A.I.D., to fund a project to preserve a species of wildfowl in the Philippines. This project will require a sum of local currencies to finance a wildfowl protection plan, as well as a commitment by the Government of the Philippines to set aside a significant acreage of public land as a wildfowl refuge.

Preservation International determines that the Government of the Philippines owes a substantial quantity of debt to foreign creditors (such as banks), and that certain creditors are selling their Philippine Government debt at a substantial discount. Preservation International contacts A.I.D./Washington or the A.I.D. Mission in Manila to determine whether the acquisition of Philippine Government debt as part of a debt exchange to finance a wildfowl preservation project in the Philippines would be consistent with U.S. and multilateral economic policy and A.I.D. project priorities in the Philippines.

If A.I.D. responds favorably to Preservation International's enquiry, representatives of the organization (perhaps in collaboration with USAID Mission personnel) initiate a discussion with representatives of the Government of the Philippines, most likely including representatives of the Central Bank. These discussions explore the interest of the Philippine Government in supporting a wildfowl preservation project financed through the proceeds of a Debt for Development transaction financed by A.I.D. Preservation International reaches an agreement in principle with the Government on the basic terms of a Debt for Development agreement establishing the terms, mechanism, and schedule for retirement of Philippine Government debt in exchange for local currency and Government commitments to establish a wildfowl refuge. Preservation International also confirms the availability of Philippine debt for sale on the secondary commercial market and the current price of such debt.

Preservation International then prepares a proposal for A.I.D. describing, among other things, the wildlife preservation objective of the project, the anticipated role of Philippine debt in financing the project, the availability of such debt for purchase, the proposed use of a broker or other means to acquire and process the debt certificates, the willingness of the Government of the Philippines to provide local currency and wildfowl refuge commitments in exchange for retirement of debt, and a plan for use of local currency to meet project objectives.

If A.I.D. agrees to finance the project, it enters into an agreement with Preservation International setting forth the basic terms and procedures of the Debt for Development transaction, as well as other issues normally addressed in a project agreement. With the financing for the transaction assured, Preservation International enters into a formal agreement with the Government of the Philippines setting the terms for the eventual debt exchange.

Preservation International then negotiates a favorable discount price for purchase of a volume of Philippine Government debt from a willing commercial seller. Consistent with the Debt for Development agreement between A.I.D. and Preservation International, A.I.D. provides grant funds to finance the purchase of this debt. Preservation International takes title to the debt but promptly retires it in exchange for the local currency and commitments promised by the Government of the Philippines in the Government's separate agreement with Preservation International.

Preservation International subsequently utilizes the local currency, which the Government provided in exchange for the debt retirement, for wildfowl preservation purposes. It monitors the Philippine Government's compliance with its commitment to set aside a wildfowl refuge, as provided in the debt retirement agreement, and it administers the project in a manner otherwise consistent with standard rules governing A.I.D.-financed projects.

II. A.I.D. DEBT FOR DEVELOPMENT GUIDELINES

A.I.D. has prepared the following Debt for Development Guidelines to govern administration of the Agency's Debt for Development Initiative. These Guidelines describe the role of intermediary organizations in the Initiative, the types of A.I.D. grants that will be available, and the various administrative and contractual procedures required in order to effect a Debt for Development transaction. A.I.D. expects to modify these Guidelines as it gains experience with the Debt for Development Initiative.

A. Introduction

1. Scope and Applicability: The following Debt for Development Guidelines govern the programming of funds made available to the Agency for International Development (A.I.D.) under the Economic Support Fund (ESF) and Development Assistance (DA) accounts (including the Development Fund for Africa), to the extent such funds are used to finance the purchase of debt owed by developing countries to parties other than the United States Government. All such debt acquired with A.I.D. financing will be exchanged for local currencies or other assets (such as local currencies or host country development efforts) needed to achieve one or more objectives of the ESF or DA program.

Organizations receiving foreign assistance funds from A.I.D. may not use such funds to acquire debt owed by developing countries, or engage in other transactions involving such debt, without prior approval of A.I.D. All debt acquisitions financed directly or indirectly by A.I.D. shall be undertaken in accordance with these Debt for Development Guidelines.

2. Purpose of Guidelines: These Guidelines are designed to ensure that A.I.D.-financed Debt for Development programs achieve the objectives stated in these Guidelines and operate in a manner consistent with United States laws governing the use of appropriated funds.

3. Issuing Party and Authority: A.I.D. issues these guidelines under the authority provided in the Foreign Assistance Act of 1961, as amended.

4. Modifications to Guidelines: Modifications to these Guidelines may be needed as A.I.D. gains experience with its Debt for Development program. Parties cooperating with A.I.D. in the implementation of this Initiative are encouraged to identify problems that arise in applying these Guidelines and to suggest any needed changes.

B. Objective

The objective of the A.I.D. Debt for Development Initiative is to finance foreign assistance activities of nongovernmental organizations (such as voluntary agencies and cooperatives) through debt transactions that will:

-- (1) assist in reducing the foreign debt burdens of developing countries that receive U.S. foreign assistance, consistent with the general economic development purposes of the U.S. foreign assistance program; and

-- (2) obtain a favorable rate of exchange for U.S. foreign assistance dollars that are converted into local currencies or exchanged for other assets needed for foreign assistance programs.

C. General Statement of Policy

To achieve the objectives stated above and consistent with A.I.D. rules and regulations (including the present Guidelines), A.I.D. invites non-governmental organizations, such as private voluntary organizations (PVOs), ~~and~~ cooperatives, (which these Guidelines refer to as Debt for Development "intermediary organizations" or "intermediaries"), to develop proposals for grants and cooperative agreements with A.I.D. to implement the A.I.D. Debt for Development Initiative.

A.I.D. will review proposals by intermediary organizations to use foreign assistance funds to finance the purchase, by the intermediary organization, of debt owed by developing countries to parties other than the United States Government. Such proposals must provide for prompt retirement of such debt through an exchange of the debt for local currencies or other assets furnished by the debtor country to the intermediary for development activities. A.I.D. will receive Debt for Development proposals from intermediary organizations in a wide range of program areas, such as environmental protection, population planning and health, and microenterprise development for both new and ongoing project activities.

A.I.D. will issue a limited number of awards to assist intermediary organizations to develop proposals for Debt for Development transactions that will achieve foreign assistance purposes. Once a Debt for Development transaction has been approved, A.I.D. will closely monitor the intermediary's use of A.I.D. funds to acquire debt and, in appropriate circumstances, will provide technical advice (usually through consultants) to assist intermediaries in purchasing and exchanging debt.

and universities which
are not instruments of
the aid recipient

D. Debt for Development Procedures

1. Role of Intermediary Organizations: A.I.D. will not directly acquire debt of a developing country for use in a Debt for Development exchange. Instead, A.I.D. will provide foreign assistance grant funds to finance the acquisition of such debt by intermediary organizations. In consultation with A.I.D. Missions, intermediaries will negotiate with the debtor country the terms of the subsequent debt retirement. Intermediaries will also arrange for the purchase of debt and will assume primary responsibility for managing the use of assets generated by the debt retirement. Intermediary organizations, therefore, will play a central and critical role in the A.I.D. Debt for Development Initiative.

2. Types of A.I.D. Awards: To assist the participation of intermediary organizations in Debt for Development transactions, A.I.D. intends to make foreign assistance funds available to support both (a) the preparation of Debt for Development proposals by intermediaries, and (b) the acquisition and retirement of the debt itself once an intermediary's proposal for a Debt for Development program has been approved by A.I.D. A.I.D. expects to allocate a larger share of foreign assistance resources to acquire the debt than to assist preparation of Debt for Development proposals.

a. Awards to support preparation of proposals: As described more fully in Part II(D)(5) of these Guidelines, A.I.D. will agree to finance debt transactions only after an intermediary organization and a debtor country have reached an agreement in principle on the purpose and terms of the eventual debt exchange, and after the intermediary has investigated the availability and price of a particular country's debt on the international commercial market. Extensive negotiations between the intermediary and debtor nation, as well as various studies and consultations regarding the availability of a country's debt for purchase, may be needed to meet these preconditions.

A.I.D. will expect most nongovernmental organizations to furnish the staff and resources needed to meet the above preconditions. However, A.I.D. will issue a limited number of awards to assist intermediary organizations in preparing Debt for Development proposals and in negotiating the terms of the debt exchange with the debtor nation. Such awards will be made only to those intermediary organizations that can demonstrate a capacity to undertake successfully the complex tasks of a debt exchange transaction, as well as to administer the development activity to be financed by the transaction.

Applications for financing to support pre-award Debt for Development activities should address the following issues: (1) the nature of the development activity or ongoing project to be financed with assets acquired through the Debt for Development transaction; (2) the information needed and steps proposed to be undertaken to develop a final proposal and to reach agreement with the debtor country on the use of assets generated through the debt transaction; (3) the opportunities for purchase and the current market price (to the extent such information is readily available) of the country debt to be acquired with A.I.D. financing; (4) the anticipated advantages of acquiring local development assets by means of debt exchange rather than through direct purchase with dollars; and (5) the projected allocation of costs and expenditure of time needed to develop a final proposal.

b. <u>Awards to finance Debt for Development transactions</u>: A.I.D. will also make resources available to finance Debt for Development transactions by intermediaries. The following provisions of these Guidelines set prerequisites for the award of funds by A.I.D. to finance Debt for Development transactions and establish procedures for effecting such transactions once an intermediary's proposal for a debt exchange has been approved.

3. <u>Foreign Assistance Purpose of Each Debt Transaction</u>: All Debt for Development transactions will advance the fundamental foreign assistance purpose of reducing a country's foreign debt burdens (see "Objectives" specified in Part II(B)). For A.I.D. to approve a Debt for Development proposal, however, the assets acquired through a Debt for Development transaction must be used for a specific development assistance activity of a nongovernmental organization. The purpose of this activity must be consistent with the objectives of the particular category of assistance from which A.I.D. makes the Debt for Development award, and it must be clearly defined in advance of the issuance of that award.

For example, Development Assistance funds made available from the Agriculture, Rural Development, and Nutrition (Foreign Assistance Act ("FAA") Section 103) account will be used only to acquire debt that is to be converted into assets needed to advance Section 103 purposes. Development Assistance funds made available from the Population and Health (FAA Section 104) account will be used only to acquire debt that is to be converted into assets needed to advance population planning and health activities. Similarly, resources from the Development Fund for Africa will be used only to acquire debt to be converted into assets needed to advance development programs in sub-Saharan Africa. Economic Support Funds, to the extent available for Debt for Development transactions, may be used more broadly to advance ESF objectives of economic or political stability.

In reviewing an application for a Debt for Development transaction, A.I.D. will consider whether the ultimate use of the asset generated through the transaction is defined with sufficient specificity and is within the purposes of an available funding source.

4. Purchase of Debt at Lowest Possible Prices from Established and Reputable Sellers; Requirement of A.I.D. Approval: A.I.D. financing may only be used to purchase debt from established and reputable debt holders, such as major commercial banks. A.I.D. will expect each intermediary to use A.I.D. financing to acquire debt from such sellers at the lowest possible price, reflecting the full discount value of such debt in private commercial markets. No intermediary may use A.I.D. financing to acquire debt without A.I.D.'s express prior approval of the proposed transaction and sale price.

5. Pre-Agreement on Purpose and Terms of Debt Purchase and Retirement: Debt for Development transactions will be used to finance intermediary organization projects approved according to the usual A.I.D. standards and rules governing projects.

In addition to standard requirements, however, before A.I.D. agrees to finance a Debt for Development transaction, the intermediary must demonstrate to the satisfaction of A.I.D. that the intermediary has: (a) identified the asset to be obtained and the program activity to be financed through the debt transaction; (b) reached at least an agreement in principle with the debtor country regarding the terms, mechanism, and schedule for conversion of the debt into the identified host country asset; and (c) developed a budget and plan for use of the host country asset to achieve project purposes. An intermediary's mere expression of intent to use assets generated from a debt exchange for a general foreign assistance purpose will not be sufficiently definite to enable A.I.D. to make a financing award; before issuing an award, A.I.D. will require careful program planning and evidence of the debtor country's prior concurrence (for example, in the form of a signed agreement or a letter from the country's central bank or ministry of finance) on significant aspects of the eventual debt exchange.

A.I.D. will also require the intermediary to demonstrate that it has: (a) investigated the availability of the host country's debt for sale, (b) identified a reputable and willing seller of such debt (as discussed in Part II(D)(4) above), (c) determined the likely market price of the debt, (d) calculated the likely transaction costs to be incurred in acquiring and exchanging such debt, and (e) analyzed the financial and other advantages of acquiring the local development assets through the mechanism of a debt exchange rather than by direct purchase with dollars.

To develop a Debt for Development proposal that addresses each of the above points and that is sufficiently specific and definite, an intermediary may, if needed, request pre-agreement funding from A.I.D. (as described in Part II(D)(2)(a) above). A.I.D., however, expects to make available only a limited amount of funding for this purpose.

6. Various Agreements Required: To effect the various transactions involved in a Debt for Development plan, separate agreements among parties will be required, in the following sequence: (a) between A.I.D. and the intermediary approving the terms and conditions of the foreign assistance financing; (b) between the intermediary and the debtor country establishing the purpose and terms (as described in Part II(D)(5) above) of the planned debt exchange; and (c) between the intermediary and the debt holder effecting the initial sale of debt.

In exceptional cases it may be most efficient to combine the first two of these agreements into a single multi-party agreement among A.I.D., the intermediary and debtor country. A.I.D. will not be a party to the agreement between the seller of the debt and the intermediary organization. As discussed in Part II(D)(4) above, however, A.I.D. will require the intermediary to receive A.I.D.'s express approval of the proposed transaction and sale price before the intermediary expends A.I.D. funds to acquire debt.

7. Technical Assistance and Fees Incurred in Purchasing Debt: To assist intermediaries to purchase debt in the new international debt market, A.I.D. may make available to such intermediaries the services of financial consultants. A.I.D. funds may also be used to pay reasonable fees and transaction costs incurred by an intermediary in the purchase and exchange of debt, if such use of A.I.D financing is included in the Debt for Development agreement between A.I.D. and the intermediary.

8. Prompt Conversion of Debt into Development Asset: A.I.D. expects intermediaries to convert A.I.D.-financed debt into local currency or other development asset (as provided in the various Debt for Development agreements among the intermediary, debtor country and A.I.D.) as promptly as possible after the intermediary acquires the debt. Intermediaries may not: (a) retain title to such debt for speculative or other purposes, or (b) exchange the debt of one country for the debt of another country without prior approval of A.I.D.

9. Use of Development Asset by Intermediary: The intermediary shall promptly report to A.I.D. the nature and amount of the development asset acquired through an A.I.D.-financed Debt for Development transaction. On a quarterly basis the intermediary shall also report to A.I.D. on the use of the asset

for the agreed upon development purpose, and it shall comply with any further reporting requirements included in project agreements with A.I.D. The intermediary shall promptly transfer to A.I.D. any asset that for any reason the intermediary has become unable to use in a manner consistent with its Debt for Development agreement with A.I.D.

ADD INSERT "A"

10. Interest Earned on Local Currencies Obtained from the Debt Exchange: ~~Local currencies obtained by intermediaries through debt exchange transactions shall be held in interest bearing accounts. The interest earned on all such currencies before their use for final program purposes shall be remitted to A.I.D., for the account of the U.S. Treasury, in accordance with standard rules governing interest earned by A.I.D. grantees on advances.~~

11. Installment Payments in Exchange for Debt Retirement: The agreement between a Debt for Development intermediary and the debtor country may provide for the debtor country, in exchange for retirement of the A.I.D.-financed debt, to furnish the development asset (such as local currencies) to the intermediary in installments rather than in a single lump-sum. ~~Any portion of such installment payments attributable to interest, or to an amount paid in lieu of interest, must be paid by the intermediary to the U.S. Treasury in accordance with the previous paragraph.~~

Installment payment amounts may take into account variations in the rate of exchange of units of local currency for dollars occurring during the payment term. For example, in exchange for retirement of the debt, the intermediary could receive a dollar-denominated note providing for installment obligations equal in value to a fixed sum of dollars, with installment payments to be made in local currencies in an amount calculated according to the exchange rate from dollars to local currencies applicable at the time of each payment.

ADD INSERT "B"

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INSERT MODIFICATIONS TO DEBT FOR DEVELOPMENT GUIDELINES

INSERT A (Section D(10))

Subject to agreement by A.I.D. and any special rules to be issued by A.I.D., the intermediary may earn and retain interest or other forms of income on the principal amount of local currencies obtained by the intermediary through debt exchange transactions, and the intermediary may use such principal and income either directly for approved program purposes or to establish an endowment for long-term financing of such program purposes. During the life of the project, the intermediary shall make quarterly reports to A.I.D. of the amount of such local currencies earned, retained or used for project purposes.

INSERT B (Section D(11))

In reviewing a proposal for such installment payments in exchange for debt retirement, A.I.D. and the intermediary should consider the risk of non-payment by the debtor country and whether insurance or other guarantees against non-payment should be provided to reduce the risk of loss.

TITLE VII—MISCELLANEOUS

SEC. 701. SHORT TITLE.

This title may be cited as the "Global Environmental Protection Assistance Act of 1989".

PART A—COMMERCIAL DEBT-FOR-NATURE EXCHANGES

SEC. 711. AMENDMENT TO THE FOREIGN ASSISTANCE ACT.

The Foreign Assistance Act of 1961 is amended by inserting after chapter 6 of part I the following new chapter:

"CHAPTER 7—DEBT-FOR-NATURE EXCHANGES

"SEC. 461. DEFINITION.—For purpose of this chapter, the term 'debt-for-nature exchange' means the cancellation or redemption of the foreign debt of the government of a country in exchange for—

"(1) that government's making available local currencies (including through the issuance of bonds) which are used only for eligible projects involving the conservation or protection of the environment in that country (as described in section 463); or

"(2) that government's financial resource or policy commitment to take certain specified actions to ensure the restoration, protection, or sustainable use of natural resources within that country; or

"(3) a combination of assets and actions under both paragraphs (1) and (2).

"SEC. 462. ASSISTANCE FOR COMMERCIAL DEBT EXCHANGES.—(a) The Administrator of the Agency for International Development is authorized to furnish assistance, in the form of grants on such terms and conditions as may be necessary, to nongovernmental organizations for the purchase on the open market of discounted commercial debt of a foreign government of an eligible country which will be canceled or redeemed under the terms of an agreement with that government as part of a debt-for-nature exchange.

"(b) Notwithstanding any other provision of law, a grantee (or any subgrantee) of the grants referred to in subsection (a) may retain, without deposit in the Treasury of the United States and without further appropriation by Congress, interest earned on the proceeds of any resulting debt-for-nature exchange pending the disbursements of such proceeds and interest for approved program purposes, which may include the establishment of an endowment, the income of which is used for such purposes.

"SEC. 463. ELIGIBLE PROJECTS.—(a) The Administrator of the Agency for International Development shall seek to ensure that debt-for-nature exchanges under this chapter support one or more of the following activities by either the host government, a local private conservation group, or a combination thereof:

"(1) restoration, protection, or sustainable use of the world's oceans and atmosphere;

"(2) restoration, protection, or sustainable use of diverse animal and plant species;

"(3) establishment, restoration, protection, and maintenance of parks and reserves;

"(4) development and implementation of sound systems of natural resource management;

"(5) development and support of local conservation programs;

"(6) training programs to strengthen conservation institutions and increase scientific, technical, and managerial capabilities of individuals and organizations involved in conservation efforts;

"(7) efforts to generate knowledge, increase understanding, and enhance public commitment to conservation;

"(8) design and implementation of sound programs of land and ecosystem management; and

"(9) promotion of regenerative approaches in farming, forestry, fishing, and watershed management.

"(b)(1) In cooperation with nongovernmental organizations, the Administrator of the Agency for International Development shall seek to identify those areas, which because of an imminent threat, are in particular need of immediate attention to prevent the loss of unique biological life or valuable ecosystem.

"(2) The Administrator of the Agency for International Development shall encourage as many eligible countries as possible to propose such exchanges with the purpose of demonstrating to a large number of governments the feasibility and benefits of sustainable development.

"SEC. 464. ELIGIBLE COUNTRIES.—In order for a foreign country to be eligible to participate in a debt-for-nature exchange under this chapter, the Administrator of the Agency for International Development shall determine that—

"(1) the host country is fully committed to the long-term viability of the program or project that is to be undertaken through the debt-for-nature exchange;

"(2) a long-term plan has been prepared by the host country, or private conservation group, which adequately provides for the long-term viability of the program or project that is to be undertaken through the debt-for-nature exchange or that such a plan will be prepared in a timely manner; and

"(3) there is a government agency or a local nongovernmental organization, or combination thereof, in the host country with the capability, commitment, and record of environmental concern to oversee the long-term viability of the program or project that is to be undertaken through the debt-for-nature exchange.

"SEC. 465. TERMS AND CONDITIONS.—(a) The terms and conditions for making grants under this chapter shall be deemed to be fulfilled upon final approval by the Administrator of the Agency for International Development of the debt-for-nature exchange, a certification by the nongovernmental organization that the host government has accepted the terms of the exchange, and that an agreement has been reached to cancel the commercial debt in an agreed upon fashion.

"(b) Grants made under this section are intended to complement, and not substitute for, assistance otherwise available to a foreign country under this Act or any other provision of law.

"(c) The United States Government is prohibited from accepting title or interest in any land in a foreign country as a condition on the debt exchange.

"SEC. 466. PILOT PROGRAM FOR SUB-SAHARAN AFRICA.—(a) The Administrator of the Agency for International Development, in cooperation with nongovernmental conservation organizations, shall invite the government of each country in sub-Saharan Africa to submit a list of those areas of severely degraded national resources which threaten human survival and well-being and the opportunity for future economic growth or those areas of biological or ecological importance within the territory of that country.

"(b) The Administrator of the Agency for International Development shall assess the list submitted by each country under subsection (a) and shall seek to reach agreement with the host country for the restoration and future sustainable use of those areas.

"(c)(1) The Administrator of the Agency for International Development is authorized to make grants, on such terms and conditions as may be necessary, to nongovernmental organizations for the purchase on the open market of discounted commercial debt of a foreign government of an eligible sub-Saharan country in exchange for commitments by that government to restore natural resources identified by the host country under subsection (a) or for commitments to develop plans for sustainable use of such resources.

"(2) Notwithstanding any other provision of law, a grantee (or any subgrantee) of the grants referred to in section (a) may retain, without deposit in the Treasury of the United States and without further appropriation by Congress, interest earned on the proceeds of any resulting debt-for-nature exchange pending the disbursements of such proceeds and interest for approved program purposes, which may include the establishment of an endowment, the income of which is used for such purposes.".

PART B—MULTILATERAL FOREIGN ASSISTANCE COORDINATION

SEC. 721. GENERAL POLICY.

It is the sense of the Congress that the Secretary of State should seek to develop an increased consideration of global warming, tropical deforestation, sustainable development, and biological diversity among the highest goals of bilateral foreign assistance programs of all countries.

SEC. 722. POLICY ON NEGOTIATIONS.

(a) IN GENERAL.—The Secretary of State, acting through the United States representative to the Development Assistance Committee of the Organization for Economic Coordination and Development (OECD), should initiate, at the earliest practicable date, negotiations among member countries on a coordinated approach to global warming, tropical deforestation, sustainable development, and biological diversity through bilateral assistance programs that would include—

(1) increased consideration of the impact of developmental projects on global warming, tropical deforestation, and biological diversity;

(2) reduction or elimination of funding for those projects that exacerbate those problems;

(3) coordinated research and development of projects that emphasize sustainable use or protection of tropical forests and support for local conservation efforts;

(4) expanded use of forgiveness of foreign assistance debt in exchange for policy changes or programs that address problems associated with global warming, tropical deforestation, sustainable development, and biological diversity;

(5) increased use of foreign assistance funds and technical assistance in support of local conservation, restoration, or sustainable development efforts and debt-for-nature exchanges;

(6) improved exchange of information on energy efficiency and solar and renewable energy sources, and a greater emphasis on the use of those sources of energy in developmental projects; and

(7) increased use of environmental experts in the field to assess development projects for their impact on global warming, tropical deforestation, and biological diversity.

(b) IMPLEMENTATION OF AGREEMENT.—Negotiations described in subsection (a) shall seek to ensure that the recommended changes are implemented as quickly as possible by member countries of the Development Assistance Committee.