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la science et la culture

Organización
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para la Educación,
la Ciencia y la Cultura

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منظمة الأمم المتحدة
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联合国教育、
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Item **5.17** of the agenda

DEBT SWAPS FOR EDUCATION

OUTLINE

Source: 34 C/Resolution 14

Background: By 34 C/Resolution 14, the General Conference requested the Director-General to continue to convene the Working Group on Debt Swaps for Education, to lead the debate on debt swap initiatives by promoting inter-agency meetings on alternative financing of education, and to report on the results to the General Conference at its 35th session.

Purpose: The Director-General highlights UNESCO's work in this field and the main findings of a desk study on debt swaps.

Decision required: paragraph 15.

1. The current global financial crisis challenges hard-won gains in the education sector and could worsen inequalities, threatening to undermine the achievement of EFA goals. Public education spending in the developing world is falling behind targets and will continue to do so if national governments and the international community do not make a major effort to scale up and reallocate resources. Counter-cyclical investment in human resources is crucial to combat the crisis and spur economic recovery. In order to counter the adverse effects of the economic downturn and close the EFA financing gap, UNESCO is considering innovative approaches to augment education spending. Debt swaps are among the possible mechanisms being contemplated. UNESCO has commissioned a desk study that seeks to systematize and build further on some important concerns that have been raised in recent research in order to identify

the necessary conditions to transform debt swaps into a more effective and efficient tool for EFA financing.[1]

The origins of debt swaps for education

2. Debt-for-education swaps can be broadly defined as the cancellation of external debt in exchange for the debtor government's commitment to mobilize domestic resources for education spending. The concept of debt-for-education swaps belongs to a broader category of so-called debt-for-development swaps, arrangements that are designed to divert public resources from debt service to spending for development. However, debt swaps originated in the commercial sphere, with the secondary market for discounted debt starting to grow at an increasing pace when the Latin American debt crisis took off in 1982. In the 1980s and 1990s, the mechanisms developed for executing debt-for-equity swaps inspired non-governmental organizations and Paris Club creditors to swap debt for development in operations that were largely multi-sector and environment-based. Donor emphasis subsequently shifted towards larger-scale and more comprehensive debt relief initiatives, most notably the Heavily Indebted Poor Countries (HIPC) Initiative and its successor, the Multilateral Debt Relief Initiative (MDRI). Debt-for-development swaps have re-emerged in recent years and further initiatives are now being proposed. This second wave of swaps typically targets low- and middle-income non-HIPC-eligible countries and non-HIPC/MDRI-eligible debt titles. Education has gained importance as a beneficiary sector. Since 1998, 18 debt-for-education swap schemes have been initiated in 14 different debtor countries.

3. The recently renewed interest in debt-for-development interventions has to a large extent come from Latin American governments, regional intergovernmental organizations and civil society. At the 12th and 13th Ibero-American Conferences on Education in 2002 and 2003, the Ministers of Education called on regional Heads of State to consider debt-for-education swaps as a vehicle to convert a part of the regional debt into education funding. In 2006, in line with 33 C/Resolution 16, the Director-General established the working group on debt swaps for education. Chaired by Mr Daniel Filmus, then Minister of Education, Science and Technology of Argentina, the Group successfully achieved its purpose of exchanging information and experiences on debt swaps and developing recommendations on their use in education. By 34 C/Resolution 14, the 34th session of the General Conference requested the Director-General to continue to convene the Working Group; however, this latter came to an end when no extrabudgetary resources were received to finance follow-up activities. At the same time, UNESCO commissioned a desk study on: "What Potential for Debt-for-Education Swaps in Financing Education for All?" It should also be noted that the Organization intends to hold, with extrabudgetary support, a conference on innovative approaches to education financing in the first half of 2010. This conference will present debt swaps as one of several alternative financing initiatives to address the financial crisis. In the meantime, Argentinian stakeholders have continued to carry out research and to promote the debt-for-education concept.[2]

The macro-economic nature of debt swaps

4. It has often been considered self-evident that debt swaps would increase net financial transfers to recipient countries. However, this is a simplistic representation of debt relief mechanisms. It is important to take several important qualifications into account. First, there is a time inconsistency between the budgetary gains from debt relief and the domestic resources that must be mobilized in a swap arrangement. The former materialize only gradually, typically over many years or even decades, at the pace of the contractual debt service payments cancelled, with the exact timing depending on the specific original repayment terms and schedule of the debt. The

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1 Cassimon, D., Essers, D. and Renard, R. 2009. "What potential for debt-for-education swaps in financing Education for All?" UNESCO, Paris.

2 Filmus, D. and Serrani, E. 2009. *Desarrollo, educación y financiamiento: Análisis de los canjes de deuda por inversión social como instrumento de financiamiento extra-presupuestario de la educación*. Buenos Aires: Fundación SES/Organización de Estados Iberoamericanos.

latter, on the other hand, is typically due much earlier, frontloaded to an early point in time – at best within a span of a few years.

5. Another implicit assumption is that the original debt would have been fully serviced in the absence of the debt relief operation. Such reasoning is obviously overly optimistic, particularly as regards countries with debt service problems. The possibility of debt service defaulting must be taken into account, as only the share of debt service that would actually have been paid up to the creditor in the absence of debt relief generates true fiscal space. Debt relief operations such as debt-for-education swaps that at the outset seem generous can therefore lead to only minor budgetary gains.

6. It is increasingly acknowledged that debt swap arrangements may crowd out other potentially more effective aid interventions such as budget support as well as domestic budgetary resources for the education sector. Current aid accounting rules seem to incite donors to treat debt for education swaps and other debt relief operations as substitutes for new aid. Since the OECD Development Assistance Committee allows the whole nominal value of debt relief to be counted as overseas development assistance (ODA), debt-for-education swaps are an attractive option for donors to boost ODA figures. Debt-for-education swaps can only be properly judged on their own merits if there is full additionality from a creditor and a debtor perspective, with freed-up funds coming on top of other aid interventions and budgetary resources that had already been reserved by the recipient government.

7. In addition, debt swaps are often deemed too small, in comparison with countries' overall debt burden, to make a real difference. This insight led to the gradual demise of the first wave of debt swaps and to the rise of schemes such as the HIPC Initiative and the Brady deals for middle-income countries with large external private debts. Critics have suggested that the size of debt-for-education and other "second-wave" debt swap operations be increased. Nevertheless, the upper limits for bilateral debt conversion set by the Paris Club are far from being reached, even by forerunners like Germany and Spain. Furthermore, aggregated World Bank data show that a significant proportion (25%) of the external debt of low-income countries is in private hands. For middle-income countries, the share of private creditors is almost three times higher (74%).

8. For all of these reasons, therefore, it is widely recognized that bilateral debt-for-education swaps in themselves cannot be used to solve the problem of excessive debt in developing countries and are no substitute for a more structural global response.

The role of debt swaps within the current aid architecture

9. Donors have committed themselves to the new aid paradigm through the Paris Declaration and the 2008 Accra Agenda for Action (AAA) on Aid Effectiveness. The goals are to avoid "donor proliferation" by reducing the number of channels through which ODA is provided, prevent "aid fragmentation" by bringing down the number of donor-funded activities and increasing their average value, reduce "conditionality", and make aid more predictable and long-term. AAA also stressed the importance of aligning education support with national development plans and the use of national systems.

10. In spite of commitments to deliver 66% of aid flows in the context of programme-based approaches by 2010, donors continue to earmark most of their contributions for a wide variety of non-aligned small projects. This practice leads to elevated transaction costs for the recipient country. If they are limited in size, strongly earmarked by the creditor and insufficiently coordinated with other education sector support, debt-for-education swaps may thus add to donor proliferation and aid fragmentation, standing in the way of a holistic approach to education and the development of a sustainable sector.

11. Some progress has been made in policy alignment. However, various studies cast doubts on the extent to which recent swap initiatives in the education sector have been "system-aligned". In

order to develop long-term capacity and strengthen the public sector, it is necessary to work closely with the recipient country's systems and procedures.

Conclusion

12. The effectiveness and efficiency of debt-for-education swaps as a development instrument and potential innovative financing approach to work towards the EFA goals is very much conditional on a number of practicalities and design issues. In order to reduce fiscal pressures on the debtor country's government, larger discount rates on counterpart payments must be granted and the timing of such payments should match the original debt service schedule. Preferably, debt-for-education swaps should target non-concessional debt that is likely to be serviced. Guaranteeing that swaps are truly additional, with freed-up funds not crowding out other aid interventions by donors or domestic budgetary resources already reserved in the debtor country, is difficult. However, "peer pressure" on donors and the use of historical spending baselines to gauge debtor government education spending could help. Debt-for-education swaps also risk returning to "old-style" micro-earmarking. This can be prevented by aligning the education support freed up by swaps with national education sector plans and by using the debtor country's own systems and procedures, leading to greater country ownership and strengthening of the public sector. Furthermore, harmonization of swaps with other bilateral and multilateral education support arrangements would avoid excessive administrative burden and accompanying transaction costs for the recipient country. In other words, it is possible to engineer a "new style" of debt swaps.

13. Nevertheless, even if all of the above is taken into account, the potential of debt-for-education swaps is limited. These instruments cannot solve the debt problem on their own; nor can they fully close the EFA financing gap. Almost all bilateral and multilateral debt of HIPC countries is due to be cancelled on reaching the completion point of the HIPC process. For most middle-income countries, external debt is largely owed to private creditors and therefore not likely to be subject to voluntary debt conversions. It is probable that those best qualified for debt-for-education swaps are the bilateral and multilateral debt titles that rest with a small number of non-HIPC low-income and lower middle-income countries.

14. Only when both creditors and debtors fully agree on the earmarking of substantial resources coming from debt swaps for the education sector can the debt-for-education concept be put to use as a complementary instrument to finance EFA. Debt swaps for education are by nature voluntary bilateral arrangements. However, UNESCO could possibly play a role in disseminating information and knowledge sharing on past debt swap practice, bringing potentially interested creditors and debtors into contact with each other, and providing a platform for dialogue where stakeholders meet on an equal basis to discuss opportunities for debt-for-education swaps.

Proposed draft resolution

15. In view of the above, the General Conference may wish to adopt the following draft resolution:

The General Conference,

1. *Understanding* that education is a key factor in human development, as a basic tool enabling national States to influence the future of their inhabitants in society and the world of work,

2. *Taking into consideration* Major Programme I – Education, which establishes basic education for all as the principal priority,

3. *Reaffirming* the importance of sustained and increased levels of investment in education in the context of preserving the gains made in education since 2000 and overcoming the current financial crisis and economic downturn,

4. *Considering* that the burden of foreign debt on the budgets of the world's debtor countries is one of the factors limiting investment in education, and that there is a need for monitoring debt sustainability in light of the crisis,

5. *Recalling* the proposal made by Argentina, Brazil and Peru during the 32nd, 33rd and 34th sessions of the General Conference, to encourage initiatives to swap debt for education, requesting UNESCO, as a worldwide flagship organization for education, to lead the debates and initiatives relating to such actions,

6. *Considering* that the Ibero-American Conferences of Ministers of Education have stressed the importance of promoting in various international forums the adoption of innovative educational financing mechanisms, in particular the conversion of parts of foreign debt servicing into investment in their education systems,

7. *Bearing in mind* that a number of international high-level conferences, including the High-Level Group on EFA and the 2008 High-Level Forum on Aid Effectiveness, raised the importance of exploring new forms of financing for public and private investment in education,

8. *Taking into account* the results obtained by the Working Group established by the Director-General pursuant to 33 C/Resolution 16 and recent research on innovative approaches to education financing, including the 2009 report provided by Argentina,

9. *Recommends* that the Director-General establish an Advisory Panel of Experts on Debt Swaps and Innovative Approaches to Education Financing, with balanced representation, to provide advice to Member States and examine how to advance knowledge on debt swaps and innovative financing, with a view to organizing the first meeting of this panel with funds from UNESCO's regular programme in early 2010 and a follow-up in 2011 with extrabudgetary resources;

10. *Further recommends* that this Advisory Panel of Experts examine the role UNESCO and the Panel may play in debt swaps for education and innovative approaches to education financing;

11. *Requests* the Director-General to create a Special Account to attract extrabudgetary resources in order to carry out the necessary follow-up activities proposed by the Advisory Panel of Experts and to secure appropriate expertise on debt swaps for education and innovative approaches to education financing to strengthen UNESCO's professional capacity in this technical area;

12. *Invites* Member States to demonstrate their support to this initiative by contributing to the Special Account;

13. *Further requests* the Director-General to report on the findings of the Advisory Panel of Experts and the status of the Special Account and activities carried out with funds from the Special Account to the General Conference at its 36th session.