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Debt swaps for financing education: Exploration of new funding resources

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Abstract: As an innovative financial mechanism to explore additional funds for social development programs in developing countries, debt swaps for development, including debt-for-education swaps, became popular between the 1980s and 2000s. Their popularity, however, seems to have diminished since the beginning of the 2010s. This article describes debt swaps for development with a focus on debt-for-education swaps, explaining how they became popular, examining why they have lost momentum, and exploring whether debt-for-education swaps are a feasible option for funding social development programs. Despite recent economic recovery and growth worldwide, one of the key obstacles for achieving the United Nations' Sustainable Development Goal 4—to ensure inclusive and equitable quality education and promote lifelong learning opportunities for all—remains inefficient funding for education programs in developing countries. Based on the findings, this article argues for the feasibility of debt-for-education swaps to seek funding with a number of conditions.

Subjects: Development Policy; Economics and Development; Public Finance

Keywords: debt swaps; social development; financial mechanism; education

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PUBLIC INTEREST STATEMENT

Education is in danger because there is not enough money available to invest in it. New funding systems to fund money have been sought. The new system was created and called debt swaps for education. Because it can cancel the past debt and use the money to use for education, it was once considered a magic bullet to work out all education problems related to money. However, debt swaps for education is no longer popular. Why? This paper tries to find out possible reasons, talking about positive and negative aspects of the system. This paper proposes that the system can still be useful but with a lot of conditions.

1. Introduction

In May 2015, UNESCO, UNICEF, the World Bank, UNFPA, UNDP, UN Women, and UNHCR organized the World Education Form in Incheon, Republic of Korea. Over 1,600 participants from 160 countries adopted the Incheon Declaration for Education 2030 that aims to achieve inclusive and equitable quality education and lifelong learning for all by 2030 (UNESCO, 2016). This declaration served as a fundamental tenet for establishing the Sustainable Development Goal (SDG) 4 that aims to ensure inclusive and equitable quality education and promote lifelong learning opportunities for all. SDGs were set by the United Nations (UN) during the 2015 UN Assembly. SDGs consist of 17 global goals,[1] fourth of which is about quality education for all.[2]

Despite some progress, many countries are off track to meet these goals. One of the major obstacles is insufficient funding for education. According to the Education Commission (2016), there is an external financing need for key education goals in low-income countries of about US$ 3 trillion annually to 2030 from the current 1.2 trillion USD. In order to mobilize extra financial resources for education, debt-for-education swaps have been implemented by several governments of developed nations.

As Buckley (2011) maintains, debt swaps are important funding tools that make debt relief politically attractive to donor countries as well as contributes to the development of recipient countries through canceling external debt and financing development projects.

Debt swaps (also called debt conversions) are a type of debt relief, often as part of the official development assistance (ODA) funding: instead of paying back the debt to creditor countries, debtor countries use the debt money for their social development, such as education and health care (Mealla, 2007; Thapa, 1998). Cassimon, Renard, and Verbeke (2008) define a debt swap as a switch from debt service spending by the public sector to development spending, made by a cancellation of debt. Fletcher and Webb (2012) define it as a financing technique to mobilize resources for development in debtor countries by converting a portion of external debt owed to the creditor country into funds for new or existing aid programs in the debtor country. The mechanism of debt swaps is that they make a fiscal space that enables the debtor government to channel fiscal resources, otherwise devoted to debt servicing, into social development programs without sacrificing fiscal and macroeconomic sustainability (Heller, 2006).

Debt-for-education swaps are an application of debt swaps for development (Organización de Estados Iberoamericanos, 2006). According to Cassimon, Essers, and Renard (2009), debt swaps for education are "the cancellation of external debt in exchange for the debtor government's commitment to mobilize domestic resources for education spending (p.2). UNESCO (2009) defines debt swaps for education as a "conversion of parts of foreign debt servicing into investment in their education system" (p. 1).

Given that debt swaps for financing, education is a relatively new approach that has rarely been discussed in educational development literature, only a handful of experts and/or scholars seem to fully understand its mechanisms. This article describes debt swaps for development focusing on debt-for-education swaps, explaining how they became popular as an innovative funding mechanism for funding development, in particular, education, examining why they have lost momentum, and exploring whether debt-for-education swaps are a feasible option for funding social development programs in current and future contexts.

2. Financial problems of development

The debt of developing countries has been a major concern for their socio-economic development, with a growing number of problems such as the accumulation of domestic debt, and short-term debt and unsecured private debt (Culpeper & Kappagoda, 2016). Debt burdens have negative impacts on debtor countries by diverting public funds away from social development programs (Fletcher & Webb, 2012). Due to the debt overhang effect from heavy debt burdens, the debtor government is unable to invest in social development programs as they strive to repay debt (Omotola & Saliu, 2009). Mealla (2007) suggests that special treatment is required to address the issues of foreign debt. Using a similar mechanism to the debt swap (Mealla, 2007), the World Bank and IMF launched an initiative called heavily indebted poor countries (HIPC) for developing countries not to face a debt burden (IMF, 2017; Nomura, 2011). HIPC consists of debt relief for the poorest and most indebted countries (low-income countries) in exchange for social development investment (Mealla, 2007). HIPC provides debt relief to countries that demonstrate solid governance, and efforts toward tackling corruption and poverty so that they can invest in health and education for societies (Omotola & Saliu, 2009). Since 2000, 27 countries have accepted the HIPC initiative and increased their social spending to cover basic social needs, including education, from 6.4% of the gross national product to 7.9% in 2003. In 2005, as a successor of HIPC, the Multilateral Debt Relief Initiative was adopted by the World Bank, IMF, and the African Development Bank. This initiative called for the cancellation of the debt issued by these banks (IMF, 2017). However, this debt relief mechanism reached few countries and the amount of debt relief was small (Mealla, 2007). Even after the very aggressive debt-relief activities in the 1990s and the 2000s, African countries still undertake annual debt repayment of $20 billion (Omotola & Saliu, 2009).

2.1. Financial problems of education

The Education 2030 Agenda and SDG 4 aim to increase access to learning opportunities for all throughout their lifetimes and places great pressure on the public funding of education (UNESCO, 2016). The Education 2030 Framework for Action, set during the 2015 World Education Forum, indicates that the shortage of funds should not endanger the provision of educational opportunities for all. The annual financial gap between available domestic resources and the funding necessary to meet SDG 4 in low and lower-middle income countries is even more serious than it was during the 2000–2015 Education for All (EFA) agenda (UNESCO, 2016).

Regmi (2016) notes that as of 2015, there were 48 countries in the category of least developed countries that are considered highly vulnerable to economic and environmental shocks and have low levels of human assets (United Nations, 2018). They account for 12% of the world population but share 1% of the overall global wealth. The average external debt of these countries between 2005 and 2013 was 28.1% of their gross national income. To make matters worse, non-concessional loans for education have increased significantly at a rate above the growth of grants since 2009 (UNESCO, 2015). Nomura (2011) argues that many sub-Saharan African countries find it very difficult to seek public funding for education due to macroeconomic instability, high debt ratios, poor tax administration, and large informal sectors. Filmus and Serrani (2009) note that external debt of developing countries is a serious obstacle for investment in education.

3. Debt swaps for development

As already mentioned, debt swaps for development are a type of instrument for debt relief. Developing countries have traditionally been indebted. To alleviate their debt burden, debt relief was elaborated on and practiced as early as the 1950s. The concept of debt swaps in exchange for various debtor commitments to development was became popular at the end of the 1980s when the Paris Club, a group of major creditor countries, discussed debt servicing problems and negotiated debt restructurings between indebted countries and their bilateral creditors (Cassimon et al., 2008). Since then, debt swaps have been actively practiced as a means to reduce debt burden in developing countries. Some members of the Paris Club such as France and Germany have carried out debt swaps to generate additional resources for education in developing countries (UNESCO, 2011), as will be described shortly.

3.1. Debt swaps for education

Excessive obligations to repay debt may discourage government from spending for social development, including education. As Filmus and Serrani (2009) note, the problems of low education investment and over-indebtedness mutually complement each other. Debt relief interventions, such as debt-for-education swaps, could resolve this issue and help restore economic growth (Cassimon, Essers, & Renard, 2011).

At the 32nd UNESCO General Conference in 2003, the application of debt swaps for financing education was considered for the first time. The Ministers of Education of Argentina and Brazil urged UNESCO to take world-wide initiatives to implement debt swap programs (Mealla, 2007). The Ministers of Education of Argentina, Brazil, and Venezuela as well as the President of Peru then requested the creation of a Working Group on Debt Swaps for Education during UNESCO's 33rd General Conference held in 2005 (Cassimon et al., 2009).

In 2006, the Working Group on Debt Swaps for Education was established in accordance with the Resolution of UNESCO's 33rd General Conference. The first meeting of the Working Group was held in Paris in 2006. The meeting resulted in the establishment of a basic conceptual framework, an exchange of experiences, and a work plan. The results from this meeting were presented to the 34th session of UNESCO's General Conference in 2007 (Cassimon et al., 2009). The second meeting of the Working Group was held in Buenos Aires in 2007. Key concepts and models, lessons learned from debt swap experiences, guidelines on best practices and recommendations were submitted to the UNESCO's Director General (Cassimon et al., 2009). The setup of a Special Account to pool funding for activities related to debt-for-education swaps (i.e., a pilot study) was also requested during the 35th session of UNESCO's General Conference in 2009 (UNESCO, 2013).

Subsequently, the Task Force on Innovative Financing for Education was established by the Leading Group on Innovative Financing for Development in 2010. UNESCO was assigned to explore the feasibility of debt swaps for education (UNESCO, 2010). Also, under the Resolution of UNESCO's 35th General Conference in 2009, the Advisory Panel of Experts on Debt Swaps and Innovative Approaches to Education Financing was established by UNESCO in 2010 (UNESCO, 2013).

The purpose of the Advisory Panel was examining how to improve funding mechanisms for education. UNESCO would use extra-budgetary funds provided from the Open Society Institute (OSI), a philanthropy NPO founded by George Soros, to conduct a pilot study to explore two topics: (i) how debt swaps have been used more effectively to provide funding for education and (ii) how debt swaps can be combined with other financial instruments to spare more funds for education. Findings from the study suggested using debt swaps to support issuing domestic bonds and explained how these Debt Conversion Development Bonds (DCDBs) could be used/applied to help fill the gap in funding needed to achieve EFA and education-related Millennium Development Goals. The Advisory Panel recommended undertaking a pilot feasibility program to test the DCDBs in a given country. This program might then be replicated in more countries (UNESCO, 2013).

As recommended by the Advisory Panel in 2012, UNESCO conducted a feasibility study to identify a debtor country and a creditor country for piloting a DCDB program. Although potential debtor countries and a creditor country were identified based on consultations with a number of stakeholders (including debtor and creditor countries, Global Partnership for Education, IMF, OSI, and UN agencies), no creditor country has committed to participating in a DCDB pilot project (UNESCO, 2013). To date, no contribution has been received to the aforesaid Special Account for debt-for-education swaps (UNESCO, 2013). Possible reasons why creditor countries have not made any contribution will be explored later.

4. Country cases

Despite the recent impasse in debt-for-education swaps, particularly in the form of DCDBs, there were several examples of similar debt-for-education swaps that were considered successful, in particular during the mid-2000s. This section presents and discusses cases of debt swaps enacted between El Salvador and Spain in 2005, France and Cameroon in 2006, and Germany and Indonesia in 2006 to further explore how these exchanges might be used for funding education initiatives.

4.1. Case between El Salvador and Spain: the rural school construction program (2005)

In December 2005, Spain and El Salvador agreed to convert debt owed by El Salvador to Spain into funds for education. The swap involved a number of education-related programs to address the issue of regional disparities in achieving EFA. To support this action, Spain contributed 10 million USD over four years in the form of debt swaps to the construction of rural schools and the purchase of educational textbooks (UNESCO, 2011). Under this agreement, instead of making repayments to Spain, the Ministry of Finance of El Salvador deposited funds into a special account at the El Salvador's Central Bank (Cassimon, Prowse, & Essers, 2011). Spain then canceled 10 million USD worth of debt owed to them by El Salvador.

The deposited funds were managed through two coordinated committees with representatives of Spain and El Salvador. The first committee implemented the overall debt swap and formulated the execution strategy. The second committee, the Technical Committee, disbursed funds and implemented the projects associated with the funds (Cassimon et al., 2011; UNESCO, 2011).

The Rural School Construction program supported by debt swaps was largely considered positive by relevant stakeholders in Spain and El Salvador. From Spain's point of view, debt swaps were able to support projects without conventional ODA funding. From El Salvador's perspective, the funds that would have been used to repay debts were returned to the country and funded its own education projects.

Nonetheless, the impact of the debt swaps was also questioned. One notable problem was the small scale of the program: 10 million USD is not enough to tackle education issues in the country. For example, improved roads and additional school buses are necessary for children to travel to and from school safely. El Salvador has over 600 million USD bilateral debt that could be used for debt swaps, but donor nations are unwilling to pursue large debt swaps with lower-middle income countries like El Salvador (Cassimon et al., 2011; UNESCO, 2011).

4.2. Case between Cameroon and France: the contract teacher program (2006)

In 2000, France agreed to work with other Paris Club members to reduce debt by canceling loan repayments through debt swaps. As a means to ensure additional debt relief to be converted into investments in education, France decided to create the Contrat de Désendettement et Développement (C2D: Contracts for Debt Relief and Development). In 2006, France signed an agreement with Cameroon for 1.17 billion Euros of debt to be diverted to education programs in Cameroon (UNESCO, 2011).

In the same year, Cameroon designed its education strategy focusing on universal primary enrollment, gender equity, and 100% completion rates to be reached by 2015. To achieve these goals, the government prioritized the recruitment of contract teachers. The contract teacher program called for the recruitment of 37,200 contract teachers, to be funded with 392 million USD over five years. While the government expected to support nearly 75% of the total cost of the program, a financing gap existed of 103 million USD. To fill some of this gap, the C2D program provided 55.3 million USD (UNESCO, 2011).

C2D was generally considered a successful program by relative constituents in both France and Cameroon. From the perspective of France, C2D can support projects without conventional ODA funding. Through frequent communications with the Cameroon government, the French government alleviated concerns about corruption and inappropriate use of budget funds released as a result of debt relief. From Cameroon's point of view, the funds generated by debt swaps were used to finance its own poverty reduction strategy.

However, the C2D program has been criticized for a number of reasons. OECD, for example, criticized C2D for the high costs associated with its complex administration (OECD, 2006). The main factor contributing to these administration costs is the number of conditions and requirements necessary to ensure that the funds are properly used for development. Given Cameroon's history for being notorious for corruption (Transparency International, 2016), French officials retained some control and visibility for the transparency of funding use.

4.3. Case between Germany and Indonesia

In 2000, Germany and Indonesia agreed to make a debt-for-education swap arrangement for the first time. Under this agreement, Germany would cancel a bilateral debt of 25.6 million Euros and Indonesia would spend the local currency equivalent of half of this amount over three years on teacher training between 2003 and 2005.

A second debt-for-education swap was agreed in October 2002. The swap included 23 million Euros of bilateral debt. The conversion rate was 50%, and the Indonesian government promised to invest in the construction of 100 new junior secondary schools in the remote Eastern provinces between 2005 and 2007. To rebuild the Indonesian schools damaged by the earthquake in Yogyakarta and Central Java in 2006, a third swap of 20 million Euros was transacted (Cassimon & Essers, 2014; Cassimon et al., 2011). There was a positive result of the debt swaps such as the (apparent) budgetary gains in the education sector (Cassimon et al., 2011).

Although this case between Germany and Indonesia is generally considered successful, their budgetary gains are more modest than expected. Cassimon et al. (2008) argue that 'budgetary gains (additional amount in the national budget for social development activities such as education and health care) from debt relief only gradually materialize over time (many years or even decades), whereas counterpart payments, on the other hand, may be due much earlier, typically within the first few years" (p. 1189). Given the German-Indonesian debt-for-education swaps with a long-term original repayment schedule, the impact of this debt swap was small.

5. Limitations and issues

Debt swaps are aimed at reducing the debt of developing countries and releasing resources for social development. However, this is a very simple representation of debt swaps, and several issues need to be considered.

First, depending on the contractual repayment and schedule of the underlying debt, budgetary gains from debt swaps are realized only slowly, typically over many years or even decades (Cassimon et al., 2009). Second, if indebted countries are financially strained, which is often the case, perhaps indebted countries are unable to pay back the debt in the first place. Therefore, the use of the debt for social development might be unrealistic and impractical proposition. Third, debtor countries' fungibility is also a concern (debtor countries put the money generated by debt swaps on the government budget). If a debtor country originally allocate 100 million USD for education, and if additional 100 million was generated by debt swaps, instead of adding the 100 million USD to make the budget 200 million USD, the debtor government might use the additional 100 million USD for education as the original budget. Fourth, even if debts are converted into funds, debtor governments will not necessarily use these resources for social development, including education. Consequently, donors tend to control to a certain degree how the funds from debt swaps are spent (Cassimon et al., 2008). However, too much donor interventions may reduce the autonomy of the debtor country over development projects (Cassimon et al., 2011). Fifth, debts are often converted and managed as bonds. For instance, a NGO buys debt from the debtor government in the form of bonds and conducts development projects with funds from the interests of the bond. In this case, only social-oriented investors such as NGOs would invest in them (Cassimon et al., 2008). Sixth, the amount of debt swap is too insignificant to create any indirect (positive) economic effect. One cannot expect the debt scenario to benefit from this piecemeal transaction (Cassimon et al., 2011).

6. Discussion

We have so far explained what debt swaps for development are, focusing on those for education, and how debt-for-education swaps have been used by looking at cases between El Salvador and Spain, Cameroon and France, and Indonesia and Germany. As these cases partially suggest, whereas debt-for-development swaps in general were popular from the end of the 1980s to the 2000s, debt-for-education swaps were particularly popular in the mid-2000s arguably because education was a top priority on the international development agenda after the World Education Forum in Dakar in 2000 (Ito, 2012). Since the beginning of the 2010s, however, there do not appear to have been many debt-for-education swap practices (The Guardian, 2014). Although there have been sporadic cases on debt-for-development swaps such as the one between Italy and Albania (2012–2016) and the one between Russia and Mozambique (2017–2021), as far as the authors know, few debts have recently swapped for education purposes. Also, UNESCO's efforts to take a worldwide initiative for debt-for-education swaps and create a Special Account to pool financial contributions related to debt swaps ended up in vain, as no creditor was engaged in debt swaps in this context.

One major reason of the recent absence of debt-for-development swaps, in particular that of education, may be attributed to the 2008 Lehman Shock and the subsequent global financial crisis. Developed nations, also creditor countries, such as the US, EU, and Japan suffered from the crisis and could not afford to carry out debt relief practices, including debt swaps for development, as they could before. Developing countries, also debtor countries, have also been strongly affected both by the spillovers from the crisis (e.g., less trade) and policy responses (e.g., fewer debt swaps for development) from creditor countries. However, for a large majority of developing countries, "the spillovers from the crisis have not been all that negative" (Akyüz, 2014, p. 3). Indeed, according to the analysis from Jubilee Debt Campaign based on IMF and World Bank databases, the average government external debt payment in 126 developing countries have increased from 6.7% of government revenue in 2014 to 10.7% in 2017, an increase of 60% (Public Finance International, 2018). This implies that many developing countries are successfully reducing their overall debt burden.

Nonetheless, recent economic recovery and growth has been strengthening and firmer in developed countries (United Nations, 2017b). In many emerging economies, in contrast, the corporate sector remains vulnerable to sudden changes in financial condition and destabilizing capital outflows, and in four major developing regions (i.e., West Africa, Central Africa, Southern Africa, and Latin America and the Caribbean), GDP per capita declined in 2016 (United Nations, 2017b). Given that many developed nations have experienced stable economic recovery and growth in the recent years while developing nations struggle with a large amount of debt and fragility of their economic systems, it is possible that debt swaps for development, including education, will become popular again. For instance, according to Devex (2017), the World Food Program mediated a debt swap deal between Russia and Mozambique. Russia agreed to waive Mozambique's public debt, releasing 40 million USD that the Mozambican government has committed to the WFP to implement a school meal program for 150,000 children between 2017 and 2021. Italy also has been engaged in the Debt for Development Swap Program with Albania. Between 2012 and 2016, Italy helped promote social development initiatives of Albania including education-related activities, with a total financial contribution of 20 million Euros. Italy has continued to help this program, as of 2018 (Italian-Albanian Debt for Development SWAP Agreement, 2016). These recent, albeit few, practices of debt-for-development swaps may suggest their revival in the near future. As cases examined in this article suggest, however, it is important to keep it in mind that debt-for-development swaps, including education, function only with a number of conditions such that the swap size should be large enough to make impact on macro-economy of the debtor country, and creditor countries should monitor how the funding is spent while respecting the autonomy and ownership of debtor countries in development projects. This article, therefore, argues that debt-for-development swaps might be an infeasible option to fund education unless these issues are addressed.

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Notes

1. (1) End poverty in all its forms everywhere; (2) End hunger, achieve food security and improved nutrition and promote sustainable agriculture; (3) Ensure healthy lives and promote well-being for at all ages; (4) Ensure inclusive and quality education and promote lifelong learning for all; (5) Achieve gender equality and empower all women and girls; (6) Ensure access to water and sanitation for all; (7) Ensure access to affordable, reliable, sustainable, and modern energy for all; (8) Promote inclusive and sustainable economic growth, employment, and decent work for all; (9) Build resilient infrastructure, promote sustainable industrialization, and foster innovation, and infrastructure; (10) Reduce inequality within and among countries; (11) Make cities inclusive, safe, resilient and sustainable; (12) Ensure sustainable consumption and production patterns; (13) Take urgent action to combat climate action and its impacts; (14) Conserve and sustainably use the oceans, seas, and marine resources; (15) Sustainably manage forests, combat desertification, and halt and reserve land degradation and halt biodiversity loss; (16) Promote just, peaceful, inclusive societies; and (17) Revitalize global partnerships for sustainable development (United Nations, 2017a).
2. SDG4 is composed of seven different sub-goals as follows: (1) Ensure that all children complete free, equitable and quality primary and secondary education leading to relevant and effective learning outcomes; (2) Ensure that all children have access to quality early childhood development, care and pre-primary education so that they are ready for primary education; (3) Ensure equal access for all women and men to affordable quality technical vocational and tertiary education, including university; (4) Substantially increase the number of youth and adults who have relevant skills, including technical and vocational skills, for employment, decent jobs and entrepreneurship; (5) Eliminate gender disparities in education and ensure equal access to all levels of education and vocational training for the vulnerable, including persons with disabilities, indigenous peoples, and children in vulnerable situations; (6) Ensure that all youth and a substantial proportion of adults achieve literacy and numeracy; and (7) Ensure all learners acquire knowledge and skills needed to promote sustainable development, through education for sustainable development and sustainable lifestyles, human rights, gender equality, promotion of a culture of peace and non-violence, global citizenships, and appreciation of cultural diversity and of culture's contribution to sustainable development (UNESCO, 2016).

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