



MADAGASCAR'S EXPERIENCE WITH SWAPPING DEBT FOR THE ENVIRONMENT

**Debt-for-Nature Swaps and Heavily Indebted Poor Country
(HIPC) Debt Relief**

*Background Paper for the
Vth World Parks Conference
Durban, South Africa*

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Ring-Tailed Lemur
Lemur Catta
The Spiny Forest
Madagascar

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Introduction

Recognized as a megadiversity country, nearly 98 percent of Madagascar's land mammals, 92 percent of its reptiles, and 80 percent of its plants are found nowhere else on Earth. With 71% of the population living below the poverty line, Madagascar is also one of the poorest countries in the world. Burdened with high levels of external debt, Madagascar has limited domestic resources to counter the environmental degradation caused by excessive reliance on agriculture and increasing population pressures in rural areas.

Madagascar is one of only a few countries in the world that has had experience with both commercial and bilateral debt-for-nature swaps and has also committed to allocate a portion of Heavily Indebted Poor Country (HIPC) debt relief savings to the environmental sector (Bolivia and Tanzania are others). In 2003, the Government of Madagascar signed a debt swap agreement with the German Government, which is expected to capitalize the new Madagascar Foundation for Protected Areas and Biodiversity and provide support for the *Association Nationale pour la Gestion des Aires Protégées (ANGAP - Parcs Nationaux Madagascar)*, Madagascar's National Association for the Management of Protected Areas. This paper reviews Madagascar's experiences with debt-for-nature swaps and focuses on current efforts to use a third debt relief tool which integrates environmental priorities into Madagascar's Poverty Reduction Strategy Paper (PRSP) through HIPC debt relief.

1. Early Experience with Debt-for-Nature Swaps

1.1 Commercial Debt-for-Nature Swaps

Beginning in the 1980s, Madagascar's commercial debt was discounted in the secondary market for commercial debt. In 1989, Madagascar became the first country in Africa to negotiate a debt-for-nature swap.¹ Based on their experience with debt-for-nature swaps in Latin America, conservation organizations such as Conservation International (CI), Missouri Botanical Garden and WWF were able to introduce the debt-for-nature swap concept in Madagascar. Given the importance of Madagascar's biodiversity, the Dutch International Cooperation Agency (DGIS) and the U.S. Agency for International Development (USAID) provided funds to purchase commercial debt from Madagascar's creditors and Deutschebank also donated debt for a swap. The conservation organizations negotiated the swaps with the assistance of financial intermediaries, such as Bankers Trust and ING Bank, who arranged for purchase of the debt and

¹ The first swap, agreed with WWF (with funding provided by WWF and USAID), financed a \$2.1 million conservation program in protected areas.

facilitated its conversion with Madagascar's Central Bank (later the Ministry of Finance).

From 1989-96, CI, Missouri Botanical Garden and WWF negotiated nine commercial debt-for-nature swaps in Madagascar, which generated \$11.7 million in conservation funds (see Annex 1). The conservation organizations signed debt-for-nature agreements with the Government of Madagascar that identified the programs to be funded and the amount of debt eligible for conversion. For example, in its first phase, the WWF Debt-for-Nature program trained over 320 nature protection agents, foresters who focused on involving communities in forest management. A second complementary phase introduced Forest Support Units, consisting of two specialized *ingénieurs forestiers*, to reinforce participatory forestry management.²

As shown in Annex 2, these early swaps involved purchase of commercial debt at 50% of face value. In exchange for cancellation of the debt, the Government of Madagascar agreed to pay the equivalent of 100% of face value in Malagasy francs. In 1994, the redemption price was reduced to 75% of face value of the debt.

"There was an atmosphere of excitement at the time of the negotiation of Madagascar's first debt-for-nature swap — the first in Africa — on all sides. Malagasy officials, Congressmen, bankers involved in the transaction and conservation NGO representatives alike were all in a state of complete enthusiasm and exhilaration. No major difficulties were encountered when the swap was presented to the National Assembly. It may not be as easy today to find opportunities for such debt swaps because of the nature and structure of today's debts, but they should nonetheless be analyzed as serious opportunities where they exist."

Léon Rajaobelina
Conservation International

1.2 Introduction of Bilateral Swaps

Paris Club. Since 1981, Madagascar has negotiated debt restructuring agreements with the so-called "Paris Club" of bilateral creditors eleven times. Beginning in 1997, Madagascar became eligible to negotiate swaps with bilateral creditors based on the inclusion of a debt swap clause in its agreement with Paris Club creditors.³ Madagascar's most recent agreement with the Paris Club, dated March 7, 2001, provides debt reduction on "Cologne terms" of up to 90% for eligible debt.

² ARCADIS Euroconsult 2001.

³ See <http://www.clubdeparis.org> under Madagascar.

Madagascar's Paris Club Debt Swap Clause

On a voluntary and bilateral basis, the Government of each creditor country or its appropriate institutions may sell or exchange, in the framework of debt for nature, debt for aid, debt for equity swaps or other local currency debt swaps:

(i) all Official Development Assistance (ODA) loans;

(ii) the amounts of other outstanding credits, loans and consolidations mentioned in paragraph 1 above, up to 20% of the amounts of outstanding credits as of December 31, 1994 or up to an amount of SDR 20 million, whichever is higher.

Tany Meva. In 1996, USAID financed a debt relief operation for the Government of Madagascar. USAID provided \$30 million in non-project assistance to Madagascar, of which \$27 million was used to service external debt. In exchange, the Government of Madagascar agreed to implement several new programs, including the creation of a \$12 million equivalent local currency (Malagasy franc) endowment fund for the *Foundation Malgache en Environnement Tany Meva* (Malagasy Environmental Foundation). One of the prerequisites for the creation of Tany Meva was the passage of a new law on foundations,⁴ which provided the legal framework for the Governments of Madagascar and the United States to "found" Tany Meva. As Madagascar's first environmental foundation, Tany Meva provides grants to local communities and not-for-profit organizations.⁵

1.3 Lessons Learned from Early Swaps

Financial Management. These early debt-for-nature transactions were negotiated during a period of high inflation in Madagascar. As a result, the beneficiaries were all faced with the challenge of managing local currency counterpart funds that were rapidly depreciating. Greater emphasis was placed on ensuring that projects had the capacity to absorb funds on a timely basis. The Government of Madagascar also authorized Tany Meva to invest a portion of its local currency endowment funds offshore on an exceptional basis. The Government sought to mitigate any potential inflationary impact of swaps on the economy by limiting the total amount of counterpart funds available for swaps during a given period.

⁴ Republic of Madagascar 1995. Law No. 95-028 relating to foundations.

⁵ Gaylord 2003.

Grants Management. Since its creation in 1996, Tany Meva's grants program has primarily financed small grants (less than \$10,000) for a period of one year. A recent evaluation of Tany Meva's grants program found that the broad biodiversity objectives funded by Tany Meva's grants program made it difficult to measure program impact. In addition, the short-term nature of its grants limited the sustainability of Tany Meva's grants program. Grant management procedures were also cumbersome, resulting in delays in disbursement. As a result of the evaluation, Tany Meva is now in the process of adopting a program approach with targeted thematic and geographical priorities for its grants program. To increase its program impact, Tany Meva will also disburse \$1,000,000 each year instead of the \$600,000 disbursed in previous years. Grants management procedures will also be streamlined.⁶

2. Debt Relief Mechanisms in the 21st Century

2.1 Selection of Debt Relief Mechanisms

Although Madagascar's environmental sector has benefited from significant foreign donor assistance over the past ten years, financial assistance remains insufficient to support operational costs for Madagascar's existing protected areas network, much less finance conservation of the 90 percent of the country's forests (7 million hectares) existing outside of the national protected areas network. In 2000, a Sustainable Financing Commission was set up to design a sustainable financing strategy for Madagascar's third Environmental Program (EP3) under the country's 15-year National Environmental Action Plan (NEAP), the first of its kind in Africa. Composed of both governmental and non-governmental members, the Commission developed its strategy through feasibility studies, learning about experiences in other countries through a study tour to Brazil, Costa Rica, Mexico and the USA, as well as reaching out to sustainable financing experts through an international symposium. The Commission identified both bilateral debt swaps and HIPC debt relief as two promising financing mechanisms that were both feasible to implement and could result in substantial funding for the environmental sector. It also recommended the creation of a trust fund for protected areas and biodiversity as an "anchor" for the sustainable financing strategy and the most effective way to manage funding generated through debt relief and other financing mechanisms.

2.2. Heavily Indebted Poor Country (HIPC) Debt Relief

Madagascar is one of over 40 countries to benefit from the HIPC initiative. Launched in 1996, by the International Monetary Fund (IMF) and the World

⁶ Andriamahenina 2003.

Bank, the HIPC initiative is the first comprehensive effort to eliminate unsustainable debt owed by the world's poorest, most heavily indebted countries. In exchange for debt relief, debtor countries commit a portion of debt relief savings to priority programs for poverty alleviation as identified in the country's Poverty Reduction Strategy Paper (PRSP), a three-year strategy document aimed at integrating macroeconomic and sector strategies in achieving poverty reduction targets. The PRSP, which is prepared by countries in collaboration with the IMF and the World Bank, incorporates contributions from civil society as well as donors and government ministries. The environment is considered to be a crosscutting theme in poverty reduction strategies.⁷

Madagascar was declared eligible for HIPC in 2000 and projected to receive the equivalent of \$62 million annually in debt relief from bilateral and multilateral creditors.⁸ In its interim PRSP, the Government committed 10%, 10% and 8% each year for the first three years, for the environment, security and gender.⁹ This was projected to amount to an estimated \$3 million per year for the environment, but it was never transformed into actual budgetary allocations.

Madagascar's final PRSP, which was issued in July 2003, identifies environmental priorities and mainstreams the environment into sector policies, including energy, tourism and mining, which have important impacts on the environment.¹⁰ Among the priorities identified are:

- environmental impact evaluations for all new projects
- consolidation of the existing protected areas network
- creation of new conservation sites and voluntary protected areas
- sustainable management of coastal and marine ecosystems
- sustainable financing for protected areas (trust fund, green taxes)
- reforestation

In 2003, for the first time, the Ministry of Environment, Water and Forests received 4 billion Malagasy francs (about \$660,000) in HIPC debt relief budgetary allocations. Although this was less than half the Ministry's budget request of 9 billion Malagasy francs, the HIPC debt relief financing provides important support for local populations participating in reforestation and production of non-timber forest products, such as aromatic plants, medicinal plants and essential oils, as well as for environmental education activities.¹¹

⁷ For more information on HIPC debt relief, see <http://www.worldbank.org/hipc>

⁸ World Bank 2000.

⁹ Republic of Madagascar 2000.

¹⁰ Republic of Madagascar 2003.

¹¹ Republic of Madagascar, Ministry of Environment, Water and Forests 2003.

Madagascar's Ministry of Economy, Finance and Budget has indicated that that it will consider earmarking HIPC debt relief budgetary allocations for Madagascar's protected areas through a capital contribution to the Madagascar Foundation for Protected Areas and Biodiversity. The budget request will be submitted to the Government in the form of a business plan to be prepared by the Trust Fund Steering Committee (responsible for design of the new Foundation) in collaboration with the Ministry of Environment, Water and Forests.

2.3. Bilateral Debt Swap with Germany

Bilateral debt swaps continue to be of interest to the Government of Madagascar for debt excluded from HIPC treatment. Since some bilateral creditors have provided as much as 100% debt relief for eligible debt under HIPC, there is less incentive to participate in debt swaps for a large share of Madagascar's bilateral debt. The German debt swap described below converted debt that was excluded from HIPC treatment.

Under the April 2003 debt relief contract and special convention between the Governments of Germany and Madagascar¹², the Government of Germany agreed to cancel Euro 23.3 million in exchange for the Government of Madagascar paying Euro 13.8 million in counterpart funds over a twenty-year period. The Government of Madagascar has committed to channel Euro 10.2 million through the Madagascar Foundation for Protected Areas and Biodiversity with an initial capital contribution of Euro 1.7 million to be deposited by December 15, 2003, and Euro 425,000 to be paid in annual installments through 2023. Madagascar's Ministry of Economy, Finance and Budget indicated that it is prepared to pay debt swap proceeds in Euros. This funding is contingent on the Madagascar Foundation being created with a management structure and financial systems acceptable to the German Government. ANGAP will also receive Euro 3.9 million in funding for designated protected areas.

3. Key Factors for Success

A number of factors have been critical for the successful introduction of debt relief mechanisms in Madagascar, but the most important has been on-going advocacy by the Ministry of Environment, Water and Forests, conservation organizations and donors for the environment to be funded through debt relief mechanisms.

¹² Kreditanstalt für Wiederaufbau (KfW) and Republic of Madagascar 2003.

3.1 Key Actors

The introduction of debt relief mechanisms in Madagascar has been feasible because of the interest of key actors, including:

Government of Madagascar: Over many years of implementing debt-for-nature swaps, the Government of Madagascar has demonstrated its willingness to allocate budgetary resources for swaps, in spite of difficult economic conditions. Government Ministries, such as the Ministry of Economy, Finance and Budget¹³ and the Ministry of Environment, Water and Forests, have also gained technical expertise in implementing debt relief operations. Although the Ministry of Environment, Water and Forests recognized the need to advocate for HIPC debt relief allocations, early efforts to obtain budgetary allocations were hampered by the limited capacity of Ministry staff to analyze poverty-environment linkages and present them effectively through the budget cycle.

Creditors/Donors: Madagascar's creditors/donors have also supported debt relief in exchange for the environment:

- The German Development Bank (KfW) not only negotiated the bilateral debt swap, but has also provided technical assistance to the Trust Fund Steering Committee.
- The World Bank has housed the Donor Group for Rural Development, Environment and Food Security (see below), supported efforts to ensure that the environment is fully integrated into Madagascar's PRSP, continues to finance the Trust Fund Steering Committee and intends to channel some of its EP3 funding through the new Foundation.
- USAID has financed sustainable financing initiatives, continues to support Tany Meva and also intends to channel some of its EP3 funding through the new Foundation to build its capacity.

Conservation NGOs: CI and WWF have played a key role in helping to negotiate the bilateral swap and, along with the Government of Madagascar, will be founders of the new Foundation that will manage debt swap proceeds. Since both organizations have representatives with economic policy backgrounds¹⁴, they are well placed to participate in the policy dialogue on Madagascar's Poverty Reduction Strategy and have made specific recommendations regarding environmental priorities and targets for the PRSP.

¹³ Note that the Central Bank was originally in charge of negotiating debt swaps.

¹⁴ For example, CI's representative was the first Governor of Madagascar's Central Bank, and also Minister of Finance.

3.2. Strategic Partnerships

The Donor Group for Rural Development, Environment and Food Security has proven to be an effective means of exchange among donors and international conservation NGOs, and was the first forum where the issue of integrating the environment into Madagascar's PRSP was discussed.¹⁵ As described above, the Sustainable Financing Commission played a key role in identifying debt relief mechanisms. The Trust Fund Steering Committee has followed up on many of the recommendations of the Commission.

3.3. Policy Environment

The link between debt relief and the environment has long been recognized in Madagascar because of the early experience with debt-for-nature swaps. As a result, it has been relatively easy to convince the Government of Madagascar to support debt relief mechanisms compared to other countries without this experience. This has been reinforced by the Government's strong commitment to the environmental sector, although competing demands from other priority sectors, such as education, health, infrastructure and justice, have limited funds available for debt-for-nature. The political crisis in 2002, following the December 16, 2001 presidential election, delayed the implementation of debt relief mechanisms and further constrained fiscal resources available for the environmental sector.

The preparation of Madagascar's third Environmental Program (EP3) is currently driving donor and government programs for the environment. As a result, debt-for-nature initiatives reflect EP3 priorities and strategies for implementation. At the World Parks Congress, President Marc Ravalomanana announced his Government's commitment to triple the island's protected area coverage, increasing the size of the network to 6 million hectares of forests, wetlands and marine areas under formal protection in the next five years.¹⁶ This renewed Government commitment reinforces the need for sustainable financing for both existing protected areas and new protected areas and conservation sites.

3.4. Outside Assistance

Poverty-Environment Linkages. In a desk review of PRSPs, Madagascar ranked 12th among 40 countries that had drafted PRSPs (mostly interim), with a score of 1.1 out of 3.¹⁷ Although Madagascar scored relatively well on its interim

¹⁵ Keck 2003. For more information, see the website for the Secrétariat Multi-Bailleurs: <http://www.smbmada.net>

¹⁶ WWF 2003.

¹⁷ Bojö and Chandra Reddy 2002.

PRSP, the study concluded that most countries had not yet fully developed environmental priorities, targets and indicators in their PRSPs. This was the case with Madagascar's interim PRSP, although much progress has been made in the final PRSP.

In Madagascar, outside assistance was critical in analyzing the link between poverty and the environment, including:

- The International Resources Group (IRG) PAGE project (funded by USAID) analyzed forestry-poverty linkages, providing input for the interim PRSP.¹⁸
- Recommendations from a World Bank evaluation of the environmental dimensions of Madagascar's interim PRSP led to renewed consultations on environmental aspects of the PRSP.¹⁹
- WWF's Macroeconomics Policy Office (MPO) analyzed the root causes of biodiversity loss in Madagascar.²⁰

3.5. Sharing Benefits

Although the global biodiversity value of Madagascar's natural resources is universally recognized, the domestic case for investment in protected areas has only recently been made. As part of preparation for EP3, the Agence française de développement (AFD) and the World Bank commissioned an economic analysis that showed that investment in the protected areas network is economically justified in Madagascar based on ecotourism and hydrological services benefits.²¹ Ten protected areas offer ecotourism benefits and twenty protected areas provide hydrological services, including irrigation and potable water. As a result, it was demonstrated that increased investment in protected areas could contribute to poverty alleviation in Madagascar. The analysis showed similar results for the creation of conservation sites managed by the Ministry of Environment, Water and Forests, and added the potential benefit of carbon sequestration through forest restoration.

¹⁸ Winterbottom 2001.

¹⁹ N'Guessan 2002.

²⁰ Montayne 2002.

²¹ Carret and Loyer 2003.

4. Recommendations

Some of the lessons learned from the early swaps have been applied in designing the German bilateral debt swap and HIPC debt relief operations. In pursuing future debt relief mechanisms, it is recommended that:

1. Debt-for-nature swaps and HIPC debt relief for the environment are sustainable financing options for countries with high levels of debt, and should be considered systematically in implementing a sustainable financing strategy for the environmental sector.
2. Environmental actors can work effectively together through coordination mechanisms like Madagascar's donor group and the Sustainable Financing Commission to advocate for debt relief for the environment.
3. Environment actors need to be more involved in financial issues, and interact with financial and planning ministries on an on-going basis regarding fiscal aspects of the environmental sector, including the sector's potential contribution to economic growth and poverty alleviation.
4. Program objectives for debt relief operations need to be focused, with performance-based indicators clearly identified from the beginning.
5. Financial management for debt swap proceeds should reflect best practice international standards for fund management, including grants management, accounting and asset management.

5. Further Information

For further information about this case study and debt relief mechanisms, please contact:

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Annex 1

Madagascar Commercial Debt-for-Nature Swaps

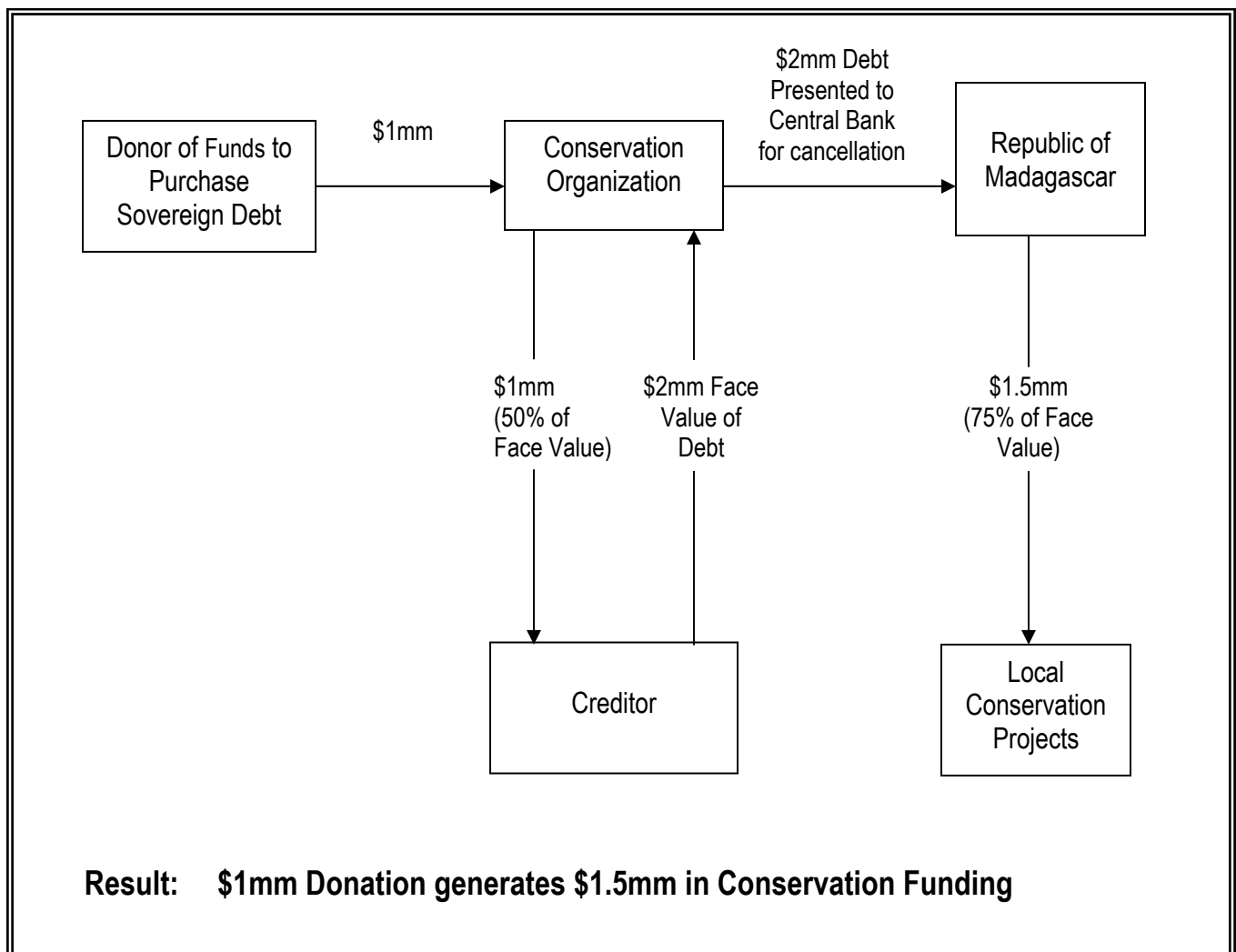
Date	Purchaser/Donor	Face Value of Debt	Purchase Price	Conservation Funds	Purpose
7/17/89	WWF (\$250,000) USAID (\$700,000)	\$2,111,112	\$950,000	\$2,111,112	First debt-for-nature swap in Africa. WWF Debt-for-Nature program: three-year conservation program in protected areas: Andringitra, Marojejy, Mandena. Training and equipment for 400 employees of the Ministry of Water and Forests to act as "nature protection agents"
8/21/90 Exchange Agreement	WWF	\$919,364 includes interest	\$445,891	\$919,364	WWF Debt-for-Nature program: Andringitra, Marojejy, Mandena.
1/91	CI UNDP	\$119,000	\$59,000	\$119,000	COEFOR - project to improve national natural forest management systems - resulted in first national map of Madagascar's forest estate. Zahamena reserve - base-line surveys of socio-economic conditions in project development planning.
3/8/93	Missouri Botanical Garden	\$725,000	\$362,500	\$725,000	2 transactions. Missouri Botanical Garden Research and Conservation Program, including support for capacity building of national botanical institutions, training programs for Malagasy students and technical personnel, botanical research and inventories.
10/93	CI USAID	\$3,200,000	\$1,500,000	\$3,200,000	Administered by Activity Continuation Trust (ACT). Zahamena reserve
10/13/93	WWF USAID	\$1,867,500	\$909,412	\$1,867,500	2 transactions. Support for local communities in forestry activities. Training and support for village groups, nature protection agents and foresters. Creation of Directorate of Environment and Forests (DEF) technical teams to manage specific natural forests and DEF Coordination Unit.
4/29/94	WWF Deutschebank debt donation	\$1,340,469	\$0	\$1,072,376	Beza Mahafaly 5-year project, including salaries, site up-keep, construction, local development projects, training for villagers and foresters, research (80%). WWF Representation (20%).
5/94	CI	\$200,000	\$50,000	\$160,000	Administered by Activity Continuation Trust (ACT). Zahamena reserve
2/13/96	WWF DGIS (Netherlands Development Cooperation)	\$2,000,000	N/A	\$1,500,000	Forestry support unit 8-year project. Training for foresters for improved management of Malagasy humid forest. Support for villagers to manage forests. Forest sites: Tsitongambarika, Tolongoina, Andravory, Antsiraka, Ankarahaka, Vondrozo
TOTAL		\$12,482,445		\$11,674,352	

Sources: CI, Missouri Botanical Garden, WWF. Summarized from WWF Center for Conservation Finance. 2003. Commercial Debt-for-Nature Swaps. www.worldwildlife.org/conservationfinance

Annex 2: Commercial Debt-for-Nature Swap Transaction in Madagascar

Assumptions

- Madagascar Commercial Debt Trading at 50% of Face Value
- Redemption Rate in local currency = 75%
- Counterpart payment made in Malagasy francs (FMG)





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- protecting natural areas and wild populations of plants and animals, including endangered species;
- promoting sustainable approaches to the use of renewable natural resources; and
- promoting more efficient use of resources and energy and the maximum reduction of pollution.

We are committed to reversing the degradation of our planet's natural environment and to building a future in which human needs are met in harmony with nature. We recognize the critical relevance of human numbers, poverty, and consumption patterns to meeting these goals.

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