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# Why Debt-for-Nature Swaps Won't Save Sri Lanka

## The Case for Community Controlled Conservation


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## The Case for Community Controlled Conservation

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# EXECUTIVE SUMMARY

Sri Lanka's US $36.6 billion debt crisis has sparked interest in Debt-for-Nature Swaps (DFNS), which are instruments exchanging sovereign debt for environmental commitments worth up to US $1 billion. Yet evidence shows DFNS delivers minimal debt relief, reducing total debt by just 3% versus 21% for traditional restructuring, while imposing transaction costs of 15%-25% and risking community displacement.

Beyond these financial limitations, DFNS fundamentally commodifies nature as tradable assets, echoing colonial patterns displacing Indigenous communities, while transferring ecosystem control to external actors. They systematically ignore environmental debts from the very projects being restructured and concentrate power among foreign creditors at communities' expense.

Rather than accepting these flawed mechanisms, this analysis reveals the need for comprehensive reforms prioritising community custodianship, land rights, and historical environmental justice. Alternative approaches focusing on tangible conservation measures – such as construction sector decarbonisation, upper-watershed restoration, and urban wetland protection – offer more direct environmental benefits while avoiding the pitfalls of abstract ecosystem commodification.

# INTRODUCTION

## The Intersection of Debt and Environmental Crisis

Sri Lanka faces one of the world's most severe sovereign-debt crises, with gross external debt climbing to roughly US $57.1 billion in 2024. About 40% is commercial debt (US $22.9 billion), while bilateral exposure remains sizable – around US $4.2 billion to China and about US $2.5 billion to Japan. The IMF's stringent conditions – most notably the requirement to realise a primary surplus of 2.3% of GDP by 2025 – impose severe fiscal constraints fundamentally limiting environmental spending capacity.

This fiscal pressure manifests starkly: only $35 million allocated across all three key conservation departments, while 60% of expected revenue must service debt obligations (2025 Fiscal Year Budget Estimate Volume III, 2025). Against this backdrop, Debt-for-Nature Swaps (DFNS) are being promoted as innovative solutions (Briceño & Morris, 2023), with early discussions suggesting potential deals worth up to $1 billion – which would represent the largest DFNS globally (Daily Mirror, 2022).

However, global experience reveals a more complex reality demanding critical examination before Sri Lanka commits to this path, particularly given the potential to establish precedents for conservation finance worldwide. International institutional voices – including the Vatican's 2025 Jubilee Report and IMF analysis – have expressed cautious support for carefully designed DFNS mechanisms, emphasising significant reservations about implementation challenges (Pontifical Academy of Social Sciences, 2025; Georgieva et al., 2022). In contrast, Sri Lankan policy institutions have shown much greater enthusiasm. Recent analysis by IPS describes DFNS as potentially 'effective fiscal instruments' that could 'accelerate economic recovery', and argues that Sri Lanka 'could be ready to implement DfCN swaps' with proper planning (Fernando et al., 2025a; Fernando et al., 2025b).

Yet this local optimism contrasts sharply with documented global limitations revealing fundamental structural problems with DFNS mechanisms. The evidence suggests that these instruments systematically fail to deliver meaningful debt relief while imposing complex operational requirements that often undermine both financial and environmental objectives. This analysis examines how DFNS mechanisms operate in practice and why they systematically underdeliver on both debt relief and environmental protection. We also explore how Sri Lanka could pioneer alternative conservation financing approaches that prioritise justice alongside ecological integrity without falling into the commodification trap inherent in debt-for-nature swaps.

# UNDERSTANDING DFNS

## How the Mechanism Works

DFNS operate through a sophisticated yet problematic multi-step processes, transforming ecological complexity into financial instruments (Hansen, 1988).

1) First, environmental benefits are identified and quantified using standardised methodologies – carbon sequestration potential measured in tonnes of $CO_2$, biodiversity conservation value assessed through habitat area or species counts, watershed protection quantified through water flow regulation.

2) Second, these diverse ecological functions are packaged into standardised, internationally tradable units, such as carbon credits, biodiversity offsets, or ecosystem service certificates, that can be bought and sold on global markets. The World Economic Forum (2024) champions these as breakthrough 'financial instruments' capable of unlocking '$100 billion' for conservation – a framing that reveals how ecological complexity becomes subordinated to financial market imperatives.

3) Third, creditors agree to forgive a portion of debt in exchange for the debtor country's legally binding commitment to generate these environmental benefits over a specified period, typically 10-20 years. These conservation obligations often reshape land tenure and restrict livelihoods, disproportionately impacting indigenous peoples and rural populations who depend on forest resources – social costs rarely accounted for in swap agreement.

4) Finally, the environmental benefits can be sold on international markets, with proceeds theoretically funding conservation activities, though transaction costs often consume substantial portions of generated revenue.

This process reveals the fundamental tension at DFNS's heart: the reduction of complex, interconnected ecosystems into discrete, monetised services optimised for financial rather than ecological logic. What emerges is not conservation finance but ecosystem commodification that privileges measurable, tradable elements, and financial instruments, while systematically ignoring ecological relationships that resist quantification.

# THE PROMISE VS. REALITY

## Why DFNS Under-delivers

Contemporary DFNS experience, emerging from Bolivia's pioneering 1987 swap, reveals a sobering disconnect between promotional rhetoric and actual outcomes (Nedopil & Sun, 2025). Bolivia's landmark transaction saw Conservation International purchase $650,000 of Bolivia's debt at a discount to secure protection of 1.6 million hectares of rainforest, focusing on quantifiable metrics like '13 endangered animal species and more species of birds than all of North America' (Chandler, 1987, unpaginated).

This framing illustrates precisely how DFNS commodify nature through what amounts to 'a new form of ecological coloniality' where Global North NGOs leverage financial power to determine land use across millions of acres of sovereign territory (Linsley-Parrish, 2024). The commodification process treats forest landscapes as standardized conservation units, while ecological elements that resist quantification – soil microbiome diversity, seasonal migration patterns, traditional management systems – remain invisible to DFNS logic.

This reductive commodification extends beyond ecological relationships to financial outcomes, where DFNS consistently fail to deliver meaningful debt relief or conservation funding. The Seychelles' 2016 transaction restructured merely $21.6m – less than 5% of external debt (Dogley, 2024). Belize's 2021 swap restructured $553m but incurred $85m in transaction costs, nearly equal to the $84m in conservation funding generated over 20 years (Furness, 2024). Ecuador's $1.6 billion Galápagos swap generated $450m for conservation but required $656m in political risk insurance (Chandrasekhar & Quiroz, 2024).

Most fundamentally, DFNS achieve only a 3% reduction in total debt stock compared to 21% for traditional restructuring (Woolfenden, 2025). Yet at the same time, it reduces interconnected ecosystems to monetised services optimized for financial returns rather than ecological health, while locally affected communities often receive little to no direct benefits, highlighting the inequities embedded in these deals.

This raises the crucial question: why accept such limited debt relief when the costs are so high? The answer lies in the desperation of debt-distressed countries facing immediate liquidity crises, making them vulnerable to mechanisms promising quick solutions while delivering minimal benefits. Crucially, these mechanisms ignore both the 'environmental debts' inherent in the original lending and the 'social debts' created by new conservation restrictions – a double erasure that lets creditors escape accountability while imposing fresh costs on local communities.

# ENVIRONMENTAL DEBTS

## The Missing Accountability

DFNS reveal a fundamental contradiction: they propose to address environmental degradation while treating ecological damage and the social costs from debt-financed projects as historical footnotes rather than ongoing injustices demanding redress. This pattern spans multiple creditors, but China's Belt and Road Initiative provides a particularly stark contemporary example.

China's $12.1 billion investments across Sri Lanka have carved paths of ecological destruction that current DFNS proposals treat as externalities (Wignaraja et al., 2020). The Hambantota Port project exemplifies this devastation: dredging 40,000 cubic metres of sand destroyed lagoon ecology while severing critical elephant corridors, intensifying human-elephant conflicts marked by escalating crop damage, property destruction, and mounting threats to both human and elephant lives (Friends of the Earth, 2017; Sunday Times, 2017; Mongabay, 2021).

Colombo Port City compounded this destruction through dredging 65-90 million cubic metres, triggering a 20% decline in fish catches and destroying coastal fishing livelihoods (International Collective in Support of Fishworkers, n.d.; Hundlani & Kannangara, 2020). Beyond coastal devastation, the project demanded extensive inland extraction – soil, gravel, and rocks quarried from areas like Kaduwela through rock blasting and hillock removal. This dual assault, spanning coast to interior, obliterated terrestrial habitats, disrupted groundwater systems, and generated pervasive air and noise pollution while displacing communities dependent on these resources (KDU, 2015; The Sunday Times, 2016; Environmental Justice Atlas, 2023). Crucially, both Chinese projects commenced construction before completing environmental approvals – revealing how weaker safeguards accelerate ecological and social destruction.

Yet when Sri Lanka now considers DFNS to restructure its sovereign debt, the environmental and social costs of the very projects that created much of this debt burden disappear from the equation. DFNS essentially allow creditors to pursue new conservation investments while ignoring environmental devastation from the very debt being restructured – effectively greenwashing unaccounted ecological costs while leaving affected communities to bear ongoing consequences (Laixhay & Perriot, 2025).

This greenwashing dynamic reveals why simply acknowledging environmental debts proves insufficient. Creditors must be held directly accountable through mandatory compensation mechanisms - dedicated restoration funds controlled by impacted communities, community-managed compensation schemes, and environmental impact bonds ensuring those profiting from destructive investments bear full remediation costs. Such mechanisms would prevent cost externalisation while pursuing new 'green' investments, ensuring DFNS address rather than perpetuate ecological colonialism.

# DEMOCRATIC DEFICITS

## And Community Displacement

These accountability failures connect directly to deeper governance problems that systematically undermine DFNS effectiveness and legitimacy. DFNS design typically concentrates power among foreign creditors, international conservation organisations, and financial intermediaries while systematically marginalising affected communities. This is a pattern that intersects dangerously with global evidence of conservation-induced displacement (Domínguez & Luoma, 2020). It also suggests a failure to recognise Indigenous peoples' natural custodianship (UN DESA, n.d.).

Sri Lanka's conservation history reveals vulnerabilities to such outcomes. The indigenous Vedda community, particularly in Bintenna and Dambana, embodies sustainable practices deeply rooted in ecological wisdom - selective gathering that maintains forest biodiversity and rotational chena cultivation enabling natural regeneration. These sophisticated knowledge systems have sustained forest ecosystems for generations through human-nature relationships based on reciprocity rather than extraction.

Yet modern conservation efforts, including protected areas covering 26.5% of territory, have displaced and marginalised these communities. A conservation paradox has emerged: state-imposed protection undermines the traditional stewardship that sustained these ecosystems, replacing community-based knowledge with externally imposed management, often less effective at maintaining ecological integrity.

This pattern echoes troubling global precedents. Ecuador's Galápagos transaction faces legal challenges from 24 local organisations citing lack of consultation and arbitrary post-completion restrictions (Latindadd, 2024). Bolivia's 1987 swap displaced Tsimané Indians from 3.7 million acres (Crespo, 2019; Resor, n.d.), and in Costa Rica a swap tied to the creation of Corcovado National Park forced local farmers from their land while criminalising their traditional livelihoods (Leonard, Harrould-Kolieb, Reyes, Torres, & Crespo, 2020).

These examples from Sri Lanka's conservation paradox to global displacement – reveal systematic governance failures inherent in current DFNS design. Such failures stem from power structures concentrating decision-making among external actors while marginalising affected communities, suggesting that comprehensive reforms focusing on tangible environmental measures rather than abstract ecosystem commodification could address these shortcomings while maintaining conservation potential.

# A REFORM FRAMEWORK

## Making DFNS Work for Justice and Effectiveness

Despite these systematic failures, momentum toward implementing DFNS in Sri Lanka continues to accelerate. The UNDP submitted a formal Policy Memorandum in April 2022, while Central Bank Governor Nandalal Weerasinghe's April 2024 statement confirmed Sri Lanka remained 'open' to such instruments (Hettiarachchi, 2022; Costa, 2023). This momentum has only deepened: in March 2025, Weerasinghe went further, publicly endorsing debt-for-nature swaps as a viable mechanism for raising funds, confirming Sri Lanka's willingness to actively pursue such deals (Bloomberg, 2025).

This institutional momentum has gained concrete foundation through Japan's completion of a US $2.5 billion debt restructuring agreement in March 2025 has created institutional foundations for potential DFNS cooperation (MOFA Japan, 2025). Political leadership has reinforced this trajectory: at a high-level awareness session with the Global Green Growth Institute in early 2025, the Prime Minister Harini Amarasuriya explicitly framed debt-for-nature swaps and sustainable finance as central to strengthening Sri Lanka's climate finance capacity (Global Green Growth Institute, 2025).

Given this mounting momentum, Sri Lanka must establish non-negotiable preconditions before engaging with any DFNS proposals. These include mandatory parliamentary approval for all transactions, independent debt sustainability analysis demonstrating at least a 15% debt stock reduction and legally binding community consent mechanisms with veto power over proposed conservation measures. Additionally, comprehensive tools, such as Natural Capital Valuation – which values elements of the natural environment that provide ecosystem goods and services to people, such as forests, water, land, minerals and oceans (Mathur, Vaidyanathan, & Modak, 2019) - must be employed to ensure environmental and social costs are not undervalued. Without such concrete safeguards, Sri Lanka risks being pressured into arrangements that replicate the documented failures of minimal debt relief and community displacement.
The path forward requires learning from global failures while establishing unprecedented standards for transparency, community participation, and historical accountability.

This approach must include robust mechanisms for assessing and remediating environmental damage from past loan-financed projects, treating historical environmental debts as integral to contemporary conservation finance. Most critically, implementation must shift from:

a) commodifying nature to strengthening community-ecosystem relationships;
b) concentrating power among international actors to supporting local governance capacity; and
c) ignoring historical environmental debts to making accountability central to conservation finance.

# RECOMMENDATIONS

## Equitable Conservation Finance

To avoid repeating global patterns of exclusion and ecological commodification, Sri Lanka should abandon DFNS in favour of community-controlled conservation approaches with measurable accountability mechanisms:

1. *Prioritise Comprehensive Debt Restructuring Over DFNS* – Prioritise debt cancellations from major emitter countries and private lenders financing polluting industries and pursue traditional debt relief achieving at least 15% debt stock reduction before considering any conservation finance mechanisms. DFNS are not alternatives to comprehensive debt restructuring but inferior substitutes that deliver minimal relief while imposing environmental conditionalities.

2. *Implement Direct Environmental Accountability* – Establish mandatory reparation mechanisms for past environmental damage from loan-financed projects, with creditors contributing proportionally to their historical lending portfolios. Create dedicated restoration funds controlled by affected communities, with measurable timelines for remediation and independent monitoring. Additionally, mandate comprehensive Natural Capital Valuation to ensure environmental assets are not undervalued in any debt arrangements.

3. *Focus on Tangible Conservation Alternatives* – Instead of abstract ecosystem commodification, pursue concrete measures with lower transaction costs and stronger community benefits:
   - Construction sector decarbonisation addressing 125 million tonnes of projected $CO_2$ emissions through low-carbon materials and retrofitting of existing infrastructure.
   - Upper-watershed restoration across Kelani and Kalu basins, integrating biodiversity conservation with disaster risk reduction while establishing compensation mechanisms for communities facing polluted drinking water and depleted natural resources critical to their livelihoods.
   - Urban wetland protection that leverages Colombo's Ramsar designation to pilot innovative conservation finance through justice-centred mechanisms like wetland mitigation banking.

4. *Ensure Community-Controlled Governance* - Shift from 'conservation for communities' to 'conservation by communities' with legal land rights protection, majority community representation in decision-making, and integration of traditional ecological knowledge. Establish community veto power over all conservation measures with measurable indicators for genuine participation.

5. *Build National Capacity for Alternative Approaches* - Develop expertise in participatory conservation finance, community-based environmental monitoring, and transparent governance mechanisms that prevent elite capture while strengthening local decision-making capacity.

# CONCLUSION

## Seizing the Reform Opportunity

Sri Lanka's approach to conservation finance will reverberate globally, offering either a template for community-centred environmental solutions or legitimising mechanisms that prioritise financial engineering over ecological justice. The evidence presented reveals why DFNS, despite institutional support for reform, cannot address their fundamental contradictions of commodifying nature while perpetuating power imbalances and delivering minimal debt relief.

Success requires rejecting the false choice between inadequate DFNS and no environmental action. Sri Lanka should instead pursue comprehensive debt restructuring alongside targeted conservation investments – construction sector decarbonisation, upper-watershed restoration, and urban wetland protection – that deliver tangible environmental benefits without abstract ecosystem commodification. These approaches can strengthen community-ecosystem relationships, support rather than undermine sovereignty, and prioritise justice alongside environmental effectiveness.

The opportunity exists to demonstrate that meaningful conservation finance need not depend on nature commodification or external control. Whether Sri Lanka seizes this opportunity to pioneer community-controlled environmental solutions will determine both its trajectory and offer crucial lessons for global conservation finance beyond the DFNS paradigm.

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