

**AN EVALUATION OF THE EFFICACY OF THE DEBT
CONVERSION SCHEME AS A STRATEGY FOR EXTERNAL
DEBT MANAGEMENT IN NIGERIA.**

BY

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ADMINISTRATION DEGREE, (MBA).**

DECLARATION

I, WAZIRI MUSTAPHA BINTUBE, hereby declare this dissertation has been composed by me. It has not been presented in any previous application for a higher degree. All references and sources of information are dully acknowledged.

Waziri

CERTIFICATION

This dissertation entitled " **An Evaluation of the efficacy of the Debt Conversion Scheme as a strategy for external Debt Management in Nigeria**" by **Waziri Mustapha Bintube** meets the requirements and regulations governing the award of the degree of Master of Business Administration (MBA) of the Ahmadu Bello University and is approved for its contribution to knowledge and literary presentation.



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DEDICATION

This work is Dedicated to the innocent God fearing citizens murdered in cold blood by law enforcement agents in Zaria during the Zangon-kataf crisis

ACKNOWLEDGEMENT

I confess that the most difficult part of this dissertation for me has been the writing of the acknowledgment due perhaps to the numerous contributions I enjoyed from several people. I could not adequately acknowledge all the friends and colleagues with whom I have been so abundantly blessed.

I am much obliged however to mention just few beginning with Usman B. Garba (KFCC) who personally encouraged and inspired me to undertake the MBA programme. I am grateful to Mallam Sami Nasir for approving my study leave from work thus allaying my apprehension about the consequences of embarking on the MBA adventure on my finances and to Mallam Kashim Baba Gana (NNDC) for assisting greatly in my initial resettlement in Zaria. I am indebted too to Karen, Ngozi and Chinedu for making my sojourn in Zaria easy and pleasurable.

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ABSTRACT

Debt Management primarily involves five basic functions: policy, regulatory, operational, accounting and statistical analysis. The policy involves co-ordination among agencies with prime responsibility for the economic management of a country in the formulation of national debt policies and strategies. The regulatory aspect of debt management concerns the establishment of a well defined institutional arrangement for recording and monitoring all external debt, monitoring new debt incurred by domestic agents (public and private) and the comprehensive recording of maturing debt. The accounting function requires collecting detailed information on debt on a loan-by-loan basis and providing for an efficient payment mechanism. The analytical aspect explores future structure of external debt and options available.

Beyond academic interest, examining historical origins of the debt problem contributes to greater understanding of its seriousness and the prospects and direction for its resolution. The origin of Nigeria's external debt dates back to the pre-independence era. Sources from the Federal Ministry of Finance indicate that Nigeria contracted her first loan from the World Bank in 1958. The loan which was about USD 28 million went into extending railway network. Generally the level of the country's debt remained relatively low until the end of the oil boom years in 1977. The reverses in the country oil fortunes during the glut years brought a lot of pressure on government finances and subsequently it became absolutely necessary to borrow for balance of payment support.

This led to the first major borrowing from the International Capital Market(ICM) of USD 1 billion in 1978. Many more ICM loans were raised especially as funds from bilateral and multilateral institutions became increasingly inadequate to the needs of government. Consequently, ICM loan rose rapidly from USD 1 billion in 1978 to USD 5.5 billion in 1982. The single most insidious source of the increase was accumulated trade arrears which emerged in 1982. A large part of the debt also came from credits granted between 1980 and 1983 when Nigeria experienced favourable exchange position. Most of the loans were used to finance social white elephant projects while some never got into the country.

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND

One of the many debt management strategies adopted by Nigeria in the continuing search for solutions to her debt problem, is the debt conversion programme (DCP). Developed under the aegis of the International Monetary Fund in 1983, the DCP involves the exchange of external debt for domestic equity or debt. In a broad sense, it is the exchange of monetary instruments e.g. promissory notes for tangible assets or other financial instruments. In a typical debt conversion deal, an investor, foreign or national, purchases a title to a foreign currency - denominated debt at a discounted price in a secondary market. The investor then presents this title to the Government authorities in the country which originally contracted the loan. The national authorities then issue the face value of local currency to the investor, a portion of which may be retained by the Government as a means of capturing part of the secondary market discount. Finally the investor spends the local currency to implement an approved equity investment project in the debtor country.

Net results expected from the DCP include a reduction in external debt stock, an increase of foreign direct investment and capital gain in the amount of the discount appropriated by the Government at the conversion point. The conversion creates a cash bonus for an investor equal to the difference between the secondary market price and the redemption price received after the government has taken its share. This bonus can be effective for attracting new foreign investment. Debt conversion can also facilitate public enterprise restructuring programmes (privatization), channel investment funds into priority sectors and encourage the return of flight capital.

However, while the proponents of the concept see the DCP as revolutionary and a potent tool for debt management, critics dismiss the concept as a surreptitious, back-door strategy designed to enslave debtor nations.

The central point of contention is the likely effects of the DCP on control over the broad direction of national economies. Many fear the scheme would bring to naught the indigenisation and mandatory joint venture programs implemented during the 1970's. The critics further argue that the scheme has the disadvantage of generating excessive monetary emission effect which is accompanied by high inflation. **Bulow and Rogoff (1988)** believe the scheme can divert capital inflows that would otherwise have taken place via other channel and has a "round tripping effect". Domestic currency acquired through the conversion process is often reconverted (legally or illegally) into foreign exchange at a premium for capital flight.

Nigeria's DCP was introduced in July 1988 with the following objectives.²

- To reduce Nigeria's external debt.
- Improve economic environment attractive to foreign investors.
- To serve as an additional incentive for the repatriation of flight capital.
- To stimulate employment generating investments in industries with significant dependence on local inputs.
- To encourage the creation and development of export-oriented industries.
- To increase access to appropriate technology, extreme market and other benefits associated with foreign investments.

To what extent have these objectives been attained since the first DCP auction in December 1988? What has been the impact of the DCP on the Nigerian economy? What are its drawbacks? Has the programme been properly implemented? How has the ubiquitous Nigerian factor affected the scheme? Who are the beneficiaries? In what ways can the programme be improved and made more meaningful? What future for the DCP?

The above in a nut shell represent the central focus of this study. It seeks to evaluate the DCP after five years of its implementation (1988 - 1993) in Nigeria and determine if the concept is relevant and a potent strategy for public sector external debt management.

1.2 JUSTIFICATION

Many countries have adopted the debt conversion programme under various names. While some have attained some degree of success, others have abandoned the Scheme for reason of failure. It has been about five years now since the DCP took off in Nigeria. This study is aimed at assessing the extent to which the objectives of the DCP have been attained so far. It is believed that five years is good enough time to assess the scheme with a view to identifying immediate benefits and other areas of failure especially the possible deviations between the theoretical conception and the practical implementation. Many a sound and well intentioned government policy had been perverted and rendered ineffective through improper implementation either out of incompetence, corruption or both. And as with many other human concepts, it is not impossible to find some lapses or loopholes in the policy conception. The justification for the study lie in identifying such possible areas and offering suggestions for improvement.

1.3 SCOPE AND LIMITATIONS OF STUDY

This work will not deviate much from the debt conversion programme. The other debt management policies will only be briefly dealt.

While it may be true that many economic variables are affected by our debt policies, this research work will only touch on the impact of the debt conversion programme on the general external debt position, inflation, unemployment and capital inflow.

The trend in most third world countries on unreliability of data was a limiting factor in this work. Figures were not consistent.

For instance unemployment figures offered by the Federal Ministry of Employment and Labour were different from those given by the Federal Office of Statistics. The Central Bank figures often conflict with the Federal Ministry of Finance.

Finally, the CBN restricts information on beneficiary companies/investors in the DCP. Such information would have enabled proper and complete analyses of the nature, motive and pattern of the debt conversions.

1.4 **HYPOTHESES**

There are three hypotheses which we shall attempt to test, derived from the set objectives of the DCP and *initial fears* expressed by critics for instance that the programme would generate excessive monetary emission effects which is accompanied by inflation. The hypotheses are:

1. Ho : Debt conversion has no effect on unemployment.
H1 : Debt conversion reduces unemployment

2. Ho : Debt conversion has no effect on capital inflow/private investment.
H1 : Debt conversion encourages capital inflow/private investment.

3. Ho : Debt conversion has no effect on inflation.
H1 : Debt conversion induces inflation.

The debt problem facing developing countries assumed crisis dimension in 1982 after Mexico announced its inability to service its debt obligations. Since then measures to alleviate the problem have become a major preoccupation for both creditors and debtors. The traditional approach to debt relief mainly through restructuring and rescheduling proved insufficient and inadequate. Consequently, a number of debt ridden countries including Mexico, Brazil, Chile, Costa Rica, Ecuador and the Philippines started to explore more radical approaches to further ease their debt burdens.

Debt conversion can be defined as any transaction in which external sovereign hard currency denominated debt is used, directly or indirectly to acquire debtor country currency, debtor country equity or other local assets (L. Clarke 1987).

There are several variations of debt conversion.

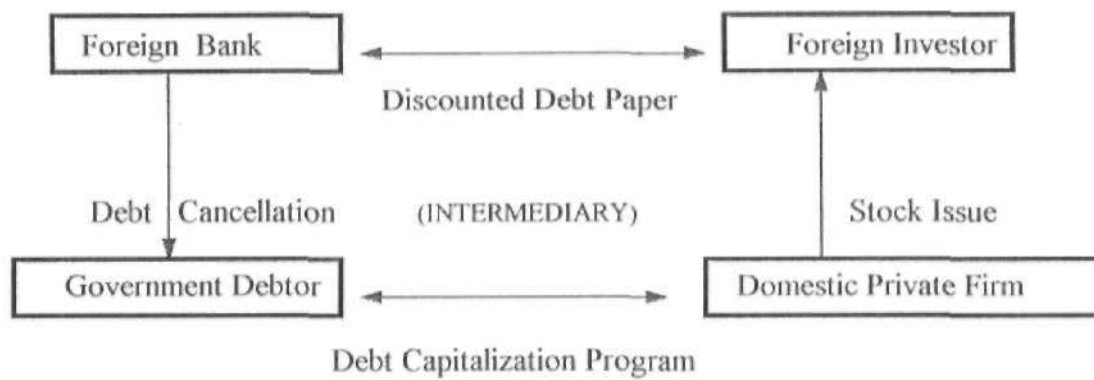
1. **Debt for Cash:** Entails exchange of debt for local currency which can be used for local working capital, tax, etc. This method is deal for multinationals in indebted countries. They can buy up such debts from creditors/bankers and as they are redeemed in local currency, such funds are injected into their subsidiaries to serve as useful working capital.
2. **Debt for Equity:** This is the most known of all the debt swap methods. It essentially involves the conversion of a portion of a country's external debt into equity.

The local currency proceeds of the conversion, is used to pay for local currency denominated equity in local companies. From the debtor country's point of view, the essence of the conversion is to direct the foreign investment to priority areas. From the point of view of the foreign company making a new or additional investment, debt/equity conversion implies a substantial lowering of the cost of the equity portion. The savings to be realised will roughly equal the percentage of the discount in the secondary market.

Mechanics of Debt Swap Transactions

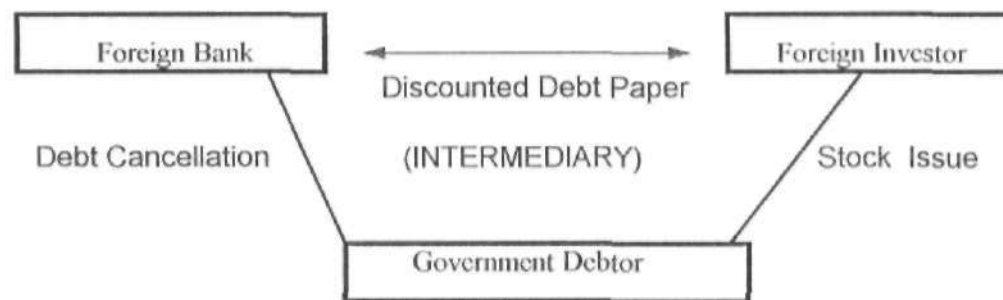
Restructured Debt - Private Entity Equity Swap

Foreign currency Discounted Debt Payment



Sovereign Restructured Debt-Privatized Entity Equity Swap

Foreign Currency Discounted Debt Payment



Sequence of a Typical Debt-Equity Conversion

The swap mechanism typically involves four separate

- i) A Potential investor uses either his own claims or purchases an existing debt asset at a discount, usually from a bank.

- ii) Authorization of the deal by the central bank of the debtor country under various conditions, including payment of relevant taxes and redemption fees to the host government;
 - iii) An intermediary institution, which may be a foreign bank or local financial institution, acts as a conversion agent; the agent receives on behalf of the seller the assignment of the credit, passes title to the ultimate investor and re-denominates the foreign currency credit into local currency through the central bank;
 - iv) Exchange by the investor of its local currency claims for an equity position in a local business previously held by a resident investor or for equity in a privatized state company.
3. **Debt Buy Back:** This is a scheme whereby the government of the debtor nation buys its foreign debt/loan papers at the discounts offered at the secondary market. Thus, it not only extinguishes part of its debt, it also buys its debt at a highly subsidized rate. The process reduces the external debt without having to repay the full value. For example, in 1988, Chile bought back \$300 million of its external debts in the secondary market at about US\$250 million.
4. **Securitization:** Debt securitization involves the conversion of debts into some form of security such as fixed or floating rate bonds and other financial instruments that can either be traded in the secondary market or passed to investors through multinational institutions. The Central Bank of the debtor country would allow such obligations to be used for instance, for the repayment of local currency debt owed to it. Depending on the level of development of the local money/capital market, the obligations could be sold for cash. Such conversion will be specially attractive to local businessmen who wish to make use of foreign currency reserves to strengthen the financial position of their companies. From the debtor nations point of view, the instrument stimulates the repatriation of flight capital.

5. **Debt For Export:** This type of conversion allows foreign buyers of export products to pay for exports with debt instruments acquired in the secondary market rather than with cash. In several heavily indebted countries, the governments have allowed exports, particularly goods not traditionally exportable, or exports outside of official regulations to be paid for in part with their foreign currency debt. If applied to the export of goods which otherwise would not easily take place, or for new additional exports the option has obvious attractions. Also certain groups of creditors who do not find other opportunities to use their blocked foreign currency claims may put pressure on a debtor government to agree with debt for exports arrangement.

GENERAL IMPLICATION

The aforementioned swaps or types of conversion generally have some common implications as stated below:

- i) The Central Bank of the debtor country often increases its money supply to meet the demands of the beneficiary companies. This may increase the rate of inflation.
- ii) Problems of sovereignty and national pride can be involved when foreigners gain control over domestic assets and enterprises.
- iii) Round-tripping is another problem usually feared in Debt Conversion Schemes. Some unscrupulous redeemors could round-trip proceeds by taking away their money through the parallel market instead of investing in the local economy.
- iv) Implicit subsidy given an investment under a debt conversion programme will inadvertently introduce a distortion into the allocation of resources in the economy.
- v) Addition of resources; the envisaged danger here is that investment that enters under a debt conversion programme may merely substitute for direct investment that would have entered the country on its own even in the absence of a conversion scheme.

OTHER DEBT RELIEF PROPOSALS

As the critical nature of the debt problem become widely recognized, more innovative proposals were put forward including some favouring increased lending. Some of the most comprehensive proposals include:

1. **THE BAKER PLAN** - Put forward by former U.S Secretary of State James Baker in 1985, the plan proposed that private Banks be encouraged to commit a total of \$20 billion in net new lending to support adjustment programmes. The plan also envisaged that 15 highly indebted countries (including Nigeria) would receive an additional \$9 Billion net lending from the Multilateral Development Banks in support of their market oriented policies. The fundamental assumption of the Baker plan was that if debtor countries adopted growth oriented adjustment policies supported by new lending, the rates of return on new lending would be so high to justify such new lending. However, the assumption became unrealistic as little or no lending took place.
2. **THE BRADY PLAN (1989):** The Brady plan emphasized two elements of the Baker plan, namely, the case approach and the need to adopt IMF economic reforms. The major highlights of the plan include the use of cash buy-back arrangement by a debtor country with its cash reserve or borrowed funds from the IMF or World Bank to repurchase some of its debts at high discounts. Secondly, debt conversion into a new asset made less risky by collateral would reduce the debt service burden.
3. **Alfred Herrhausen of the Bundes Bank** suggested the creation of an "Interest Compensation Fund" (ICF) to stabilize and limit the interest payments of eligible countries (eligibility being determined by the need and the debtor's commitment to an adjustment programme). The ICF would be financed jointly by governments, international financial institutions and banks on the basis of their respective exposure to the debtor and would be managed by the IMF. It would limit interest rates to a pre-agreed level but allow for a recovery of earlier unpaid interest if rates subsequently fall below this level.
4. **Toronto and Trinidad Terms:** At the Toronto Economic Summit in June 1988, leaders of the Group of seven (G-7) agreed that the non-concessional bilateral official debts of low-income African countries should be rescheduled at the Paris Club, under a menu of three options.
 - (i) cancel one-third of eligible maturities and reschedule the remainder;

- (ii) adopt the longer repayment of 25 years applicable to concessional debts with market interest rate; and
- (iii) charge moratorium interest rates below market rates with 14 years repayment period.

The Trinidad terms provide for 2/3 reduction of eligible debt stock, while the remaining 1/3 is to be paid off over 25 years. Essentially, the Toronto and Trinidad proposal involve rescheduling arrangements ranging from 14 to 25 years, and 8 to 10 years period of grace, as well as concessional interest rates.

- 5. **The Paris Club Plan (1987)** has essentially two main features. It requested the creditor governments to waive repayment of past debt by converting them into grants for low income debtor countries pursuing structural reforms. It also called for a reduction of interest on officially guaranteed debt below market rate and to reschedule such debts over a longer period of up to twenty years. However, the major limitation of this plan was that it did not allow rescheduling of previously rescheduled debts.
- 6. **The African Development Bank Proposal (1987)** was tailored strictly to African debts. The plan sought to convert Africa's medium and long term securities of at least twenty year maturity at fixed interest rate below the market rate and to establish a redemption fund into which debtor countries would make annual payments over twenty year period. This would accumulate over the period to the amount of loan that would be outstanding at maturity. Through this fund, it was envisaged that sufficient funds would have been built up in the redemption fund to ensure that the outstanding securities were liquidated at maturity. The ADB plan like other plans, has its limitations. First the creditor banks were reluctant to accept the scheme on the ground that interest rate risks were completely shifted to them. Second, **P. Okigbo (1989)** observed that "the plan excluded debt owed the multilateral institutions as well as concessional bilateral loans which constituted the greater proportion of the debt of most African countries".
- 7. **Kenen Proposal** - this calls for the establishment of an International Debt Discount Corporation (IDDC) to buy up the less developed countries debt from banks at a 10%

discount. The new agency would be established by the OECD countries and would require paid-in capital subscription. The proposal allows for the restructuring of the less developed countries debt at a reduced rate but such restructuring can only occur if there exists a stand-by agreement between the IMF and the debtor nation. The scheme is voluntary. 5

1.6 METHODOLOGY

In carrying out this research, emphasis was more on secondary data especially papers delivered at seminars and workshops organized by the government and the Central Bank of Nigeria. Statistical data obtained are mostly presented in tabular form from where analyses are made. Quantitative tools will be employed to assess relationship between the DCP and inflation, unemployment, capital inflow, etc. Questionnaires are considered not necessary for this study.

FOOT NOTES

1. **Bulow, J. and Rogoff, K** "The Buy-back boondoggle" Brookings Papers, 1988 (2) PP 675 - 704.
2. **Federal Republic of Nigeria** "Guidelines on Debt Conversion Programme" April 1989.
3. **Clarke, L. (1987)** "Debt Equity Conversion Programme" Washington D.C. July 31.
4. **Okigbo, P. (1990)** "The African Debt Trap", Central Bank, The Bullion January/March, Lagos. page 37
5. **R. A. Olukole (1991)** "Management of the External Debt of Nigeria" Central Bank - Bullion Volume 15 No. 2 of April/June 1991 Lagos, page 27

CHAPTER TWO

MANAGEMENT OF NIGERIA'S EXTERNAL DEBT

Debt Management refers to the process of administering the national debt. It involves the establishment of the conditions of issue and redemption of public securities, providing for the repayment of the principal, payment of interest and arranging the refinancing of maturing debts.

Olukole, et al (1991) define debt management as "any official action by the Central Bank as well as the treasury, designed to alter the quantity and kinds of a national governments debt obligations outstanding".

Debt Management primarily involves five basic functions: policy, regulatory, operational, accounting and statistical analysis. The policy involves co-ordination among agencies with prime responsibility for the economic management of a country in the formulation of national debt policies and strategies. The regulatory aspect of debt management concerns the establishment of a well defined institutional arrangement for recording and monitoring all external debt, monitoring new debt incurred by domestic agents (public and private) and the comprehensive recording of maturing debt. The accounting function requires collecting detailed information on debt on a loan-by-loan basis and providing for an efficient payment mechanism. The analytical aspect explores future structure of external debt and options available. This chapter is arranged in three parts. The first part addresses the origin and structure of Nigeria's external debt. Part two discusses the causative factors of the external debt and external borrowing policy while the last part examines the debt management strategies adopted in Nigeria.

2.1 ORIGIN AND STRUCTURE

Beyond academic interest, examining historical origins of the debt problem contributes to greater understanding of its seriousness and the prospects and direction for its resolution.

The origin of Nigeria's external debt dates back to the pre-independence era. Sources from the Federal Ministry of Finance indicate that Nigeria contracted her first loan from the World Bank in 1958⁽²⁾. The loan which was about USD 28 million went into extending railway network. Generally

the level of the country's debt remained relatively low until the end of the oil boom years in 1977. The reverses in the country oil fortunes during the glut years brought a lot of pressure on government finances and subsequently it became absolutely necessary to borrow for balance of payment support.

This led to the first major borrowing from the International Capital Market(ICM) of USD 1 billion in 1978. Many more ICM loans were raised especially as funds from bilateral and multilateral institutions became increasingly inadequate to the needs of government. Consequently, ICM loan rose rapidly from USD 1 billion in 1978 to USD 5.5 billion in 1982. The single most insidious source of the increase was accumulated trade arrears which emerged in 1982. A large part of the debt also came from credits granted between 1980 and 1983 when Nigeria experienced favourable exchange position. Most of the loans were used to finance social white elephant projects while some never got into the country. It has to be noted that while the debts incurred between 1970 and 1978 consisted mostly of soft long term loans from bilateral and multilateral institutions, the borrowings after 1978 were from the private capital markets with very high interest rates. Nigeria's external debt stood at USD 28,718.2 million as at 31 December 1993^(a) compared to USD 27,564.8 million in 1992 representing an increase of N1,153.4 million or 4.2%. The figure outstanding as at 31 December, 1992 was about \$6,165.2 million or 18.3 percent and \$5,634.9 million or 17.0 percent below the levels at the end of 1991 and 1990 respectively. The decrease in 1992 was principally due to the closing of the London Club 1991 refinancing deal (to be discussed in detail later in the chapter). The debt situation in Naira value during same period however deteriorated remarkably as a result of the depreciation in Naira the exchange rate. Total external debt outstanding as at 31 December 1993 stood at N633,144.4 million compared to N544,264.1 million in the preceding year (Tables 2.1 & 2.2).

STRUCTURE

The structure and composition of the country's debt stock can best be explained by creditor groups; conventionally classified as follows:

- **Multilateral Creditors** - are the World Bank, the International Monetary Fund (IMF), the African Development Bank (ADB), the International Finance Corporation (IFC) and the International Development Association (IDA).
- **Paris Club** represent official government creditors in respect of insured debts.
- **London Club** represent claimants in respect of uninsured debts owed to commercial banks.

- **Promissory Notes holders** are the creditors in respect of refinanced debts.
- **Others** include the bilateral creditors, suppliers credit and the private sector.

The external debt structure could also be classified into short, medium and long term debt. The short term debt having an original maturity of not more than one year while the medium term has a maturity of over one year. The maturity of the long term debt however spans over 5 years.

Table 2.1

EXTERNAL PUBLIC DEBT OUTSTANDING (\$ Million)

	1989	1990	1991	1992	1993
Multilateral	2,807	3,845.1	3,650.0	4,518.0	3,694.7
Paris Club	15,847	17,172.1	17,793.0	16,433.9	18,160.6
London Club	5,600	5,936.8	5,988.0	2,120.0	2,055.8
Promissory Notes	4,584	4,550.0	4,479.0	3,246.0	3,159.9
Others	2,586	1,675.0	1,454.0	1,226.2	1,647.3
Total Debt Outstanding	31,424	33,179.0	33,364.0	27,544.1	28,718.2

Sources (1) Central Bank of Nigeria
(2) Federal Ministry of Finance.

Table 2.2

(Naira Million)

	1989	1990	1991	1992	1993
Multilateral	21,473.5	34,578.4	39,058.8	89,274.3	81,456.3
Paris Club	121,299.6	154,540.7	173,053.2	324,729.9	400,380.9
London Club	42,480.0	52,749.6	58,238.1	41,890.6	45,323.8
Promissory Notes	35,067.6	40,950.4	43,561.9	64,140.0	69,665.7
Others	19,782.9	15,075.2	14,144.3	24,229.3	36,317.7
Total Debt Outstanding	240,103.6	297,894.3	328,054.3	544,264.1	633,144.4

Converted at end period exchange rates which were \$1/N7.650, \$1/N9,7258, \$1/N19.7597 and \$1/22.0468 in 1989, 1990, 1991 and 1993 respectively.

Sources (1) Central Bank of Nigeria
(2) Federal Ministry of Finance

Table 2.3

SELECTED EXTERNAL DEBT RATIOS

	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
(Naira Million)	(1)	(2)	(3)	(4)
1. Debt Service/Exports	26.8	29.1	20.1	16.9
2. Interest/Exports	11.6	14.3	5.7	6.3
3. Capital Repayment/Exports	15.2	14.9	14.6	10.5
4. Debt Stock/Exports	242.1	275.0	231.9	273.3
5. Debt Stock/GNP	114.7	116.6	121.2	128.8

Note: 1 - 5 are Naira denominated figures converted to Dollar at the official average exchange rates for each of the four years.

Source: CBN, Federal Ministry of Finance.

2.2 **THE CAUSES OF NIGERIA DEBT BURDEN**

A global view is often taken in analysing the root causes of the debt crisis afflicting most less-developed countries (LDC's). Economic events that led to the debt crisis according to most writers, include:

- The increases in oil prices in 1973 and 1979.
- The policy reactions to the price increases by governments of the industrialized countries.

Keith Criffins (1988)⁴ states that the oil price increases which he calls "shocks" had three major effects.

1. It generated huge balance of payment surpluses in OPEC countries.
2. Large balance of payment deficits were created in the oil importing developing countries which were financed by the recycled surpluses from OPEC reserves.
3. There was increase in general price levels in the developed countries. This in turn encouraged reduction in aggregate demand either by restrictive tax and expenditure policies or by restrictive monetary policies. These further led to a rise in real interest rates to unprecedented levels and a general contraction in the growth of world trade. The effect of all the above on the LDC's was a escalation in their debt positions.

Since most of the borrowings were from commercial banks, with maturity terms of five to eight years and variable interest rates, the debt grew at rates exceeding the income and output growth rates of these countries. Debt was growing without increasing the resources for development. The result was that the link between debt-service and development was broken.

Roger Kubaryah (1985) on the other hand cogently argues that four factors precipitated the debt crisis. The LDC's such as Nigeria:

1. Were too optimistic about their continued prospects for growth in the uncertain world economy of the 1970's and did not adequately consider the possibility of recession when they borrowed.
2. Followed misguided domestic economic policies.
3. Tolerated uncontrolled budget deficits.
4. Suffered from internal fraud, corruption and massive capital flight, which drained them of their capital before it was put to productive use.

R. A. Olukole (1991) classified the causes of Nigeria's debt burden into endogenous and exogenous categories as follows:

ENDOGENOUS FACTORS

1. Nigeria had a great propensity not only to consume but also to waste. During the oil boom days the nation developed exotic and expensive taste, wasted and squandered resources even as they were drying up.
2. The monetary and exchange rate policies did not respond quickly to the decline in the inflow of resources as a result of the oil glut. Consequently the Naira became highly overvalued and this created distortion and leakage in the economy which seriously depleted external reserves.
As the balance of payment deteriorated, the reserves of foreign exchange got depleted and external borrowing surged further leading to a sharp rise in the country's debt burden.
3. Lack of coherent borrowing policy (until 1988) and a mismatch in the application of loans. Long term projects were financed with short and medium term loans. The structure of Nigeria's debt tilted in favour of short and medium term debt as earlier observed.

EXOGENOUS FACTORS

1. Nigeria's major foreign exchange earner since 1970's has been crude oil. The dormant position of oil as the mainstay of the economy made the country vulnerable to the price shocks which resulted from factors beyond the country's control.
2. The depreciation of the US Dollar against major international currencies in which most loans were originally contracted. Since the country's debt stock is denominated in the US Dollar, the conversion of debt contracted in French Franc, Japanese Yen, Deutsche Mark, Pound Sterling, etc. led to significant hikes in the debt position. The problem intensified with the global recession since 1986.
3. The capitalization of interest for reasons of default on the country's part also led to significant increases particularly during the period 1982 - 1984.
4. When variable market based interest rate is the contracted interest rate applicable to a particular loan, the increase in the variable rate in response to the market situation constitutes additional burden on the debt problem.

2.3 EXTERNAL BORROWING POLICY

Following the accumulation of debts over the years, the Federal government in 1988 enunciated external borrowing policy for the country. The objectives of the policy even though belated, include:

- (a) To set out the criteria for borrowing from external sources and determine the type of projects for which external loans may be obtained.
- (b) To outline strategies for increasing foreign exchange earnings thereby reducing the need for external borrowing.
- (c) To outline the mechanics for servicing external debts of the public and private sectors of the economy.
- (d) To outline the roles and responsibilities of the various organs of the Federal and State Governments as well as the private sector in the management of external debts

The policy in the main stipulates the procedure for obtaining foreign loan:⁷

1. State Governments, parastatals and the private sector must obtain Federal Government's approval before contracting fresh loans. Contracts for projects requiring external financing should therefore not be signed by the State Governments and parastatals until there is assurance that the required external loan would be guaranteed by the Federal Government.
2. State governments may obtain external loan only after obtaining Federal government consent that it would guarantee the loan. Potential external creditors are therefore advised not to grant external loans to state governments and their parastatals without Federal government backing.
3. All external borrowing proposals of state governments in a fiscal year should be submitted in good time to the Federal Ministry of Finance for vetting and incorporation in the external borrowing programme of the public sector in the annual budget.

On repayments the policy made the following provisions:

- (a) For purposes of ensuring that payments are made promptly to creditors thereby avoiding penalty charges, state governments and their agencies as well as Federal parastatals should make available to the CBN directly or by debit of their accounts with the CBN, the Naira equivalent of payments due pre-SFEM and transactions covered by the rescheduling agreements. With regard to all other transactions, all public sector institutions including State Governments and Federal parastatals should service their debts through IFEM and promptly inform the Federal Ministry of Finance.
- (b) States or Parastatals which fail to service their loans will have the Naira equivalent deducted at source before the balance of the share of proceeds in the Federation Account in the case of States and budgetary allocation for parastatals, is released.
- (c) In the case of loans that are on-lent by the Federal Government to states, the Federal Ministry of Finance will make the due payments and deduct the full amount at source from the statutory allocation.
- (d) As for private sector loans, industries that are export-oriented should service their debts from their export earnings while others should utilize the Foreign Exchange Market (IFEM) facilities.

2.4 NIGERIA'S DEBT MANAGEMENT STRATEGIES

The Government of Nigeria has adopted several debt relief strategies since 1983. The most popular ones include:

1. REFINANCING SHORT TERM TRADE ARREARS

As a result of the economic difficulties facing the country in the early 1980s which constrained the nation's ability to pay for its imports, arrears of trade debts were accumulated. The foreign creditors refused to open new lines of credit. To solve the problem, it became necessary to seek for relief by refinancing the trade arrears. Arrangements were therefore, entered into with creditors to refinance arrears in respect of letters of credit outstanding as at July 13, 1983. A total of US\$2,112 million worth of letters of credit were refinanced. The main features of this first refinancing exercise included a repayment period of 30 months from January 1984 to July 1986, with a grace period of six months.

Despite this effort, the trade arrears continued to mount, thus further increasing the level of the country's indebtedness. It became absolutely necessary to intensify all efforts to secure further relief. Thus in 1984, Government decided to refinance the remaining trade arrears especially those contracted through open accounts and bills for collection by issuing promissory notes to cover them. The terms of the promissory notes agreement included the payment of interest at the rate of one percent above the arithmetic average of the lending rates quoted by some major international banks in New York, London and Paris. They also included a maturity period of six years with a grace period of two and half years and the redemption of the notes in 14 equal quarterly installments beginning from October 1986.

However, following the difficulty in servicing the debt under these terms, the agreement was renegotiated leading to the stretching of the repayment period over 22 years with an effective rate of return of 5 per cent per annum. The new terms are generally believed to be the best relief package which the country has got. The total value of promissory Notes issued amounted to US\$4.8 billion.

RESCHEDULING AND RESTRUCTURING OF COMMERCIAL BANKS DEBTS
(i.e LONDON CLUB DEBTS).

London Club debts covered arrears of commercial bank debts which were incurred through the medium of letters of credit. These debts were those that were accumulated after the first refinancing exercise of 1983. Negotiations with the club commenced in 1986 and the agreement to refinance and restructure the debts were signed on 23rd November, 1987.

Under the agreement, a total sum of US\$2.8 billion of incorporated and payable debts were refinanced while US\$5.8 billion of medium and long term component of the debt was restructured. Thus, the total exposure of Bank's debts amounted to US\$5.8 billion. The banks were to provide new money of US\$320 million. Under the terms of the agreement the country was required to repay US\$1.345 billion per annum. The high debt service obligation made it impossible for the country to meet its commitment and consequently it defaulted. The banks in turn, did not provide new money. This necessitated a new round of renegotiation of the agreement with the Club.

New agreements known as the Refinancing and Restructuring Amendment Agreements were signed on 22nd March, 1989. The agreements contained a menu of options included longer terms of repayment, conversion of payable debt into interest bearing Naira denominated securities with a coupon rate of 13.25% per annum and with a maturity of 18 months. The agreements had the effect of reducing payments to the club from US\$1,345 billion under the 1987 agreement to US\$711 million. However the cash flow situation of the country could not absorb such a high debt service rate as provided for under the 1989 amendment agreements. Consequently, the country once more approached the banks in March 1990 with a request for the entire debt to be restructured. The country's proposal was designed to achieve effective debt service reduction. Essentially, the Proposal was for the conversion of all the commercial banks debt into a 30-year bond with a grace period of 10 years and at an interest rate of 3% per annum.

The banks made a counter proposal which contained a menu of options viz.

- (i) debt buyback;

- (ii) issuance of Par Bonds with principal and interest collateralised; and
- (iii) traditional rescheduling.

Following these proposals both side entered into an intensive and protracted negotiations which lasted for one year and on March 1, 1991 an agreement in principle was reached.

The highlights include:

- conversion of the debts into a single currency denomination i.e. US Dollars;
- debt buyback;
- issuance of a 30-year Par Bonds with principal amount fully collateralised with US Treasury Zero coupon or equivalent US obligations and interest amount for one year also collateralised.
- fixed interest rate of 6.25% per annum on the Par Bonds;
- traditional rescheduling with interest rate of LIBOR plus 13/16% and repayment period of 20 years (10 years grace period and 10 years repayment period);
- banks favouring the traditional option were required to provide new money of up to 10% of the amount so committed.

The implementation of the agreement ran into a hitch when Nigeria offered to collateralise the Par Bond with the Resolution Funding Corporation Zero Coupon Bonds (REFCORP BONDS) instead of US Treasury Zero Coupons. The argument was that the agreement provided for an alternative which would be equivalent to a US Treasury obligation. The country argued very firmly that REFCORP Bonds were equivalent to US Treasury Zero coupons. The banks rejected the collateral and this led to a stalemate and consequently both sides went back to the negotiation table. The negotiation resulted in a revision of some of the terms of the agreement. The highlights of the revision included:

- Principal amount to be collateralised with US Treasury Zero Coupon Bonds;
- Interest rate was fixed at 5.5% per annum for the first three years and at 6.25% per annum thereafter, and
- Banks that elected for the traditional rescheduling were required to provide 20% of the amount so committed to the option.

The agreement was successfully closed on January 21, 1992 and Nigeria bought back 62% of the debt and issued collateralised Par Bonds for the remaining 38%⁽⁸⁾. Thus the country was able to achieve a debt and debt service reduction through a Brady type deal.

PARIS CLUB RESCHEDULING

Nigeria first entered into an agreement with the Paris Club in December 1988. Since then there has been two other similar agreements with the Club in March 1989 and January 1991. The first two agreements provided for rescheduling under conventional or traditional terms with market related interest rates.

Under the 1991 rescheduling exercise, the debts were rescheduled on terms applicable to the medium income heavily indebted countries of the lower category. The country was grouped along with Congo, Morocco, Honduras and El-Salvador which had earlier been accorded a similar treatment by the Paris Club. Debts rescheduled under the 1991 agreement amounted to US\$3.2 billion.

At US\$18,160.5 million at the end of December, 1993, Paris Club debt constitutes about 63.3 percent of the country's total debt stock and its debt service commitments result in substantial net outflow of foreign exchange. The debt is, therefore, the most significant overhang which needs to be adequately addressed in order to accelerate the much-needed economic growth. It is, however, recognised that the Club provides other concessional *rescheduling terms like the Toronto terms, Trinidad terms, Poland/Egypt terms and Benin/Nicaragua initiatives* which are designed to provide the beneficiary debtor countries with debt and debt service reduction.

Despite Nigeria's efforts at securing any of these concessional rescheduling terms the Paris Club has not deemed it fit to grant any concession, probably because of the Club's exaggerated notion of the country's wealth and resources. The package which the country had obtained from the Club had only provided very temporary relief and had not resulted in any meaningful reduction of the net present value of the debt. The package was always structured to apply only to maturities falling due within a consolidation period of about 15 months and not the entire debt stock. This made rescheduling under the Paris Club very complex and complicated as several agreements could run concurrently.

DEBT CONVERSION SCHEME

The Federal Government accepted the principle of debt conversion in 1988, soon after the introduction of the Structural Adjustment Programme (SAP).

Rules and Regulations - Eligible Foreign Debt. At the initial phase of the programme, the only class of debt eligible for conversion were the Central Bank of Nigeria Dollar denominated Promissory Notes issued under Central Bank of Nigeria circular of April 1984 and Promissory Notes issued by the Federal Ministry of Finance and Economic Development.

Later, the programme was extended to cover any other foreign currency denominated debt of maturity greater than 365 days owed to commercial banks by the Federal Republic of Nigeria or the Central Bank of Nigeria. The decision to make any class of debt eligible rest with the debt conversion committee and made in the light of developments under the programme.

Eligible Transaction Categories. In the application of the Naira proceeds from debt conversion, the only three categories of application entertained by the committee include:

- (i) Conversion to cash for the purpose of making a gift/grant to Nigeria entities;
- (ii) Conversion for expansion or recapitalization of investments in privatized enterprises;
- (iii) Conversion for investment in completely new projects.

Priority within Eligible Transaction Categories. Within the eligible transactions stated above, the following economic activities were given priority in the following order:

- (i) Investment in production processes based on at least 60 percent local raw materials, especially in the development of agriculture and agro-allied industries, production for export and production of raw materials and other requirements of local industries.
- (ii) Investment in high employment content;
- (iii) Investment for extracting, exploiting and commercialization of Nigeria's mineral, forestry, and other national resources;
- (iv) Investment that will seek to improve or use existing inventions and discoveries in Nigeria relating to new machinery, new products or new processes or with technology component appropriate or adaptive to the Nigerian situation.

Minimum Size of Transaction. In order to minimise administrative work, discourage frivolous applications and facilitate the supervision of, or surveillance over the projects in which the Naira proceeds of debt conversion are invested in (ii) and (iii) above the minimum amount of debt

considered under the scheme was \$0.25 million (one quarter of a million United State Dollars) in first instance and \$25,000 (Twenty five thousand U.S. Dollars) in subsequent redemption. In the case of conversion to cash for the purpose of making a gift, there was no minimum limitation.

Eligible participants. All legitimate holders or assignees of designated debt(s) including Nigerians and foreign nationals whether corporate bodies or individuals, resident or non-resident, are eligible to participate in the debt conversion programme provided that the foreign exchange required for the purpose of promissory notes and/or other foreign debts from an original or a previous holder originated from abroad and not from foreign exchange purchased in FEM or in other way from Nigeria.

The enterprise(s) financed with the redemption proceeds is (are) registered as Nigerian enterprises under existing company laws at the time of the transactions.

Volume Control. An attempt was made to see that the DCP is consistent with the fiscal, monetary and other policies of the Federal Military Government by ensuring that the amount, timing and application of the proceeds of conversion are in accordance with national priorities especially the policies on inflation and acceleration of industrial and agricultural development.

To keep DCP within the framework of the SAP, a volume control was applied in the form of annual and monthly ceilings. Such ceilings were kept under consistent review in line with monetary, credit and other macro-economic objectives and development. Any conversion short fall in one month may, at the discretion of the Debt Conversion Committee (DCC) be carried over and added to the following month's specified limit.

Protection of foreign Investment. Any approved investment made from the proceeds of conversion under the Nigeria DCP shall be recognised as investment made in foreign currency like any other and accordingly will benefit from approved status, for the purpose of such matters as tax treatment and repatriation of dividends and capital subject to the remittance restriction clause below.

Remittance Restriction. In order to ensure that the relief being sought through DCP is not frustrated and in order that the exercise does not result in giving preferential terms of repayment to

an investing redeemptor over other creditors contrary to the terms and conditions of existing debt rescheduling arrangements, the following limitations were placed on remittances of redemption proceeds and incomes arising thereof:

- (i) Interest income, profits/dividends, patent license fees, and other invisible connected with approved projects under the DCP shall not be repatriated for a minimum period of five (5) years from the date of release of redemption proceeds for actual investment or five years after such profits/dividends are made or paid whichever is later.
- (ii) Any capital proceeds arising from subsequent disposal of the investment made under the programme cannot be repatriated for a minimum of ten (10) years after effective investment of the proceeds.
- (iii) Repatriation of capital after 10 years shall not exceed 20 percent per annum.

Transaction commission. A transaction commission payable in U.S. Dollars and equivalent to 2.5 percent of the discounted value of the debt to be converted is payable to the Central Bank of Nigeria (CBN) by the redeemptor.

Financing of off-shore Costs of Projects. The Naira proceeds of Nigeria's DCP is applicable only to the local cost of the projects. The ability to provide the off-shore costs is a condition precedent to any debt equity conversion. Such additional foreign capital investment shall be accorded all the privileges of foreign investment in Nigeria under existing laws.

Taxation of profit and dividend arising from approved DCP projects shall be in accordance with the existing tax laws in Nigeria at the time such profits and dividends are declared.

Application Procedure. Prospective participants whether corporate or non-corporate, national or foreign must obtain the prior consent or approval in principle of the Debt Conversion Committee in order to qualify for participation. Application for approval in principle is processed on case by case and on first come first served basis.

The DCC meets at least once every two weeks (and more often as dictated by the volume of work to review and approve applications).

The approval or rejection of an application must be communicated to the applicant and/or his agent(s) within four (4) weeks of the receipt of such application. The DCC is not under any obligation to give reasons or justifications for approval or rejection of any application and its decision is final.

Required Information. The application to the Debt Conversion Committee shall contain the following information:

- (i) Detailed identity of applicant and where applicable, detailed identity of agent(s) in Nigeria.
- (ii) Information pertaining to applicant's business should include: Nature and type of current business activity and particulars of incorporation; capital and volume of operations, business conducted in or with Nigeria; other investment/operations/activities in Nigeria, and nature and volume of business intended to be conducted in Nigeria with proceeds of proposed conversion.
- (iii) Previous experience, if any, in debt conversion with particulars of volume and nature of business done with profile of actual investment performance in other DCP countries (if any).
- (iv) Undertaking of acceptance of and adherence to the guidelines contained herein.
- (v) Beneficiary or recipient of conversion proceeds and whether it is an existing organisation or a new company to be specifically organised for debt-equity conversion programme.
- (vi) In the case of foreign persons or entities, particulars of agent(s) or representative(s) in Nigeria. Copies of mandate/agreement between the applicant and the agent(s) whether a person or body corporate, certified by a court declaration or a notary public. Agreement must contain details of agents, including detailed instruction for handling and delivery of conversion proceeds.
- (vii) Any other verifiable information or references which could facilitate decision making on the application.

Conversion Procedure - Auction. The method of debt conversion is by auction. However, the DCC can, at its discretion approve an application for conversion on its own merit.

Eligible Bidders. All redeemors who have received approval in principle or their agents are eligible to participate in monthly auction to bid for the amount offered by the DCC for the month.

Conversion Procedure. An approved prospective redemtor or his agent(s) shall submit bid form(s) to the DCC at its secretariat located in the CBN giving particulars of the promissory note(s) debt instrument(s) to be redeemed. The redemtor or his agent(s) may submit up to two alternative bids at an auction: If both bids are successful, the more beneficial bid to Nigeria is taken as his bid for the auction. The right to redeem will be awarded by discount rank until the monthly allocation is

exhausted. If two or more bids offer the same discount the balance of monthly allocation is distributed pro-rata among the two or more bids in respect of offers at the same price. Award will be made to a successful bidder at his bid price (discount)

The DCC may set a reserve price above which no deal can be effected. Redemptors or their agent(s) will be informed of bid award by telephone or telex within 2 working days of the close of the auction.

Within 5 banking days of date of notification, the conversion due from successful bidders must be paid to the U.S. Dollar account of the CBN at the Federal Reserve bank of New York. Redemptors who fail to comply within the requisite time period will forfeit their allocations.

Exchange Rate. The applicable exchange rate shall be the effective FEM rate at the time of the auction and this shall be applied to the successful redeptor's bid price in the calculation of the Naira proceeds

Delivery of Debt instrument for Conversion. The redeptor(s) or his agent(s) will deliver the promissory note(s) debt instrument(s) for conversion to Chase Manhattan bank within 10 working days of the auction in which his bid is successful. If a redeptor fails to deliver the debt instrument(s) to Chase within the stipulated time, he shall forfeit his allocation in the auction. Upon the confirmation of receipts of promissory note(s) debt instrument(s) by Chase Manhattan through telex to the DCC the CBN will provide the naira proceeds directly to a designated blocked account at the CBN in favour of the redeptor. The redeptor or his agent will be promptly informed.

Blocked Account and Release of Funds. Naira proceeds of converted promissory note(s) debt instrument(s) is kept in a blocked account at the CBN and released in tranches to the redeptor's bank according to the cash needs of the approved project(s) as approved by the DCC.

Cancellation of Redeemed Promissory Note(s)/Debt(s). After redemption, the DCC will advice Chase Manhattan Bank to cancel the notes and surrender them to the DCC. Where the amount of debt to be converted is less than the face value of the promissory note(s) submitted for cancellation, Chase Manhattan Bank shall issue a fresh promissory note in the amount of the redeemed balance to the redeptor.

Approved Status. Pursuant to the provision of sub-section 14(2) of the FEM Decree, the DCC within 14 days of the conversion of dollar denominated promissory notes into Naira, issues a certificate of capital Importation in the usual way, and upon which the Federal Ministry of Finance

and Economic Development will in turn issue Approved Status Certificate.

In a similar manner, separate certificate of Capital Importation is issued for additional importation of foreign exchange either in cash or in the form of machinery and equipment etc which constitutes the off-shore cost of approved debt conversion projects.

Monitoring - Designated Redeptor's Bank. The blocked conversion proceeds held at the CBN is released to the designated redeptor's bank in amounts approved by the DCC from time to time. The redeptor's bank open only one special account for every redeptor into which funds released from the blocked account is credited for the execution of the approved project(s).

The redeptor's bank shall furnish the DCC with monthly reports on each debt conversion account operated by it. Such reports must include all the import and other foreign exchange transactions of the enterprise/company in which the redemption proceeds have been invested. It shall also include it's source of foreign exchange outside the FEM including inter bank market.

No Access to Foreign Exchange. All such designated debt conversion accounts shall have no access to FEM without the prior authorization of the DCC. The enterprise/company in which redemption proceeds have been invested should lodge information about all their import and other foreign exchange transactions with the DCC.

Documentation. The DCC maintains at all times at its secretariat, a list and amount of all existing promissory notes. The committee also maintains a list and amount of all canceled promissory notes following conversion. It also maintains a comprehensive record of all projects financed with debt conversion proceeds.

FOOT NOTES

1. **R. A. Olukole (1991)** "Management of the External Debt of Nigeria", Central Bank, The Bullion Volume 15 No. 2 April/June, Lagos, page 25
2. **Sanusi, J. (1987)** "Nigeria's External Debt, Genesis, Structure and Management" Central Bank, The Bullion, October/December, Lagos, page 105
3. **Central Bank of Nigeria** Annual Report and Statement of Accounts for The year ended 31 December 1993, page 72
4. **Keith Criffin (1989)** "Towards a Cooperative Settlement of the Debt Problem". Finance and Development, June 1988, Page 13.
5. **Roger Kubaryah (1985)** "The International Debt Crisis", Princeton University Press, page 215
6. **R. A. Olukole OP cit.** Page29.
7. **Falegen S. B. (1988)** "External Borrowing and Public Policy NIIA Lecture Series No. 26.
8. **Central Bank of Nigeria,** Economic and Financial Review Volume 30 December 1992.

CHAPTER 3

DATA PRESENTATION AND ANALYSIS

We have in the preceding chapters examined the concept of debt conversion, its nature and general implications in the context of debt management. We have as well attempted to trace the origin, structure, magnitude and severity of Nigeria's external debt position. We shall in this chapter critically examine the implementation of the conversion programme from August 1988 to December 1993 and assess the degree to which its objectives have been achieved. Beyond the specific details and statistics of the DCP, we shall attempt to study the impact it has had on the domestic economy, its correlation, if any, with key economic indicators such as inflation, unemployment rate, cumulative private investment and consumer price index.

i.1 APPLICATIONS RECEIVED

From inception in August 1988 to December 1993, a total of 186 applications for conversion worth \$3,197.9 million were received. Of the total number, 52 applications (valued at \$333.3 million), 73 applications (valued at \$1,265.2 million), 16 applications (valued at \$147.1 million), 33 applications (valued at \$347.7 million) and 12 applications (valued at \$1,104.6 million) were received in 1989, 1990, 1991, 1992 and 1993 respectively (**Table 3.1**). A number of factors adversely affected the pace and number of applications during the years. Among these were the de-regulation in both money and foreign exchange markets which made the cost of borrowed funds higher than funds via the DCP, the relatively large parallel market premium, the rise in the market price of Nigeria's Promissory Notes and the unstable political atmosphere. The wide parallel market premium made it attractive for intending foreign investors to bring in capital in the form of foreign exchange which easily can be exchanged at the unofficial market at much higher rates. This tendency was reinforced particularly in 1993 by the sharp increase in the price of Nigeria's Promissory Notes.

3.2 APPROVAL IN PRINCIPLE

The DCC meets every two weeks or more often as dictated by the volume of work to review and approve applications. During the period August 1988 - December 1993, a total of 180 applications worth \$1,782.6 million were granted approval in principle, representing 55.75 percent of the total value of applications (**Table 3.2**).

Further breakdown showed that 52 applications (valued at \$373.69 million), 55 applications (valued at \$596.8 million), 35 applications (valued at \$276 million), 25 applications (valued at \$395 million) and 13 applications (valued at \$140.3 million) were approved in the years 1989, 1990, 1991, 1992 and 1993 respectively. Of the total applications approved, the manufacturing sector got the largest share of 40.1% followed by building and construction with 15%.

Agriculture, hotel and tourism sectors followed with 13.6% and 8.3% of the total value of approvals respectively (1). Gifts and grants got 8% while 11.9% went to services/others. All redemptors who received approvals in principle become eligible to participate in monetary auction to bid for the amount offered by the DCC for any month. The particulars of the promissory note(s)/debt instruments to be redeemed are normally outlined in the bid forms. The right to redeem is awarded by discount rank until the monthly allocation is exhausted. If two or more bids offer the same discount, the balance of monthly allocation will be distributed pro-rata among the two or more bids in respect of offers at the same price.

3.3 REDEMPTION AND DISBURSEMENT

By the end of 1993, total external debt redeemed from the inception of the DCP stood at \$800.1 million (**Table 3.3**). Other benefits derived from the programme included aggregate discounts of \$376.2 million and transaction commissions amounting to \$10.1 million. In addition there were new foreign capital inflow by residents and non-residents amounting to \$240.8 million and \$230.5 million respectively. Amount disbursed to various approved projects at the end of 1993 stood at N4,254.1 million (**Table 3.4**). At N1,544.8 million or 33.8%, the manufacturing sector received the largest share. Building and construction sectors absorbed N574.27 million or 12.5% of the total sum disbursed. Hotel and tourism received N516.76 million or 11.3% while gifts and grants took N594 million or 13% (**Table 3.4**).

Table 3.1

**SECTORAL BREAKDOWN OF APPLICATION FOR DEBT CONVERSION
AS AT END OF DECEMBER, 1993**

NUMBER AND VALUE OF APPLICATION RECEIVED IN:						
SECTORS	1989 (JAN- DEC)	1990 (JAN- DEC)	1991 (JAN- DEC)	1992 (JAN- DEC)	1993 (JAN- DEC)	CUMULATIVE: 1989-1993
	NO. OF APPL.	NO. OF APPL.	NO. OF APPL.	NO. OF APPL.	NO. OF APPL.	NO. OF APPL.
Number						
Agriculture	8	8	-	5	1	22
Manufacturing	32	42	12	19	6	111
Mining and Exploration	1	1	-	-	-	2
Building and Construction	3	4	1	4	1	13
Hotel and Tourism	1	1	1	-	-	3
Gifts & Grants	4	7	1	2	3	17
Services	-	2	1	1	-	4
others	3	8	-	2	1	14
TOTAL	52	73	16	33	12	186
Value (US\$ Million)						
Agriculture	48.3	50.4	-	18.0	10.0	126.7
Manufacturing	156.9	274.1	105.8	179.1	1,023.5	1,739.4
Mining and Exploration	8.0	30.0	-	-	-	38
Building and Construction	10.4	41.1	10.0	62.4	1.0	124.9
Hotel and Tourism	50.0	84.9	5.0	-	-	139.9
Gifts & Grants	47.2	168.3	26.0	80.3	20.1	341.9
Services	-	121.4	0.3	2.5	-	124.2
others	12.5	495.0	-	5.4	50.0	562.9
TOTAL	333.3	1,265.2	147.1	347.7	1,104.6	3,197.9

Source: DCC Secretariat, Central Bank of Nigeria, Lagos.

Table 3.2

**SECTORAL BREAKDOWN OF APPROVED APPLICATION FOR
DEBT CONVERSION AS AT END OF DECEMBER, 1993**

NUMBER AND VALUE OF APPLICATION WITH APPROVAL:						
SECTORS	1989 (JAN- DEC)	1990 (JAN- DEC)	1991 (JAN- DEC)	1992 (JAN- DEC)	1993 (JAN- DEC)	CUMULATIVE: 1989-1993
	NO. OF APPL.	NO. OF APPL.	NO. OF APPL.	NO. OF APPL.	NO. OF APPL.	NO. OF APPL.
Number						
Agriculture	17	10	6	6	1	40
Manufacturing	29	32	21	14	4	100
Mining and Exploration	1	1	1	-	-	3
Building and Construction	1	3	1	2	3	10
Hotel and Tourism	-	2	1	-	-	3
Gifts & Grants	1	5	2	2	3	13
Services	-	2	1	1	1	5
others	3	-	2	-	1	6
TOTAL	52	55	35	25	13	180
Value (US\$ Million)						
Agriculture	76.1	55.6	44.4	57.7	10.0	243.8
Manufacturing	237.7	226.6	106.4	135.9	20.3	726.9
Mining and Exploration	2.6	8.0	30.0	-	-	40.0
Building and Construction	2.7	40.4	61.5	133.0	30.0	268.6
Hotel and Tourism	-	142.9	5.0	-	-	147.9
Gifts & Grants	5.1	23.3	27.0	60.3	27.1	142.8
Services	-	100.0	0.3	8.1	2.5	110.9
others	49.4	-	2.3	-	50.0	101.7
TOTAL	373.6	596.8	276.9	395.0	140.3	1,782.6

Source: DCC Secretariat, Central Bank of Nigeria, Lagos.

Table 3.3
SUMMARY OF DEBT CONVERSION TRANSACTIONS
AS AT END OF DECEMBER 1993

	At Auctions	Outside Auctions	Total
	1989-1993 (1)	1989-1993 (2)	1989-1993 (3)
1. Amount Redeemed:			
a) \$ Million	604.4	195.7	800.1
b) N Million	6,202.5	1,914.1	8,115.6
2. Discount Offered:			
a) \$ Million	276.5	99.7	376.2
b) N Million	2,822.7	1,008.5	3,831.2
c) Average Discount %	-	-	-
3. Proceeds:			
a) \$ Million	326.5	97.3	423.8
b) N Million	3,378.9	905.6	4,284.5
4. Commission Paid:			
a) \$ Million	7.8	2.3	10.1
b) N Million	7.8	1.4	9.2

Source Debt Conversion Secretariat, Central Bank of Nigeria, Lagos

Table 3.4

SECTORAL DISTRIBUTION OF DISBURSEMENT OF
DEBT CONVERSION PROCEEDS 1989 - 1993
(N MILLION)

SECTORS	1989	1990	1991	1992	1993	CUMULATIVE	
	(1)	(2)	(3)	(4)	(5)	1989 - 1993	%
Agriculture	209.5	165.6	41.0	115.2	4.4	535.7	11.7
Manufacturing	332.6	389.2	152.8	617.5	52.7	1,544.8	33.8
Mining & Exploration	-	34.2	55.2	-	-	89.4	2.0
Building and Construction	10.3	46.2	155.1	321.3	31.3	574.2	12.5
Hotel & Tourism	-	149.4	244.0	120.0	3.4	516.7	11.3
Gift & Grants	201.5	144.4	68.0	89.0	121.3	594.2	13.0
Services	-	-	1.2	5.5	266.6	373.3	6.0
Others	78.6	115.3	67.2	57.3	125.8	25.8	9.7
	832.5	1,044.3	784.5	1,325.8	605.5	4,284.1	100.0

Source Debt Conversion Secretariat, Central Bank of Nigeria, Lagos

Table 3.5

SELECTED ECONOMIC INDICATORS
(Percent, except otherwise indicated)

	1989	1990	1991	1992	1993
		1st Half	1st Half	1st Half	1st Half
Industrial Production Index (1985=100)	125.0	127.2	137.3	156.9	161.2
Manufacturing Index	154.3	158.1	175.0	172.5	176.7
Mining Index	109.2	122.2	119.3	119.3	121.5
Electricity	165.2	125.5	124.0	130.9	139.8
Manufacturing Capacity Utilization Rate	42.5	37.6	38.2	38.7	37.0
National Unemployment Rate Composite	4.0	3.1	4.2	3.2	4.0
Consumer Price Index (1985=100)	272.7	288.4	305.4	314.7	665.5
Composite	50.4	26.9	5.9	26.8	54.2
Inflation Rate					

Source: CBN Economic Report for the First Half of 1993

Table 3.6

CUMULATIVE PRIVATE INVESTMENT IN NIGERIA
(1988 - 1991)
(Naira Million)

Year	Paid - Up	Other	Total
	Capital Plus Reserves (1)	Liabilities (2)	(1) + (2) (3)
1988	5,495.2	5,844.0	11,339.6
1989	7,214.7	3,685.1	10,899.8
1990	9,263.4	1,172.1	10,435.5
1991	12,034.0	210.0	12,244.0

Source: CBN Economic & Financial Review, Vol 31, No.3.

3.4 TOOLS OF ANALYSIS

There are various methods for measuring the relationships existing between economic variables. The simplest are correlation analysis and regression analysis. **Groebaer and Shaon (1987)** defined correlation as the quantitative measure of strength in linear relationships between variables. Two variables may have a positive correlation, a negative correlation or they may be uncorrelated. Two variables are said to be positively correlated if they tend to change together in the same direction, that is if they tend to increase or decrease together. Two variables are said to be negatively correlated if they tend to change in the opposite direction: When x increases, y decreases and vice versa. Two variables are uncorrelated when they tend to change with no connection to each other. For any two variable x and y, the sample correlation estimate R_{xy} is given by

$$R_{xy} = \frac{\text{cov}(X, Y)}{\sqrt{\text{var}(X) \text{var}(Y)}}$$

The values that the correlation coefficient may assume vary from -1 to +1. When R is positive, x and y increase or decrease together. When R is negative, x and y move in opposite directions. When R is zero, then the two variables are uncorrelated. Correlation analysis has serious limitations as a technique for the study of relationships. It seeks to discover only if a relationship exists, but does not establish and/or prove any causal relationship between the variables. The correlation coefficient does not prove which is the dependent and which is the explanatory variable. To estimate the parameter of economic relationships, we may apply various methods the simplest of which is the method of ordinary Least Squares Regression. The relationship between x and y is represented with a model of the form $y = a + bx + e$ where a is the y - intercept, b is the slope and e is the error term (the difference between the actual y value and y as predicted by the model). After the estimation of the parameters and the determination of the Least Squares Regression line, we need to measure the dispersion of observations around the regression line or the goodness of fit of the regression line to the sample observations of y and x. A measure of the goodness of fit is given by the square of the correlation coefficient R-squared, which shows the percentage of the total variation of the dependent variable that can be explained by the independent variable x.

The square of the correlation coefficient is used for judging the explanatory power of the linear regression of y and x.

The next test is based on the standard errors of the parameter estimates and is applied for judging the statistical reliability of the estimates of the regression coefficients b_0 and b_1 . It provides a measure of the degree of confidence that we may attribute to the estimates b_0 and b_1 . It enables the researcher to decide how good the estimates of the parameters of the relationship are. Since *sampling errors are inevitable in all estimates, it is necessary to apply tests of significance in order to measure the size of the error and determine the degree of confidence in the validity of the estimates.* We shall apply in this work, a popular test in applied econometric research, namely the “standard error test”(3). This test helps us to decide whether the estimates b_0 and b_1 are significantly different from zero i.e. *whether the sample from which they have been estimated might have come from a population whose true parameters are zero.* Formally we test the null hypothesis

$$H_0 : b_1 = 0$$

against the alternative hypothesis

$$H_1 : b_1 \neq 0$$

The acceptance or rejection of the null hypothesis has a definite meaning. Namely that acceptance of the null hypothesis implies that the explanatory variable does not in fact influence the dependent variable y and should not be included in the function, since the conducted test provided evidence that *changes in x leave y unaffected.* In other words acceptance of the null hypothesis implies there is no relationship between y and x.

Rejection of the null hypothesis means that our estimate comes from a sample drawn from a *population whose parameter is different from zero.* In order to define how close to the estimate the true parameter lies, we must establish limiting values around the estimate within which the true parameter is expected to lie with a certain degree of confidence. In this respect we say that with a given probability the population parameter will be within the defined confidence interval or limits. It is customary to choose the 95 percent confidence level.

Table 3.7

SUMMARY OF REGRESSION AND VARIANCE ANALYSES RESULTS

VARIABLES	CORRELATION COEFFICIENT	T VALUE	PROB LEVEL	STANDARD ERROR OF EST.	R SQUARD
NATIONAL UNEMPLOYMENT RATE AND DCP	-0.827051	-2.54835	0.8406	0.330971	68.4%
CUMULATIVE PRIVATE INVESTMENT AND DCP	-0.812163	-1.39205	.39658	774.969	65.96%
CONSUMER PRICE INDEX AND DCP	-0.589182	-1.26299	.29583	155.194	34.71%
INFLATION AND DCP	-0.35701	-0.661983	.55529	21.3153	12.75%

The hypohese of the study includes:

1. Ho : Debt conversion has no effect on unemployment or X is not statistically significant at 5% level if significance.
 H1 : Debt conversion reduces unemployment or X is statistically significant at 5% level of significance.
2. Ho : Debt conversion has no effect on capital inflow/private investment or that X is not statistically significant at 5% significance level.
 H1 : Debt conversion encourages capital inflow/private investment or that X is statistically significant at 5% significance level.
3. Ho : Debt conversion has no effect on inflation or that X is not statistically significant at 5% level of significance.
 H1 : Debt conversion induces inflation or that X is statistically significant at 5% level of significance.

DCP AND NATIONAL UNEMPLOYMENT RATE

Appendix (I) profiles the regression of the National Unemployment Rate (NUR) as a dependent variable on Debt Conversion Proceeds (DCP) as independent or explanatory variable. To test for the significance of the explanatory variable, the computed sample T value of the slope (-2.54835) is compared to **students** (4) theoretical value of T distribution at 5% level of significance with 3 degrees of freedom (n-2). The acceptance region is $-3.18 < t < 3.18$. Since the samples T value of -2.5483 falls within the acceptance region, we accept the null hypothesis and reject the alternative hypothesis.

The R-squared at 68.4% is still very low for any statistical goodness of fit, buttressing further the acceptance of the null hypothesis. In other words the R-squared at 68.4% shows a not very strong correlation between DCP and NUR in consonance with the contention of the null hypothesis. The intercept parameter at 5.10268 means that unemployment rate will be 5.1026% even without DCP.

DCP AND CUMULATIVE PRIVATE INVESTMENT/CAPITAL INFLOW

The Regression of Cumulative Private Investment (CPINV) which is a measure of capital inflows on Debt Conversion Proceeds (DCP) is captured in Appendix (ii). The computed sample T value (-139205) is again compared to the theoretical value of T distribution at 5% level of significance with 3 degrees of freedom.

Since the sample T value falls within the acceptance region which is $-3.18 > t > 3.18$, we accept the null hypothesis that Debt conversion has no effect on capital inflow/private investment. This means that X is statistically not significant at 95% confidence interval. The R-squared at 65.8% again does not indicate a high correlation between the variables implying that the relationship between DCP and capital inflow is weak. This further reinforces the acceptance of the null hypothesis.

DCP AND INFLATION

Our investigation of the relationship between DCP and inflation will be two pronged anchored on consumer price index (CPI) and absolute inflation figures (INF) over the years. Critics of the DCP contend among others that the programme would inevitably entail increasing total money supply which precipitates inflation. However the analysis of the Regression of CPI and DCP shown in Appendix (iii) reveals a sample T value of -1.26299 which when compared to students theoretical value of T distribution at 5% level of significance with 3 degrees of freedom, $(-3.18 > t > 3.18)$, falls

within the acceptance region. This suggests accepting the null hypothesis and the underlying contention that the DCP has no effect on inflation. The R-squared at 34.71% further indicates a weak correlation between DCP and CPI, supporting the rejection of the contention of the alternative hypothesis that DCP induces inflation.

Similarly the Regression of DCP on absolute inflation figures shown in Appendix (iv) shows a sample T value of -0.6619 which falls within the theoretical acceptance region of $-3.18 > t < 3.18$ at 5% level of significance with 3 degrees of freedom. This implies that DCP is statistically not significant at 95% confidence interval. We therefore accept the null hypothesis and reject the alternative hypothesis. The acceptance further corroborates the result of the preceding test that the DCP has no effect on inflation. The R-squared at 12.75% again indicates a very weak correlation between DCP and inflation supporting the acceptance of the null hypothesis.

FOOTNOTES

1. **Central Bank of Nigeria** Annual Reports and Statement of Account 31, December 1993, Page 72 -76
2. **Groebner, P. Shannon (1987)** Essentials of Business Statistics, Meril Publishing, Columbus. Page 43
3. **Koutsoyiannis A., (1973)** Theory of Econometrics Macmillan Press LTD. Page 81
4. **Bowers D. (1982)** Statistics for Economists Macmillan Press Limited. Page 234

SUMMARY, RECOMMENDATION AND CONCLUSION

4.1 SUMMARY OF FINDINGS

This study has been concerned with assessing the Debt Conversion Programme (DCP) in Nigeria, the concept, implementation and achievements of the programme from inception in 1988/89 - 1993. It was shown that in the five years of the DCP, only US\$800.1 million out of the total external debt figure of US\$28,718.2 Million as at 31st December, 1993 or 2.7% were redeemed. Other benefits derived from the programme included aggregate discounts of US\$376.2 million and transaction commission amounting to US\$10.1 million. On the whole, the results achieved are a far cry from the very high expectations at the commencement of the programme and compare poorly to the achievements of countries like Mexico and Chile. In Mexico after the first two years of the programme, US\$2.6 billion was converted. The implementation of the scheme in Nigeria has been adversely affected by the large parallel market premium and high cost of borrowed funds which resulted from the de-regulation of both the money and foreign exchange markets. The political crisis witnessed during the years also severely eroded the confidence of foreign investors with negative consequences on the DCP.

The hypotheses of this work which were premised on the set objectives of the DCP were tested. We discovered from the result of our first statistical test that the DCP has had no effect on the National Unemployment Rate contrary to the expectation that the programme would stimulate employment generating investments. The null hypothesis was therefore accepted.

The second hypothesis attempted to establish a possible relationship between the DCP and cumulative private investment in Nigeria. The test results showed a very weak relationship between the variables which influenced the acceptance of the null hypothesis that the DCP has no effect on private investment/capital inflow contrary to the initial expectations that the programme would

attract foreign investors, encourage the creation and development of export-oriented industries, etc. To test the third hypothesis on the impact of the DCP on inflation, we employed both the consumer price index and absolute inflation figures as declared by Government sources.

We discovered in both instances that the DCP has had little impact on inflation contrary to the initial apprehension of critics of the programme. The first regression test revealed that DCP accounted for only 34.71 percent of the total variation in the consumer price index which is not statistically significant. The second test also showed that DCP can only explain 12.75 percent of the total variation in the inflation rate which is again statistically weak.

We also saw in the course of the study that out of the total debt redeemed of US\$ 800.1 million, about US\$ 195.7 million or 24.5% of the redemptions were done outside the official auction sessions. It has not been clearly established if the proceeds from such conversions went into priority areas as most of it were done on directives from high offices. Details of the beneficiary companies/individuals are shrouded in secrecy. We however saw that 33.8% of the total debt conversion proceeds disbursed to date went to the manufacturing sector, followed by gifts/grants with 13%. The building/construction and agricultural sectors got 12.5% and 11.7% respectively.

4.2 RECOMMENDATIONS

Debt conversion as a strategy for external debt management is not only a revolutionary financing tool for economic development, it is perhaps the most dynamic debt management strategy. Its implementation in Nigeria however during the review period (1989-1993) has been plagued by several factors such as the large parallel market gap vis-a-vis the official exchange rate, political instability, etc which negatively impacted on the results of the scheme. Useful lessons and experience have been gained however, which can be harnessed and built upon for greater achievements in the years ahead. The following measures need to be considered if the objective of the programme are to be fully achieved.

- (i) The local cost component of specific joint venture projects such as the Liquefied Natural Gas (LNG) and OSO condensate projects estimated to cost about US\$2.5 billion should be part financed through the DCP.
- (ii) The frequent exchange rate fluctuation should be checked through regular funding of the FEM and liberalization of the foreign exchange trade. The reversals in the de-regulation of the market has only succeeded in widening the parallel market gap which serves as a dis-incentive to potential investors.
- (iii) The disbursement of proceeds from Debt conversions should not be unduly delayed. It is recommended that they be released at least within three working days.
- (iv) The enthronement of a stable and durable policy is a sine-quo-non for investor confidence and the success of the scheme. The transition to a responsible and responsive civilian administration should be quickened. The tide world over is against military regimes no matter how benevolent.
- (v) Finally, it is important that data on Nigeria's debt is presented accurately. It should be more comprehensive and timely for better decision and policy making.

4.3 CONCLUSION

This dissertation has looked into the debt conversion scheme in Nigeria from inception in 1989 to the end of 1993. Various observations have been drawn and the impact of the scheme on unemployment, private capital inflow and inflation ascertained using statistical tools. We saw that very little of the objectives of the scheme have been achieved in the five years of its implementation. Recommendations have been put forward for greater results in the future. It is hoped that this work would be useful in studies into the resolution of the external debt problem. It must be emphasized that the long-term solution to the nation's debt crisis lies in consistent enactment and implementation of policies that will amongst others promote exports and discourage the penchant for imported items.

APPENDIX I

row	YEAR	DCP	NUR
1	1989	832.50	4.00
2	1990	1044.30	3.10
3	1991	784.50	4.20
4	1992	1325.80	3.20
5	1993	605.50	4.00

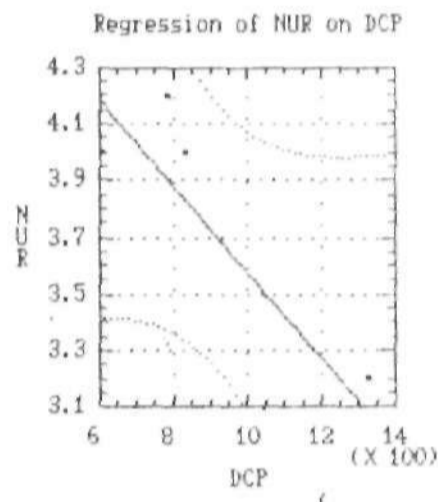
Regression Analysis - Linear model: $Y = a + bX$

Dependent variable: NUR		Independent variable: DCP		
Parameter	Estimate	Standard Error	T Value	Prob. Level
Intercept	5.10268	0.569982	8.95236	2.94094E-3
Slope	-1.52711E-3	5.99255E-4	-2.54835	0.0840639

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	Prob. Level
Model	.7113744	1	.7113744	6.4940862	.08406
Error	.3286256	3	.1095419		
Total (Corr.)	1.0400000	4			

Correlation Coefficient = -0.827051 R-squared = 68.40 percent
 Std. Error of Est. = 0.330971



KEYS: NUR = National Unemployment Rate
 DCP = Debt Conversion Proceeds

row	YEAR	DCP	CPI
1	1989	832.50	272.70
2	1990	1044.30	288.40
3	1991	784.50	305.40
4	1992	1325.80	314.70
5	1993	605.50	665.50

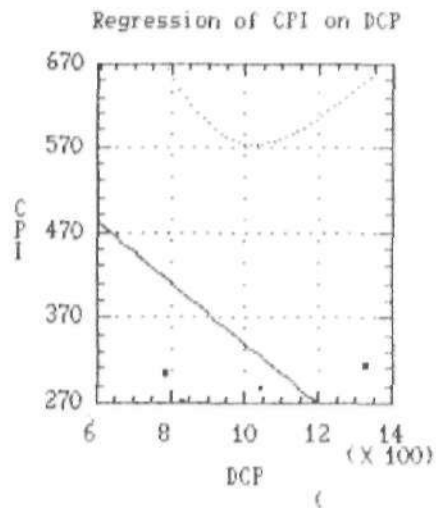
Regression Analysis - Linear model: $Y = atbX$

Dependent variable: CPI		Independent variable: DCP		
Parameter	Estimate	Standard Error	T Value	Prob. Level
Intercept	695.315	267.268	2.60152	0.0802671
Slope	-0.354892	0.280994	-1.26299	0.295832

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	Prob. Level
Model	38419.251	1	38419.251	1.595	.29583
Error	72255.921	3	24085.307		
Total (Corr.)	110675.17	4			

Correlation Coefficient = -0.589182 R-squared = 34.71 percent
 Std. Error of Est. = 155.194



KEYS: CPI = Consumer Price Index.
 DCP = Debt Conversion Proceeds.

row	YEAR	DCP	INF
1	1989	832.50	50.40
2	1990	1044.30	26.90
3	1991	784.50	5.90
4	1992	1325.80	26.80
5	1993	605.50	54.20

Regression Analysis - Linear model: $Y = a+bX$

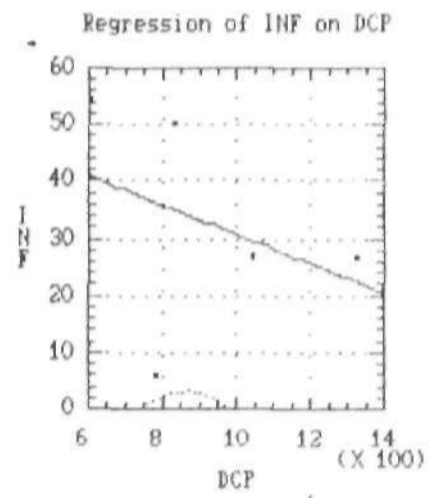
Dependent variable: INF		Independent variable: DCP		
Parameter	Estimate	Standard Error	T Value	Prob. Level
Intercept	56.3065	36.7082	1.5339	0.222603
Slope	-0.0255482	0.0385934	-0.661983	0.555291

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	Prob. Level
Model	199.10292	1	199.10292	.43822	.55529
Error	1363.0291	3	454.3430		
Total (Corr.)	1562.1320	4			

Correlation Coefficient = -0.35701
 Std. Error of Est. = 21.3153

R-squared = 12.75 percent



KEYS: INF = Inflation Rate.
 DCP = Debt Conversion Proceeds.

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