# THE NIGERIAN DEBT CONVERSION PROGRAMME: AN APPRAISAL OF ITS IMPACT ON NIGERIA'S EXTERNAL DEBT MANAGEMENT

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KASHIM IBRAHI

## DEDICATION

***To my wife, Badiya and our children, Safiya and Farida, whose patience and understanding saw me through this programme.***

## DECLARATION

**I hereby declare that I am responsible for the materials published in this project. Any reference made to books and journals have been acknowledged.**

| | | |
|---|---|---|
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## CERTIFICATION

This project entitled "The Nigerian Debt Conversion Programme: An Appraisal of its Impact on Nigerian External Debt Management", by Bello, M. A. meets the regulations governing the award of the degree of Master of Business Administration of Ahmadu Bello University, and is approved for its contributions to knowledge and literary presentation.

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# A B S T R A C T

The collapse of world oil price early in the 1980s coupled with prouncement by some countries that they were broke and therefore unable to service their debt signalled the beginning of what is commonly referred to as the world debt crisis.

Hitherto, oil rich nations have engaged in a spending space and have in the process acquired expensive tastes. Following the fall in their export receipts occasioned by the decline in oil prices, and the continued reliance on the importation of luxury goods plus the need to sustain economic development; there was a need for external borrowing by developing nations. The liberal measures taken by banks in the industrial nations in granting loans to the developing nations also helped in accumulating debts worth billions of dollars by these countries.

Nigeria, being a developing nation was also caught in this web of international debt entrapment. In an attempt to turn-around the economy, the Shagari administration adopted some restrictive import control policies

which later became popularly known as "Austerity Measures" in 1982. Implementation of the policy became difficult due to the liberal attitude of the administration.

Under the Buhari regime, emphasis was on the reduction of trade deficit through import restriction. Much was not achieved here either, partly due to severe pressure on the country's earnings brought about by the debt burden and the decline in credit worthiness of Nigeria which resulted in outright cancellations of credit lines to the country. The Babangida administration introduced Structural Adjustment Programme (SAP), the Second-tier Foreign Exchange Market (SFEM) and the Debt Conversion Programme (DCP) introduced in 1984 is still continued by the present administration.

This study, which hinges on the programme was conducted with the aim of analysing the extent to which Nigeria's external debt obligation were reduced as a result of the operations of the programme.

The research found out that debt conversion programme alone cannot solve the nation's external debt problems, it can only complement other debt management strategies, such as debt rescheduling debt buy back and debt forgiveness.

# CHAPTER ONE

# INTRODUCTION

## 1.1 PREAMBLE

This introductory chapter will attempt to lay bare the background to external borrowing by low developing countries, (LDCs) with emphasis on Nigeria and their consequent indebtedness. It will also outline the statement of the problem, research methodology employed, scope and limitations of the study and conclude with brief definition of some common terms used in debt conversion programme.

## 1.2 BACKGROUND TO EXTERNAL BORROWING AND INDEBTEDNESS

Foreign or external borrowing can be explained both in terms of technical, managerial and financial requirements in support of development plan and economic growth of a nation. Economic growth usually depend upon a process of domestic capital formation and accumulation, though low productivity and low capital absorptive capacity in most developing nations severely limits this[1]. Thus requirement for external assistance in terms of

technical, managerial and financial become imperative on a developing nation like Nigeria. This is further explained by the fact that money alone or financial resources, cannot finance developing needs of nations, hence the need for technical, managerial or executive assistance from countries that have such specialised skills in abundance.

We may therefore safely assume that foreigners engaged in running or executing projects either through foreign direct investment or portfolio investment, constitute importation of skilled personnel whose emoluments are remitted back to their countries as home remittance profits or dividends.

Also, domestic business including affiliates or branches of multinationals/transnational companies do require short-term financing in the form of supplier credits or bills for collection from time to time. Without such financing from abroad, such businesses may not be able to operate successfully.

Thus, most third world countries have at one time or the other resorted to big scale external borrowing to supplement domestic savings efforts to finance a substantial volume of investment rapid economic growth and developments. Some countries have also used such external borrowing to finance transitory balance of payments deficits. Therefore, borrowing to finance such resource

gaps is not undesirable. However, the loans become problematic where the debt service payments absorb a sizeable proportion of the nations budget.

Having gone this far, let us now consider some international developments that precipitated or even encouraged borrowing by developing nations which consequently led to the current world debt crisis.

Following the two world wars, the Vietnam and Korean wars, there was a dare need for reconstruction and development of nations destroyed by war. Also in the early 1980s banks in the developed western countries assumed a conscious expansion of loans to developing countries by as much as 25 per cent increase per year loans during that period were generally not collaterised. Makin (1984) observed that loans to LDCs during the period were "... offset against nothing mere tangible than a set of political attitudes and assumptions in a group of countries that were in a group of countries that were at once economically and politically volatile..." The result of this liberal lending policy or huge expansion of direct lending by the western banks to the developing countries were generally believed to have precipitated the current world debt crisis which started in earnest in 1982[2].

To an extent, the oil boom of the early 1970s which over might sent oil prices to the high heavens and created a whole new category of borrowers and lenders too, contributed to the crisis[3].

The oil exporting countries who are mostly not sophisticated in financial matters and now saddled with a lot of cash, wanted just to dump their money in the banks. The banks on the other hand had a field day re-cycling the money among borrowers and earning fees, interest and commissions in the process.

This trend continued for sometime well after the oil exporting countries started spending their "bonanza" at a much faster rate which resulted in the reduction of their combined current account surplus from US$68.3 billion in 1974 to US$35.4 billion in just one year. The debt crisis in the early 1980s, is not the first in Nigeria's history. Soon after independence in 1960, the country experienced some level of economic crisis which led it to incur some external debt which stood at about N82.4 million that year. The figure rose to N489.0 million in 1970 and by 1977 it was a whopping N5.001 billion[4].

Much of this was then attributed to the growing tastes of imported items by Nigeria, and what Olashore cited in Olukoshi (1990) identified as the "...

various built-in margins of fraud and other exorbitant finance charges on such imports[5].

Other factors have been identified and shall be discussed in subsequent chapters. By the early 1980s it had become obvious that the Nigerian economy had to undergo a restructuring if the country wants to come out of the debt issue. The inflow of foreign exchange had started to dry while the balance of payments deficit was becoming worse mostly, as a result of the increase in short term letters of credits being opened by the then Shagari administration for such agencies like the Police, Federal Electoral Commission, etc[6].

Nigeria's effort to reduce the debt burden started during the Shagari administration through Buhari's and which later culminated in to the introduction of debt conversion programme in 1988, by the Babangida administration.

Of course in between, the government did try other measures like rescheduling, refinancing and restructuring all of which though lessened the debt service burden did not make an impact in reducing the total debt outstanding. President Ibrahim Babangida had in 1988 budget speech stated that the essence of the debt conversion programme was to allow creditors to convert

debts into "equity investment especially in high priority projects which used local raw materials and provide employment for our people."[7]

With the introduction of the programme, the path to reducing the stock of the nations external debt obligation was set.

Of course, the major consequence of the strategy has to do with increased ownership of equity participation of Nigerian companies by foreigners, encouraging capital flight through round tripping of proceeds and possible increase in inflation due to huge increases in domestic money supply also resulting from the proceeds of the programme.

The programmes however likely to increase the productive capacities of beneficiary industries and in the process generate employment. The products of such companies are also likely to be exported and may therefore bring in the much needed foreign exchange that will apart from part funding the Autonomous Foreign Exchange Market (AFEM) will increase the profitability of the exporting companies. In the chapter that will follow, we shall discuss in detail effects of the programme to the Nigerian economy.

## 1.3 STATEMENT OF THE PROBLEM

Some commentators on the state of the economy including some sections of the media have contended that because the government has not put in place adequate incentives that would mitigate the political risk and other risks associated with investing in Nigeria, the programme is yet to attract adequate investment that could have a significant impact on the external debt position of the country.

However, the commentators may have conveniently ignored the provisions of paragraphs 2-7, 2-8 and 4-12 of the guidelines governing the operations of the programme which, recognised investments made under the DCP as investments made in foreign currency and accordingly granted approved status for such purposes like tax, repatriation of dividend and the issuance of share/debt certificate by the securities and exchange commission (SEC) which is subsequently deposited at the redemptors depository Bank.

It is the contention of this researcher that, the problem may well be that of bureaucratic red-tapism which is likely to cause unnecessary delay in both the issuing, registering and depositing such certificates with redemptor's banks.

## 1.4 Significance of the Study

The broad effect of inefficient debt management is the emergence of debt overhang and an unsustainably high debt service burden. This study is intended to show the importance of debt conversion through the reduction of debt overhang.

## 1.5 Research Methodology

The sources of data for this research will mostly comprise the use of secondary sources of data like textbooks, magazines, newspapers, seminar papers, published articles, etc.

However, due to the difficulty in getting textbooks on the subject of study - "The Nigerian Debt Conversion Programme: An Assessment of its Implication on Nigeria's External Debt Management", the use of seminar papers and articles (both published and unpublished) will be emphasised. Central Bank of Nigeria Annual Reports will also be used.

Secondary sources of data mentioned above have the advantage of well informed and acknowledged sources of information and are therefore generally accepted by researchers and readers alike.

The use of questionnaires and interviews were de-emphasized because of their major shortcomings of biasness or even outright refusal to supply information by respondents.

## 1.6 SCOPE AND LIMITATIONS OF STUDY

This research intends of study the effect of the use of certain management tools in managing Nigeria's external debt and will specifically focus on the debt conversion programme currently being implemented. Accordingly, the study will be limited to the analysis of the programme up to December, 1995.

## 1.7 SCHEME AND ARRANGEMENT OF WORK

Chapter One introduces the concept of externa or cross border borrowing and indebtedness. It also outlines factors that helped the development of the current world debt crisis. Significance of the study; scope and limitation and research methodology are part of the chapter.

Chapter two reviewed literature on external debt management while giving debt conversion strategy special emphasis. Merits and demerits of the strategy as employed by Nigeria was also looked at. Chapter three analysed the effect of the strategy in Nigeria from inception to date. Experiences of countries

like Mexico, Chile, Argentina who are also implementing the strategy are also looked at. The last chapter summarised the research, made some conclusions and proffered some recommendations based on conclusions arrived.

## 1.8 DEFINITION OF TERMS

Balance of indebtedness: Financial statement prepared for a given country summarising the levels of assets and liabilities that the country has vis-a-vis the rest of the world.

Bond: A promise under seal to pay. The term is generally used to designate the promise made by a corporation, either public or private, to pay money to the bearer. Bonds can also be issued by governments.

Commission: The sum of money, interest brokerage, compensation or allowance given to a factor or broker for carrying on the business of his or her principal.

Exchange Rate: The price of one currency expressed in terms of another.

Letter of Credit: An agreement sent from one party (usually a bank) to another, concerning funds which will be made available upon completion of some business transactions.

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# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 INTRODUCTION

This chapter will first look at the origins of Nigerian's debt crisis and the various strategies tried in managing the external debt burden. It will also look at the objectives and operations of the debt conversion programme in Nigeria along with its merits and demerits.

## 2.2 GENESIS OF THE NIGERIAN DEBT BURDEN

The Nigerian economy was basically agrarian in the 1950s and the 1960s with over 70 per cent of the nations population engaged in farming and living in the rural areas. Agriculture then contributed about 70 per cent of the country's total revenue which was about 60 per cent of the nation's gross domestic product (GDP).

The discovery of oil in the early 1970s and its emerging prominence in the nation's export earnings precipitated the gradual marginalisation of the agricultural sector. Suleiman (1990) noted that "sharply rising oil prices boasted

Nigerian's export earnings from $4 billion in 1975 to $26 bill on in 1980, while GNP per capita rose from $360 to more than US$1000 ..." This new found fortune considerably raised public expenditures most of which became white elephant projects.

Nigeria soon began to depend on external sources of food as well as general increase in the consumption of luxury items most of which were also imported. It is

therefore no surprise that following the collapse of oil prices as a result of a glut at the turn of the decade, Nigeria's export earnings too began to decline.

By 1986, the nation's export earnings were down to US $6 billion in 1980 to $25 billion in 1986. Also, GNP per capita fell to $370 close to its 1980 level.[1] Increasing demand for foreign goods, luxury goods and consumer goods all of which put tremendous pressure on our external reserves coupled with declining oil fortunes made Nigeria to resort to massive external borrowing.

Yet, other reasons had been advanced by other researchers as the cursory factors that exacerbated Nigeria's external debt problem. Nwoke (1990) identified the following factors.

(a) Disarticulation of production and consumption pro iles in the country: This arises out of the deliberate attempt by advanced western nations to marginalise third world nations - Nigeria inclusive, as producers and suppliers of natural resources or primary products and also to serve as markets for the advanced countries manufactured goods. This stifles domestic productive forces with the country producing what it does not consume and consuming what it does not produce. Such a situation gives rise to excessive import dependence and makes the economy vulnerable to balance of payment crisis.

(b) External Dependence: Nigeria like other developing nations depend on the advance western countries for manufactured goods. Productive capital market for its primary commodities products and even food. As a result, crisis in the economics of such advanced countries are systematically transmitted to the developing nations. This again impact on their balance of payments and exacerbate their debt crisis through accumulation of

import bills arising from such dependence.

© Foreign Domination and Exploitation: Persistent drainage of surplus from the developing countries through the activities of transnational and multinational corporations of the advanced countries and the vigorous push of the foreign capital in form of loans, is a major cause for slow growth and periodic depression that helps in reinforcing the debt trap.

(d) Enclave Status of the Dominant Petroleum Sector: Nigeria whose economy is typically monocultural depends on oil resources for its development needs. This is however open to manipulation by the advanced western countries as they to a large extent determine the price of oil. National planning therefore becomes difficult since export earnings, domestic money supply and accumulation are affected by such manipulation and therefore renders them volatile and unpredictable.

(e) Limited Access to World's Available Pool of Credit Facilities: The numerical strength of third world nations in the United Nations

General Assembly coupled with their limited or insignificant voting strength, further perpetuated their entrapment and debt bondage. As they could neither obtain any access to credits by such institutions nor could they create international credit through deficit financing operations.

(f) Discriminatory Protective Walls erected by Metropolitan Countries: The framework of Adam Smith's classical economies suggest that, the back borne of free market economics is free movement in labour and capital (as well as goods and services). However, immigration laws in the advanced countries makes it almost impossible for any large scale movement of labour except for a few cases of brain drain of skilled personnel. Poor third world nations can ill-afford to put up such stringent measures on such movements of capital and technology into its economy, because it desperately needs its current foreign exchange earnings, if only to survive. This perpetuates the dependency syndrome, drain foreign reserves and ultimately leads to balance of payment

problems.

(g) Distribution of Value Added from International Trade weighted against Nigeria: Nigeria, a third world country and a producer/exporter of primary products, necessarily receives only small fraction of the price that consumers pay for its export in the international market. This is because the advanced countries process such products and much of the benefit accrues to it and its middlemen.

Finally, the origin of Nigeria's external debt crisis could be placed in the context of the workings or machinations of the advanced western economies. Fundamentally, the main problem that arose out of the above is that of external dependence and structural underdevelopment.

## 2.3 EXTERNAL DEBT MANAGEMENT STRATEGIES OPTIONS TESTED BY NIGERIA

Nigeria's external debt has undergone a lot of restructuring and rescheduling in the past few years. These will be discussed under various sub-titles below:

(a) Management of Trade Debt: As a result of the economic difficulties facing the country in the early 1980s which constrained the nations ability to pay for its imports, arrears of trade debts were accumulated. The reality of Nigeria's accumulated trade arrears did not down on her until 1982 when foreign creditors refused to open new lines of credit. It thus becomes necessary to seek for relief by refinancing the trade arrears. In 1983, refinancing agreement was entered into with our creditors in respect of letters of credit outstanding as at 13th July, 1983. The agreement had as its main features, a repayment period of 30 months (January 1984 to July 1986) with a six month grace period and interest fixed at LIBOR plus 1 per cent per annum.

With continued accumulation of trade arrears, further relief had to be sought. Thus government refinanced the remaining trade arrears especially those contracted through open accounts and bills for collection by the issuance of promissory notes. The promissory notes agreement involved a maturity period of six

years (two and half years grace period inclusive); redemption of notes in fourteen equal quarterly installments beginning from October, 1986 and payment of interest rate at the rate of 1 per cent above the arithmetic average of the lending rates quoted by some major international banks in New York, London and Paris.

The total value of promissory notes issued amounted to US$14.8 billion. However, Nigeria had difficulty in fulfilling these terms and the agreement was renegotiated. This led to the stretching of the repayment period to 22 years with an effective rate of return of 5 per cent per annum.

(b) Management of London Club Debts: Arrears of commercial bank debts which accumulated through the medium of letters of credit after the first refinancing exercise of 1983 constitute London Club debts. 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 (principal amount) and payable

debts (accumulated interest) were refinanced while US$3 billion of medium and long term component of the debt was restructured. Thus, the total exposure of banks amounted to US$5.8 billion. Under the terms of the agreement, the country was required to repay US$11.345 billion per annum. The high debt service obligation made it impossible for the country to meet its commitment and consequently defaulted. The banks, in turn, did not provide new money. This necessitated a new round of negotiations of the agreement with the Club. New agreements known as the Refinancing and Restructuring Amendment Agreement were signed on 22nd March, 1989. The agreements contained a menu of options designed to provide the country with further debt service relief. It 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 afford such a high debt service 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 in a way that will achieve an effective debt service reduction. Essentially, the proposal was for the conversion of all commercial bank's debts into a 30 year bond with a grace period of 10 years and at an interest rate of 2 per cent per annum. The banks made a counter proposal which contained a menu of options viz:

( i) Buy back.

(ii) Issuance of Par bonds with principal and interest collaterised; and

(iii) traditional rescheduling.

The agreement was successfully closed on January 21, 1992. Nigeria bought back 62 per cent of the debt and issued collaterised par bonds for the remaining 38 per cent. Thus the country was able to achieve a debt and debt service reduction through the Brady plan. The cost of closing the deal amounted to US$2 156 billion.

(c) Paris Club Debt Rescheduling: Governments to governments

(official bilateral credits and exports which were guaranteed by the various export credit agencies constitute the Paris Club debts. So far, Nigeria had signed three rescheduling agreements with Paris Club. The first was in December, 1986, while the second was in March 1989. Under these agreements, debt service payments which were due within a period of 15 months were consolidated and rescheduled under the Club's conventional traditional rescheduling terms.

These terms involved capitalisation of the interest due and the rescheduled debts are charged market related interest rates. Under the third agreement signed in January 1991, the debt was rescheduled on terms applicable to the middle income heavily indebted countries of the lower category. The terms were hardly better than those of the first two agreements.

The package which the country had obtained from the Paris Club so far had only provided very temporary relief and had not resulted in the reduction of the debt stock.

(d) Debt Conversion Programme: Another debt management strategy adopted by the country is the debt conversion programme (DCP) which was introduced in 1988. The main objectives were to reduce the external debt stock and lighten the debt service burden, encourage capital inflowsincludinginvestment and the generation of employment opportunities. This is the subject of our review in the next sub-heading.

## 2.4 DEBT CONVERSION IN NIGERIA:

While debt restructuring, refinancing and rescheduling provide only temporary relief, these instruments do not eliminate or reduce indebtedness. They only serve to postpone payments so as to enable the debtor take appropriate measures to sort himself out.

Debt conversion as a technique of debt management seeks to reduce foreign currency - dominated debt. In its simplest form, it refers to the transformation of a debtor's obligation into equity capital in the name of the creditor within the debtor country. Debt conversion is also known as debt equitisation. Turkey is listed as the first country to have pioneered the debt

conversion scheme when it offered in 1981, an opportunity to foreign investors to maximise the value of their chosen level of equity investment.[2]

Other countries like Brazil, Argentina, Mexico, Chile and the Phillipines soon followed suit especially following the announcement by Mexico in 1982, that it was unable to meet its foreign debt obligation. These countries have had the largest and most formalised programmes on debt conversion. The Central Bank of Nigeria guidelines on debt conversion programme of July 6, 1988, stated the following as the objectives of the scheme:-

( i) To reduce Nigeria's external debt position by reducing the stock of outstanding foreign currency denominated debt in order to alleviate the debt burden.

( ii) To improve economic environment to foreign investors.

(iii) To serve as an additional incentive for the repatriation of flight capital.

( iv) To stimulate employment generating investments in industry with significant dependence on local inputs.

( v) To encourage the creation and development of export oriented

industries thereby diversifying the export base of Nigerian economy.

( vi) To increase access to appropriate technology, external market and other benefits associated with foreign investment.

Debts that are eligible for conversion are CBN Dollar denominated promissory notes issued under the CBN Circular of 18th April, 1984, Promissory Notes issued by the Federal Ministry of Finance, any restructured debt under the restructuring and refinancing agreements having a maturity of over one year and the Nigerian investment bonds. The decision to make any other class of debt eligible for conversion rests with the debt conversion committee which is made up of the Governor of the Central Bank of Nigeria as chairman with the Ministers of Finance, Industries, Justice and Planning plus the Secretary to the Federal Government as members. The following classes of conversion transactions represent eligible transaction categories.

(a) Conversion to cash for the purpose of a gift/grant to Nigerian non-profit making organisations like religious bodies, educational institutions, etc.

(b) Conversion for acquisition of Naira denominated debt instrument issued by the CBN e.g. Development Stocks, and any other local debt instrument specially designed for the programme.

(c) Conversion for acquisitions, expansion or recapitalisation of existing project and or companies in Nigeria; and

(d) Conversion for investment in new projects.

Priority areas listed in the CBN guidelines are as follows:

( i) Conversion from investment in production processed based on at least 70 per cent 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 for extracting, exploiting and commercialisation of Nigeria's mineral, forestry and other natural resources.

(iii) Investment with high employment content.

( iv) Investment that will improve or use existing inventions and discoveries in Nigeria relating to new machinery, new products or

new processes or with technology components appropriate or adoptive to the Nigerian situation.

Under the scheme, the minimum amount of debts to be considered for conversion is US$250,000 in the first instance and US$25,000 in subsequent redemptions. However, there is no limit in the case of conversion for cash gifts.

Furthermore, legitimate holders or assignees of designated debts including Nigeria's foreign nationals, whether corporate bodies or individuals, resident or non-resident are eligible to participate in the programme. The foreign exchange that is required for the purchase of the debt should however originate from abroad.

It has also been recognised that investments made through the programme are recognised as investment made in foreign exchange and are accordingly granted approved status for the purpose of such matters as tax treatment and reparation of dividend and capital but subject to the following provisions.

( i) That interest income, profit/dividends, etc. connected with the approved project under the programme (DCP) shall not be repatriated for a minimum of 5 years from the date of redemption

proceeds for actual investment.

( ii) That interest and capital repatriation by redemptors of restructured debt with maturity of 18 months shall not take place before end December, 1991.

(iii) That any capital proceeds arising from subsequent disposal of investment made under the programme cannot be repatriated for a minimum of 10 years often effective date of investment of the proceeds.

( iv) Repatriation of capital including off-shore cost after 10 years shall not exceed 20 per cent per annum.

Another important provision of the scheme is the requirement for the payment of transaction commission in US Dollar and equivalent to 2.5 per cent of the discounted value of the debt actually converted which is payable to the CBN by all redemptors.

Commissions in respect of cash gifts may however be paid in the local currency (naira).

At this juncture, it is pertinent to distinguish between various types of

debt conversion schemes:

1. **Relending:**

This normally arose in a situation where the original borrower of a rescheduled foreign currency loan pays into the Central Bank the local currency equivalent but which the CBN could not pay the creditor due to shortage of foreign exchange instead, the creditor becomes a holder of a foreign currency deposits with the CBN. Such deposit could be used to extend new loans to a borrower in the same country by foreign creditor, this again denominate in foreign currency.

2. **Debt/Quasi Equity Conversion (also called Discount Loans):**

This is a situation where for instance, a subsidiary of a foreign corporation and subsequently sold to its parent company. The local subsidiary has in effect received quasi equity. Brazil has been practicing this form of debt conversion.

3. **Debt/Equity Conversion**:

Under this, the local currency proceeds of the conversion are used to pay up local currency denominated equity in local companies. The local company is expected to use the proceeds in making payment to suppliers, repayment of local currency loans and payroll, etc. Effective and careful monitoring is essential here so as to prevent "round tripping" which is a situation where the proceeds is used to purchase foreign currency or used for imports.

This system is what most countries (including Nigeria) are using as debt management strategy to reduce their debt stock.

4. **Debt/Peso Conversion:**

In this case, the Central Bank issues, in exchange for the foreign currency denominated debt claim, a local currency bond or note which is allowed to be used for settlement of local currency debt owed it.

5. **Debt for Restricted Use Local Currency:**

Here the Central Bank pays the local currency proceeds of conversion directly into a local currency account on condition that only certain types of payments may be made from it.

6. **Debt for Exports:**

This represents a situation where a debtor nation allows the payment of its exports to be paid (normally in part) with the country's foreign currency debt.

7. **Debt for Other Services:**

In some instances, debtor countries have agreed to certain specific services in return for cancellation of an amount of foreign currency debt. Examples may include programmes on nature and environment protection, wild life protection, etc.

## 2.5 The Advantages and Drawbacks of Debt Conversion Schemes

All the participants under the debt conversion programme have to take into consideration costs and benefits of the transaction before embarking on it. The investor should analyse the complex relationships among the various

creditors of the debtor country, the prospects of the debtor country generating budgetary and balance of payment surpluses to meet its debt servicing obligations, the investment code of the debtor country, the effects of debt conversion on the secondary market price of the remaining debts and other economic, accounting and regulatory variables.

On the other hand, the debtor country must keep in perspective the impact of debt conversion on its social, economic and political realities, while the creditor must weigh the effect of conversion on its after-tax profits position, its balance sheet and finally the market price of its shares if the creditor is a bank or a corporate entity.

**The Benefits**

One of the most obvious benefits of the debt conversion programme is that a nations stock of external debt as well as debt service payments are reduced. Debt conversion may also enhance the repayment capacity of debtor nations by shifting the composition of their external liabilities away from debt, towards equity, while a country is relieved of their obligation to pay off the converted debt in foreign exchange. It also enjoys part of the discount arising

from the original transaction of the debt purchased. Another advantage is that the domestic environment becomes developed conciously for the acceptance of foreign investment. This could be in the form of provision of infrastructure necessary for industrial development. Foreign investment will thus increase access to outside technology and external market.

Other benefits that have been attributed to the scheme include the enhancement of local privatisation programmes as has been noticed in Nigeria recently and developement and stimulation of local capital market. Also, the contention that the creditor, having become an equity partner, will show more commitment to the recovery of the economy.

**DISADVANTAGES**

The advantages notwithstanding, a debt conversion scheme if not properly conceived and managed could have adverse consequences on the economy of the debtor country. These consequences include:

- An advance impact on the balance of payments position of the country. This arises when nationals of the debtor country source foreign exchange from the local foreign exchange market to purchase the debt instrument.

If this happens, the country would not only be making premature payments indirectly on debts that have been rescheduled for payment on a latter date, but at the same time undue pressure is being put on scarce foreign exchange.

Possible monetary emission if the Central Bank provides local currency in exchange for the redeemed debts. Money supply level will increase substantially in the local economy unless off-setting sterilization measures are

put in place. Also, large conversion of debts relative to the domestic money supply will fuel domestic inflationary pressures.

Possible increase of round tripping which involves the conversion of part of or all of the redemption proceeds back into foreign exchange in the local foreign exchange market for exportation either immediately or at a latter date.

Danger of non-additionality of resources/investment in the sense that investment through 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.

Possibility of changing the structure of business ownership with probable loss of control over the economy to foreigners. This issue is particularly important because of national sensitivity in increasing foreign control of the economy and may become a critical constraint on the value of debt conversion.

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# CHAPTER THREE

## APPRAISAL OF THE DEBT CONVERSION PROGRAMME IN NIGERIA (UP TO DECEMBER, 1995)

### Introduction:

There is no doubt that the debt conversion programme as a strategy of external debt management has achieved some measures of success since its inception in 1988. The performance of the programme would be evaluated in relation to its set objectives which are to reduce the Nation's external debt stock and lighten the debt service burden, appropriate part of the secondary market discount for the benefit of the national economy, attract investment into the country and contribute to the industrial development of the country.

### 3.1 DEBT REDUCTION:

As at the end of December, 1995, a total number of 390 applications valued at US$6.04 billion were received, out of which 285 applications with a value of US$2.795 were granted approval. In principle, sixty-one (61) applications amounting to US$2.73 billion were rejected while the remaining forty-four (44) applications were being processed.

Since inception, a total of 59 auction sessions had been held out of which the discounted naira equivalent of N16.07 billion were offered for redemption. Out of this amount debt worth N12.55 or US$726.63 million were redeemed. In addition to conversion at the auction, another US$222.5 million or N3.74 billion worth of debts were converted outside the auction system. Thus, this brings the total debts cancelled through the programme to US$949.46 million as at end of December, 1995.

Table 1 shows details of auctions held between 1988-1995 while Table 2 shows summary of debt conversion as at end of December, 1995 with the total value of debt converted.

# TABLE 1

## DETAILS OF AUCTIONS HELD: 1988-1995

| | 1988-1991 | 1992 | 1993 | 1994 | 1995 | TOTAL |
|---|---|---|---|---|---|---|
| No. of Auction | 36 | 11 | 7 | 5 | 10 | 59 |
| Amount Offered (N Million). | 3312.59 | 2,120.00 | 1,400.00 | 540.00 | 8700.00 | 16072.59 |
| Highest Discount (Average %) | 194.5 | 49.76 | 52.67 | 30.70 | 50.60 | - |
| Lowest Discount (Average %) | 82.31 | 18.18 | 27.41 | 20.00 | 7.00 | - |
| Marginal Discount (Average %) | 163.69 | 46.46 | 41.10 | 28.81 | 41.00 | - |

**SOURCE: Debt Conversion Committee Secretariat, CBN, Abuja.**

# TABLE 2

## SUMMARY OF DEBT CONVERSION UP TO DECEMBER, 1995 (1988-1995)

| WITHIN AUCTIONS | | | | | | |
|---|---|---|---|---|---|---|
| | 1988-1991 | 1992 | 1993 | 1994 | 1995 | SUB-TOTAL |
| 1. **Amount Redeemed** | | | | | | |
| (a) US$ Million | 513.24 | 107.84 | 24.12 | 7.78 | 73.65 | 726.63 |
| (b) =N= Million | 3889.02 | 2003.92 | 572.32 | 169.39 | 5918.75 | 12553.37 |
| 2. **Discount Offered** | | | | | | |
| (a) US$ Million | 236.79 | 52.27 | 12.60 | 2.32 | 33.51 | 337.49 |
| (b) =N= Million | 1756.85 | 971.30 | 299.15 | 50.57 | 2693.03 | 5770.90 |
| (c) Av. Disc. (%) | 129.87 | 48.47 | 52.23 | 29.89 | 45.50 | - |
| 3. **Proceeds** | | | | | | |
| (a) US$ Million | 276.45 | 55.57 | 11.52 | 5.46 | 40.14 | 389.14 |
| (b) =N= Million | 2132.17 | 1032.62 | 273.17 | 118.79 | 3225.72 | 6782.47 |
| 4. **Commission Paid** | | | | | | |
| (a) US$ Million | 6.95 | 1.10 | 0.25 | 0.01 | 1.21 | 9.52 |
| (b) =N= Million | 4.65 | 1.90 | 1.36 | 2.30 | 14.27 | 24.46 |

| OUTSIDE AUCTIONS | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 1988-1991 | 1992 | 1993 | 1994 | 1995 | SUB-TOTAL | GRAND TOTAL |
| 1. **Amount Redeemed** | | | | | | | |
| (a)US$ Million | 160.39 | 25.11 | 10.50 | 5.57 | 21.26 | 222.83 | 949.45 |
| (b)=N= Million | 1233.56 | 466.60 | 213.07 | 121.17 | 1708.54 | 3742.94 | 16296.31 |
| 2.**Discount Offered** | | | | | | | |
| (a)US$ Million | 80.4 | 11.93 | 4.42 | 1.66 | 9.87 | 108.28 | 445.77 |
| (b)=N= Million | 625.4 | 221.68 | 89.00 | 35.84 | 792.76 | 1784.89 | 7555.59 |
| (c)Average Disc.(%) | 151.61 | 47.50 | 42.09 | 29.43 | 46.40 | - | - |
| 3.**Proceeds** | | | | | | | |
| (a)US$ Million | 79.99 | 13.18 | 6.08 | 3.91 | 11.39 | 114.55 | 503.69 |
| (b)=N= Million | 577.45 | 244.92 | 124.07 | 85.33 | 915.78 | 1978.25 | 8760.72 |
| 4.**Commission Paid** | | | | | | | |
| (a)US$ Million | 1.32 | 0.37 | 0.07 | - | 0.34 | 2.10 | 11.62 |
| (b)=N= Million | 1.32 | 0.19 | 0.07 | 217 | 5.72 | 9.47 | 33.93 |

**SOURCE: Debt Conversion Committee Secretariat, CBN, Abuja.**

On the classification of debts cancelled under the programme, US$670.54 million accounting for 70.57% of the total debts cancelled was promissory notes. While US$237.25 million or 24.99% worth of London Club debts and US$42.17 million or 4.44 per cent were cancelled. See Table 3 for details.

**TABLE 3**

**CATEGORY OF DEBTS CANCELLED AS AT DECEMBER, 1995**

| | 1988-1991 | 1992 | 1993 | 1994 | 1995 | TOTAL | (%) |
|---|---|---|---|---|---|---|---|
| Promis-sory Note | 401.7 | 132.95 | 29.62 | 13.35 | 92.16 | **670.04** | 70.57 |
| Restruc-tured Debts | 165.36 | - | - | - | - | 165.36 | 17.42 |
| Refinanced Debts | 64.14 | - | - | - | - | 64.14 | 6.75 |
| Others | 42.17 | - | - | - | - | 42.17 | 4.44 |
| Par Bonds | - | - | 5.00 | - | 2.75 | 7.75 | 0.82 |
| TOTAL | 673.37 | 132.95 | 34.62 | 13.35 | 94.91 | 949.46 | 100 |

**SOURCE: Debt Conversion Committee Secretariat, CBN, Abuja.**

During the period under review, that is between 1989 and 1995, the programme had been able to reduce the debt stock by US$949.46 million on the aggregate, or 2.9% of the total external debt stock. The effect of the reduction

is more significant on the categories of the debt affected. For instance, Promissory Notes which stood at US$4.58 billion as at the end of December, 1989, has been reduced to US$3.15 billion while conversion accounted for US$670.04 million or about 50% of the reduction, the rest was due to principal repayment, while buy-back reduce the stock of London Club debt from US$5.8 billion to US$2.1 billion, debt

conversion further reduces it by US$236.75 million. No conversion was effected on the Paris Club and Multilateral debts.

### 3.1.2 **Effects on Debt Service Obligation**

Table 4 below shows official status from the debt conversion Commission Secretariat, Central Bank of Nigeria, Abuja of calculation of savings on interest payments on debts cancelled from November, 1988 to December, 1995. Once a debt is extinguished through Debt Conversion, the interest element on such debts are automatically eliminated. On the converted Promissory Notes of US$670.04 million as at December, 1995, total savings on interest obligation was US$599.39 million.

## TABLE 4

## CALCULATION OF SAVINGS ON INTEREST PAYMENTS ON DEBTS CANCELLED FROM NOVEMBER, 1988 - DECEMBER, 1995.

| YEARS | AMOUNT CONVERTED ($) | AMOUNT SAVED ($) |
|---|---|---|
| 1988-1991 | 401,959,483.9 | 372,151,278.4 |
| 1992 | 132,944,825.83 | 122,508,358.20 |
| 1993 | 29,619,411.19 | 21,930,837.03 |
| 1994 | 13,352,833.94 | 10,883,537.52 |
| 1995 | 92,163,445.18 | 71,911,520.24 |
| TOTAL | 670,040,000.00 | 599,385,531.44 |

SOURCE: Debt Conversion Committee Secretariat, C.B.N., Abuja.

### 3.1.3 Gain on Secondary Market Discount

The Debt Conversion Programme was established as an avenue to appropriate part of the secondary market discount to the national economy. The value or percentage of discounts being appropriated depend largely on the prevailing secondary market discount at the time of conversion. In fulfillment of this objective, debts are converted at a discount. Thus, of the total debts of

US$949.46 million cancelled at as December, 1995, a total discount of US$426.69 million was received. This implies that debts are redeemed on the average at a discount of 43.38% while redemptors receive value for only 56.62% of the face value of the debt cancelled on Naira.

### 3.1.4 **Inflow of Foreign Investment**

Unlike the traditional approaches to debt management which may not invariably involve the inflow of new money into the domestic economy, the Debt Conversion Programme generally involves the inflow of new money for investment in the domestic economy.

Under the Nigerian programme, there were two distinct capital flow, this comprises of Nigerians repatriating capital back into the country for investment purposes and foreign investors importing capital into the country. Total inflow of foreign money for investment purpose through the programme stood at US$395.81 million (N6,656.95 million) as at end of December, 1995. Out of this amount investment by Nigerians accounted for 36.68% or US$145.19 million (N2,618.95 million) while foreign investors accounted for the balance of 63.32% or US$250.62 million (N4,038.01 million). See Table 5 below.

**TABLE 5**

**ANALYSIS OF DIRECT FOREIGN CAPITAL INFLOW THROUGH D.C.P. AS AT END OF DECEMBER, 1995**

| | ($) Million | ($) Million | =N= Million | =N= Million | ($) Million | ($) Million | =N= Million | =N= Million |
|---|---|---|---|---|---|---|---|---|
| Discount Amt Redeemed | - | 20.88 | - | - | - | 505.75 | - | - |
| Proceeds of Conversion | - | - | - | 1701.7 | - | - | - | 8586.5 |
| Less: Conversion by Nigerians | 6.96 | - | 558.94 | - | 145.19 | - | 2618.9 | - |
| Les: Conversion for cash gift/grant | 2.85 | - | 229.81 | - | 75.69 | - | 1427.6 | - |
| Less: Conversion for Debt for Debt. | 1.85 | - | 150.21 | - | 10.72 | - | 283.36 | |
| Less: Conversion for contractor's finance. | - | - | - | - | 23.53 | - | 281.51 | - |
| | | 11.66 | | 938.96 | | 255.11 | | 4548.46 |
| Inflow of Direct Foreign Investment | | $9.22M | | N762.74M | | $250.62 | | N4038.01 |

SOURCE: D.C.C. Secretariat, C. B. N., Abuja.

### 3.1.5 Contributions towards industrial development

The total sum of N69,656.95 million was imported into the country by investors through the programme, which was invested in the equity, debenture and loan stock of 127 companies. Thirty-four (34) or 26.77% of the total companies financed under the programme were completely now projects while

the remaining ninety-three (93) companies were existing companies which were either expanded or recapitalised. Injection of fresh capital into the already existing beneficiary companies led to improved production capacities as proceeds of conversion augment their working capital requirements. For new projects, a sizeable number of employment have been created while the export revenue of export oriented projects have been widened. Some measures of technology transfer has also taken place. In the area of privatisation at the state levels, some foreign investors had taken up various percentages of equities in four partially privatised companies. See Table 6 below.

**TABLE 6**

**CLASSIFICATION OF PROJECTS FINANCED THROUGH D.C.P.**

| | 1988-1991 | 1992 | 1993 | 1994 | 1995 | TOTAL |
|---|---|---|---|---|---|---|
| (a) No. of Projects | | | | | | |
| New | 20 | 10 | 3 | - | 1 | 34 |
| Existing | 68 | 9 | 6 | 2 | 8 | 93 |
| (b) Non-profit Organisations | 9 | 1 | - | 2 | 1 | 13 |
| (c) Debt for Debt | 1 | - | - | - | 1 | 2 |
| TOTAL | 98 | 20 | 9 | 4 | 11 | 142 |

SOURCE: D.C.C. Secretariat, C.B.N., Abuja.

A total of 142 projects financed under the programme were spread in

twenty states (20) of the Federation and the Federal Capital Territory. Lagos State has the lion share of 67 projects or 47.2 per cent. On sectoral basis, investment were geared more into the manufacturing sector which accounted for N3,646.27 million or 44.8 per cent of the total projects financed through the programme. Mining and construction accounted for N854.66 million or 10.5 per cent while Agriculture and hotel and Tourism has N614.2 and N516.76 million (7.61 and 6.31 per cent) respectively. Table 7 below explains further.

**TABLE 7**

**SECTORAL DISTRIBUTION OF DISBURSEMENT OF DEBT CONVERSION PROCEEDS (=N= MILLION)**

| SECTOR | 1988-1991 | 1992 | 1993 | 1994 | 1995 | TOTAL (1988-1991) |
|---|---|---|---|---|---|---|
| Agriculture | 347.91 | 115.23 | 4.41 | 1.6 | 145.05 | 614.2 |
| Manufacturing | 890.23 | 617.5 | 52.7 | 0.63 | 2085.21 | 3646.27 |
| Hotel & Tourism | 393.36 | 119.96 | 3.4 | - | 0.04 | 516.76 |
| Cash Gift & Grants | 413.18 | 88.99 | 121.3 | 196.64 | 564.69 | 1384.8 |
| Mining & Construction | 219.03 | 321.27 | 31.33 | 4.6 | 278.43 | 854.66 |
| Services | 89.24 | - | - | - | - | 89.24 |
| Financial | 1.23 | 5.5 | 266.56 | 75.7 | 490.12 | 839.11 |
| Others | 193.9 | - | - | - | - | 193.9 |
| TOTAL | 2548.1 | 1268.45 | 479.7 | 279.17 | 3563.54 | 8138.5 |

SOURCE: Debt Conversion Committe Secretariat, CBN, Abuja.

# TABLE 8

## SECTORAL BREAKDOWN OF APPLICATIONS RECEIVED (1988-1995)

| SECTOR | 1988-1991 | 1992 | 1993 | 1994 | 1995 | TOTAL 1988-1995 |
|---|---|---|---|---|---|---|
| **NUMBER** | | | | | | |
| Agriculture | 55 | 9 | 1 | - | 19 | 84 |
| Manufacturing | 118 | 15 | 5 | - | 45 | 183 |
| Mining & Exploration | 4 | - | 1 | - | 3 | 8 |
| Build. & Construction | 9 | 3 | 1 | - | 13 | 26 |
| Hotel & Tourism | 7 | - | - | - | 3 | 10 |
| Gift and Grant | 20 | 2 | 3 | 4 | 6 | 35 |
| Financial | 3 | 2 | - | - | 1 | 6 |
| Services | 4 | 3 | - | - | 14 | 27 |
| Debt for Debt | 5 | - | 1 | - | 4 | 10 |
| Others | 6 | - | - | - | - | 6 |
| TOTAL | 232 | 34 | 12 | 4 | 108 | 390 |
| **VALUE ($ MILLION)** | | | | | | |
| Agriculture | 560.57 | 62.99 | 10.00 | 0.30 | 134.35 | 768.21 |
| Manufacturing | 1363.46 | 142.90 | 22.51 | - | 403.41 | 1,932.28 |
| Mining & Exploration | 98.62 | - | 1000.00 | - | 30.00 | 1,128.62 |
| Building & Construction | 112.84 | 133.35 | 1.02 | - | 88.23 | 335.44 |
| Hotel & Tourism | 329.63 | - | - | - | 93.00 | 422.63 |
| Gift & Grants | 245.35 | 82.26 | 27.12 | 186.48 | 9.76 | 550.97 |
| Financial | 115 | 36.46 | - | - | 5.00 | 156.46 |
| Services | 46.51 | 7.20 | - | 9.00 | 111.55 | 174.26 |
| Debt for Debt | 273.17 | - | 50.00 | - | 46.00 | 369.70 |
| Others | 204.26 | - | - | - | | 204.26 |
| TOTAL | 3349.94 | 465.16 | 1110.65 | 195.78 | 921.30 | 6042.83 |

SOURCE: Debt Conversion Committee Secretariat, CBN, Abuja.

### 3.1.6 Inflow of Foreign Grants

A total sum of US$75.69 million or N1,427.64 million was imported into the country by 10 non-profit organisations through the programme. These funds have met the current and capital expenditure of the local affiliates of the donors and were geared towards eradication of leprosy, River blindness diseases, illiteracy and health care programmes, among others in the country.

### 3.1.7 Effects on the Balance of Payment Account

As at the end of December, 1995, a total sum of US$11.62 million has accrued to the services and income account of the nation, being transaction commission received on the redeemed debts. During the same period, total surplus that accrued from the inflow of foreign grants and discounts offered by redemptions under the programme amounted to US$502.38 million.

## 3.2 COMPARATIVE ANALYSIS OF SIMILAR PROGRAMMES IN ARGENTINA, MEXICO AND CHILE

### 3.2.1 Argentina

Argentina started the conversion programme in 1984, under Circular A-532 of the Central Bank, but was terminated in 1985. Argentina Central Bank communication A-1169 of October 27, 1987 however, set out the new

conditions that will govern the debt conversion programme.

The programme allows foreigners to acquire majority of Argentine companies and invest in sectors not open to foreigners. In other countries, Argentine nationals ere also allowed to participate by converting debt into equity investment.

During the first two (2) auctions, about US$200 million worth of country's total external debt over US$100 billion, represent an unsatisfactory performance of the programme. Amongst the reason for this development as sighted by Herman Caffarone in a paper titled: "Perspective of the Debt Conversions Programme in Latin America", include:

(a) A restriction of four (4) years for capital repartriation;

(b) A lengthy approval process which generate alot of paper work and is time consuming.

(c) That profit generated by price differential between the external debt market value of 22% and price paid by the Central Bank 45% is tax deductibles. The lesson here is that the restrictions serve as disincentive to prospective investors.

### 3.2.2. **Mexico**

The main aim of the conversion programme in Mexico was to stimulate investments in priority areas like Hotels and other tourism industries. The programme utilises a system of varying discounts which range from 5% for export-oriented business and technology transfer to 14% debt reduction to 25% for investment not specifically covered.

The years after the start of the programme in 1985, a total of US$2.5 million or 2.38% of the total country's external debt was successfully converted. Caffarane (1988) asserted that the Mexican programme contributed positively to the improvement of the economy as evidenced by the utilisation of industrial idle capacity, generation of employment and promotion of exports. These achievements, it was hoped, will contribute to the growth of Mexican economy.

### 3.2.3 **Chile**

Chile's debt conversion programme, which started in 1985, is today listed as one of the most successful programme. The compodium of foreign exchange rules, which is a document issued by the Central Bank of Chile; provides amongst others, that a foreign entity may submit an application to the Central

Bank to convert certain types of eligible Chilean foreign debt into registered equity in an approved investment at a negotiated discount on the fact value of the debt.

Broadly speaking, except for the much flexibility in pricing for major projects which the Chilean Central Bank exercises in the operation of the programme, much of the rules and regulations governing the scheme are similar to that of Nigeria.

By 1988 the programme has achieved a debt reduction of US$4.05 billion, representing more than 18% of the country's external debt of US$21 billion. On the whole, the low level of activity of the Nigerian debt conversion programme, like those in Mexico and Argentina, could be attributed to the following:

(a) Delay in the process and release of the conversion to the beneficiary.

(b) Perceived political instability by external investors.

(c) Continued depreciation of the Naira against other currencies, and

(d) Lack of inclusion of oil and gas related industries in the scheme. On the other hand, the flexibility in pricing of major projects and the general

liberal terms of investment allowed by the Chilean government contributed to the much talked about success of the programme in that country. Despite marginal performance of the programmes as at the period under review, it is obvious that if the shortcomings enumerated are taken care of, the potential for external debt reduction under the scheme is enormous as was witnessed in the case of Chile.

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# CHAPTER FOUR

## SUMMARY, CONCLUSION AND RECOMMENDATION

### 4.1 Problems

The volume of conversion done in its past years has been limited by various factors. In fact, with the exception of 1989, the volume of conversions done each year were below the volume of conversion allowed within the monetary and credit policies. In other words, more conversions could have been done but for the following contraints:

4.1.1 The disparity between the official exchange rate at which conversion was done and the parallel market rate made capital importation through the programme unattractive in the last two years.

4.1.2 There are also difficulties associated with sourcing for eligible debts. Of the four categories of debts that are eligible for conversion, only two are available in the secondary market. These are CBN Promissory Notes and the Par Bonds. The later category is more expensive and the procedure for acquiring it is more cumbersome. Thus far, no Ministry of Finance Promissory Notes and Paris Club debts have been converted largely because no secondary

market exists for these and partly because the modalities for their conversion are yet to be put in place.

4.1.3 The remittance restrictions placed on repatriation of capital and dividents under the programme proved to be too restrictive, thus, discouraging investors from using the programme to import capital into the country

## 4.2 **Prospects**

The prospects for Nigeria to reduce its debt stock substantially while at the same time getting some kind of relief by way of discounts through the debt conversion programme is very bright. Many debtor countries have benefitted immensely from the debt conversion programme. Chile was able to reduce its debt by over US$8 billion through the debt conversion scheme, while 60 per cent of direct foreign investment between 1986 and 1987 in Mexico resulted from the implimentation of a debt conversion programme. The Nigerian programme has potentials for better performance considering the number and value of applications received as well as the unutilised approvals.

With well articulated initiatives and the prevalence of a conducive

investment environment, the programme could during the next two years reduce the country's debts by between US$750 million and US$1 billion.

## 4.3 Summary, Conclusion and Recommendation

This study has been concerned with analysing the factors responsible for the current state of Nigeria's external debt crisis, the measures undertaken and those currently being implemented in tackling the debt issue.

The programme did revealed the involvement of the advanced Western countries especially, with regards to manipulation of prices of primary products, in their efforts to continually subjugate the economies of developing nations. Other factors identified included unprioritised policies of past governments in the country as well as the acquired high taste of Nigerians for imported luxury items (including food stuff). 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 and effective management tool for debt reduction. It is also a welcome departure from Nigeria's overall debt management policy as it has amongst others, instilled more confidence on the nation's external creditors. However, government needs to take certain measures

if the objectives of the programme are to be fully achieved.

4.3.1. The continued downward slide of the exchange rate of the Naira should be seriously examined with a view to arriving at a more realistic rate. If it remains unchecked, the net effect will bethe redemption of small amount of foreign debt by investors, because the scheme will not guarantee the remittance of enough dividend in foreign currency to justify the investment.

4.3.2 The debt conversion committee (DCC) should reduce delays in releasing proceeds of the conversion to beneficiary companies. This could be done by ensuring that release of proceeds are processed not more than 4 days after receipt of the requests. Failure to do this, has the potential of redering the programme unprofitable to investors as the margin accrued to them from the conversion may likely be lost.

In conclusion, the success of the debt conversion programme should not be seen only in the context of its impact on the economy but from its unique achievement vis-a-vis other debt management tools. It should be noted that the programme is the only debt management strategy adopted that has reduced the debt stock without the use of the country's scarce foreign exchange. Also, it is

the only debt management innitiative that has so far led to unconditional inflow of new capital especially in a situation where new money inflow has virtually dried up; this in addition to its immediate and demonstrable salutary impact on the economy.

Further, it should be noted that debt conversion programme alone cannot solve the nation's external debt problem. It can only complement other debt management strategies such as debt rescheduling and debt forgiveness. Moreso, the debt conversion programme can only thrive in a stable and conclusive environment for foreign investment while the repeal of exchange control act of 1962 and abolition of the Nigerian enterprises promotion decree are wellcome developments towards encouraging foreign capital inflows, economic policies, especially with regards to the exchange rate and interest rate would need to continue to be right, seen and perceived by foreign investors as realistic, consistent and sustainable overtime to make planning meaningful. We need, in addition to a conclusive political environment, to develop and maintain a legal financial environment which is supportive of, and conclusive to investment.

# APPENDIX I

## CONVERSION PROCEDURE

### Auction

The method of debt conversion shall be by auction. On very rare occasions however, the DCC can, at its discretion, approve an application for conversion on its own merit and at a price determined by the weighted average of discounts offered by successful bidders at the most recent auction.

### Eligible Bidders

All applicants who have received approval in principle or theri agents are eligible to participate in auction(s) to bid for the amount offered by the Debt Conversion Committee. The auction(s) shall be conducted as often as deemed necessary by the DCC. However, if an applicant fails to put in his bid after two auctions after receiving approval in principle, the approval will be deemed to have lapsed. An applicant who has received an approval in principle is not obliged to submit bid to convert the whole amount in a single auction.

A prospective redemptor who has received an approval in principle and

wishes to participate in any of the auction(s) should have acquired/identified the Promissory Note(s) debt instrument(s) to be redeemed prior to the date of the auction(s).

**Bid Schedule**

Bid forms will be provided by the DCC Secretariat at the CBN, Lagos. The redemptor or his agent(s) shall submit only one bid for each application at an auction. Bid will be received up till 11.00 a.m. and the auction will take place at 12.00 noon on the day designated by the DCC. The auction date, amount to be offered for redemption, and relevant conditions will be announced ten banking days before the date of the award. Bid process will be handled by the DCC Secretariat.

**Bidding**

Bids will be delivered to the DCC Secretariat at the CBN and such bids will specify the discount offered as percentage of the face value of the debt to be redeemed, value of debt to be converted by the prospective redemptor and the particulars of the Promissory Notes/debt instruments to be redeemed.

The DCC Secretariat reserves the right to reject any irregular bid while

failure to supply the particulars of the Promissory Notes/debt instrument(s) will lead to instant disqualification at the auction.

**Award**

Bids will be ranked in decreasing order of discounts offered. The right to redeem will be awarded by discount rank until the amount offered for redemption is exhausted. If two or more bids offer for the same discount and the balance of the amount offered for conversion is insufficient to cover both, that balance will be 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 agents will be informed of bid award by telephone or telex within 2 working days of the close of the aution.

**Exchange Rate**

The applicable exchange rate shall be the effective IFEM rate at the time of the auction and this shall be applied to the successful redemptor's bid price in the calculation of the naira proceeds.

**Payment of Transaction Commission**

Within 10 banking days of date of notification the conversion commission due from successful bidders must be paid to the US Dollar Account of the CBN with the Morgan Guaranty Trus Co. of New York or any foreign bank as may from time to time be designated by the CBN.

**Cancellation of Redeemed Debt Instrument(s)**

After the auction, the DCC will advice Chase Manhattan Bank, N A, or the Accountant-General of the Federation, at the Federal Ministry of Finance and Economic Development to cancedl the debt instruments of successful bidders and surrender them to the DCC. Where the amount of debt to be converted is less than the face value of the debt instrument(s) submitted for cancellation, the concerned agent shall issue a fresh debt instrument in the amount of the unredeemed balance to the redemptor.

**Delivery of Debt Instrument for Cancellation**

The redemptor(s) or agent(s) holding Promissory Notes, issued under the CBN Circular of 18th April, 1984, will deliver them to Chase Manhattan, N.A., New York for cancellation. Those holding Promissory Notes issued by the Federal Ministry of Finance and Economic Development shall deliver them to the Accountant-General of the Federation at the Federal Ministry of Finance and Economic Development, Lagos. If a redemptor fails to deliver the debt instrument(s) within fifteen working days of the auction in which his bid is successful, he shall not participate in subsequent auctions without the approval of the Debt Conversion Committee. Such redemptor shall therefore write to convince the Debt Conversion Committee why he could not take up the award.

**Provision of Redemption Proceeds**

Upon the confirmation of receipt of debt instrument(s) by the appropriate agent to the DCC, the CBN will provide the naira proceeds directly to a designated blocked account at the CBN. The redemptor or his agent and the beneficiary will be promptly informed.

**Blocked Account and Released of Funds**

Naira proceeds of converted Promissory Note(s) debt instrument(s) will be kept in a blocked account at the CBN and released in tranches on application to the beneficiary's bank account according to the cash needs of the approved project(s) as approved by the DCC. However, naira proceeds of conversion to cash for gift to trusts and foundations may be invested in long-dated government debt instruments.

**Issues of Shares, Debenture, Loan Stock and Other Certificate(s) to the Redemptor**

The Registrar of the company in which the redemption proceeds is invested shall on receipt of the first tranche of the naira proceeds of conversion, issue share/debt certificate to the redemptor in accordance with the price placed on the company's securities by the Securities and Exchange Commission of Nigeria. Such share/debt instrument certificate(s) should pass through the Debt Conversion Committee Secretariat to the depository bank of the redemptor.

APPENDIX II

**APPROVED STATUS**

Pursuant to the provision of sub-section 14(2) of the (S)FEM Decree, the Central Bank of Nigeria shall issue a Certificate of Capital Importation in the usual way, and upon which the Industrial Development Coordinating Committee will in turn issue Approved Status Certificate.

In a similar manner, separate certificate of capital importation shall be 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 project.

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