TOWARDS THE REDUCTION OF NIGERIA'S DEBT BURDEN - THE ROLE OF DEBT CONVERSION SCHEME

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A PROJECT SUBMITTED TO THE POSTGRADUATE SCHOOL AHMADU BELLO UNIVERSITY, ZARIA, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTERS CF BUSINESS ADMINISTRATION - (MBA)

DEPARTMENT OF BUSINESS ADMINISTRATION

INSTITUTE OF ADMINISTRATION

AHMADU BELLO UNIVERSITY

ZARIA

NOVEMBER, 1988

C E R T I F I C A T I O N

This project entitle TOWARDS THE REDUCTION OF NIGERIAS DEBT BURDEN - THE ROLE OF DEBT CONVERSION SCHEME, by GAZI, Nanle Ruth has been read and approved as having met the requirements of the Department of Business Administration, Ahmadu Bello University, Zaria for the Award of the degree of Masters of Business Administration (MBA) and is therefore approved for its contribution to knowledge and literary presentation.

SUPERVISOR DATE

EXTERNAL EXAMINER DATE

HEAD OF DEPARTMENT DATE 9/5/90

DEAN OF POST GRADUATE SCHOOL DATE 5/6/90

D E C L A R A T I O N

I hereby declare that the work done in this MBA project is wholly my effort. No any other project of this nature or similar work has been done before in anywhere for any other degree before this research was conducted. All materials used from other sources have been duely referenced.

Ruth Nanle Gazi

November 1988

D E D I C A T I O N

To my beloved parents. (RTD) MAJOR & MRS.
NICHOLAS GAZI

A C K N O W L E D G E M E N T

Praise be to God for his bounty in providing me with the determination and health to see this MBA programme to its completion.

In preparing this work, I received assistance from many people too numerous to be mentioned individually.

I am particularly grateful to my Supervisor Mr Alex Amedu who offered a lot of guidelines and suggestions in designing and writing up this project.

I am also grateful to Mallam Halidu I. Abubakar of the Department of Local Government Studies for providing me with the bulk of the meterials for this work.

A B S T R A C T

The world economic trend of rising prices of consumer goods, falling commodity prices and increasing debt especially as it affects developing countries, has attracted considerable attention and action from experts in various fields.

Many measures have been adopted to ensure stability in world finance. These measures have worsened the financial position of many countries like Nigeria.

The current debt crisis faced by Nigeria emanates from our disregard for information when made available, aversion to making projections of whatever data is at our disposal and an uncanny desire for an event to occur before solutions are sought.

The debt conversion programme has been embarked upon by many nations with nothing as regards success to show for it, Though Nigeria's debt is small when compared to some Latin American countries. It has been found that the extent to which debt conversion has reduced the nation's external debt has not been appreciable enough to make it a worthwhile venture.

I am therefore submitting here that the debts should be cancelled on the basis of the aurgument made above. As such, all avenue for arriving at such an option, should be sought by the government.

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Chapter One

1.0 INTRODUCTION

The Nigerian Economy is going through a difficult phase in her development is an understatement. That nation is heavily indebted when compared with what obtained a few year's back.

A host of measures have been taken to revitalize the economy, some have had some element of success though short-lived, while others have failed outright (recall for instance, the 1982 Economic Stabilization Measures) and even plunged the economy into deeper crisis.

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The major focus of this project is on Debt - Conversion as a strategy to reduce our external debt burden, and authenticate debts owed to willing foreign creditors.

Adequate guidelines have been worked out to ensure that the Naira proceeds of the exercise are channeled into productive ventures in the country and ensure that this laudable objective does not run counter to the Structural Adjustment Programme (SAP)

With the guidelines published, the implementation took off in 1988 fiscal year. The scheme is interrelated and interconnected with other policies of government such as the privatization of entreprises in which government has shares.

Other countries have adopted the scheme, each with its own objectives of which reduction in external debt is paramount. In this project, an attempt is made to analyse the extent to which the scheme will succeed in reducing the nation's external debt burden.

1.1 Problems

Debt conversion (Debt-Equity-Swap) is an option for reducing or totally eliminating debts. Viewed by many as new economic concept, not much has been written about it.

Therefore there is the problem of lack of analytical information as regards the actual workings of this option and all that it entails. This project seeks to provide such information.

1.2 Justification of Study

Many countries have adopted the debt conversion programme under various names. Some have abandoned their's for reason of failure, others have attained minimimal success (see Table 1.1) while others are contemplating the adoption of the scheme with variations in modalities. Nigeria is one of such countries that have adopted the programme. It is one thing for government to be seen as taking measures to revitalize

the economy (there is no disputing the fact that the economy needs the injection of external capital, based on the economic system in operation) and another for such measures to succeed.

The justification of study is to investigate the capability of the debt conversion programme in easing Nigeria's external debt burden. The study is aimed at assessing the extent to which the programme has so far gone in reducing Nigeria's debt.

1.3 Limitations of Study

This project has been limited by the non - availability of data on which concensus have been reached, especially as pertains to the magnitude of Nigeria's external debt.

1.4 Literature Review

The increasing awareness of the debt problems facing many developing countries since 1982 has led to concerted efforts on the part of both creditor and debtor nations to design measures to alleviate it. More importantly, it has become increasingly recognised that the best solution to the debt problem lies in the revival of economic growth and recovery in normal market access.

Table 1.1

Country	Inception	Redemption Price	Eligible Debt	Volume done as % Table of Total debt	Coversion Exchange Rate
Brazil	1982	100%	All public/ private Maturities	2.7%	official
Chile	May, 1985	90-100%	All restric-ted public/ private	10%	"
Mexico	April, 1986	75-100%	Restructured and public debt	1.8%	Free
Turkey	1976	95-100%	Trade arrears foreign bank loans	6.1%	Free
Phillipines	Aug., 1986	76-100%	Most public private sector debts	1.0%	Free

Source: Business Times, April 25th 1988

The prominence given to the debt crisis came as a result of Mexico's announcement (in August 1982) of a moratoria on debt service payment. This was a month before the annual meeting of the World Bank/International Monetary Fund (IMF) with the Finance Ministers and Governors of Central Bank and within a period of twelve months, the crisis has spread to other major debtors.

According to Chandra, the speed with which the problem spread was a direct result of the rapid accumulation of commercial bank debts during the 1970s coupled with the

inappropriateness of the terms of the loan.

Writers have often made a global analysis as to why debtor Nations of which Nigeria is one, have resorted to the debt conversion schemes. According to these writers that the global economic events that led to the crisis include the following:

- Increase in oil prices in 1973 and 1979
- The policy reactions of these oil shocks by governments of the industrial countries

Oil price increases had three major effects:-

1. It generates huge balance of payments in OPEC countries (of which Nigeria is one) these huge balance of payments represented a net income in world savings, and unless they were spent or "recycled" through lending, a reduction in world aggregate demand and subsequently, a world wide recession would occur. Fortunately they were recycled.

2. Large balance of payments deficits were created in the oil importing developing countries which were financed by the recycled surpluses from OPEC countries.

3. There was increase in general price levels in the developed countries. The reaction to this rise by the governments of these countries lies close to the heart of the problem. It encouraged reduction in

aggregate demand either by restrictive tax expenditure policies or by restrictive monetary policies. This restrictive measure gave rise to the following results:

1. A rise in real interest rates to unprecedented levels. The real rates of interest which the developing countries faced in the 1970s were on the average, negative, but they rose from 14.1% 1979-80 to an average of 14.5% 1981-85

2. A contraction in the growth of world trade and the export markets of developing countries, 7% a year from 1950-1974 to 3-4% a year from 1974-75

3. A decline in external credit to developing countries after the initial period of recycling OPEC surpluses and after the Mexican crisis of 1982. Portfolios investment which composed essentially of bank lending, fell from 1.1% of the GDP of developing countries in 1979 to 0.1% in 1985. There was also a decline in foreing direct investment from 0.6% to 0.2% in the years 1979 and 1985 respectively.

Generally the effect of all the above on the Developing countries, was an increase in their external borrowings and subsequently, their burden. 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. The result was that the link between debt - service and development, was broken. Debt was growing without increasing the resources available for development. Borrowing becomes a means of debt servicing. By the end of 1982, more than 50% of the total debt was variable interest rate debt and nominal interest rates had risen from 7.3% (1972) to 17.5% (1982). Since 1982, the debt has grown from resheduling of principal payment at moratorium interest rates.

The Mexican crisis of 1982, led the commercial banks to:

i. reduce new lending

ii. withdraw short-term credits, inter bank deposits and trade credit finance.

The reduction in net bank lending resulted in a rapid loss of reserves and the accumulation of arrears, thus escalating the debt crisis.

Emergency procedures that were developed in 1982 to deal with the crisis, works as follows:-

A debtor nation seek short term loans from Western countries which are to be repaid once an agreement has been reached between the debtor nation and the IMF, on a stabilization programme. This was

so because the only active forum for debt management are the London and Paris Clubs, under whose watchful eyes commercial and official debts are rescheduled or restructured. The Clubs provide relief by extending the period over which the debts are repaid. Though there does not exist a formal link between the Clubs and the World Bank/IMF, the IMF rubber stamp on a country's economic reform programme is a sine quo non for a successful rescheduling. In exchange for this official support, the borrowing nation had to agree to undertake a programme of Structural Adjustment which meant belt - tightening.

Borrowers were required to:-

i. cut down on their current accounts deficits by demand management

ii. increase the efficiency of resource used by reducing the role of the government in the economy (Privatising) and as a provider of essential goods and services to the poorer members of society

iii. increase exports by devaluation and increase investment in the export sectors.

All these are contained in the Structural Adjustment Programme which the Nigerian Government as well as other debtor nations embarked upon. One should recall that no sooner had Nigerian said no in the October - December, 1985 IMF debate (which has been

described as a successful political operation) than the government took a $4.3 billion World Bank loan and the Structural Adjustment Programme was in place by July, 1986

Though there was an increase in the volume of expert as a result of the adjustment programme, such increase were not accompanied by an increase in net flows due to a decline in commodity prices after 1983. This further led to cuts in imports, outputs, and investments, as the assumption that the Structural Adjustment implementation would lead to a resumption of voluntary lending by banks and export credit agencies proved false.

The first public sign that (SAP) Structural Adjustment Programme, as a debt management strategy, was unacceptable, came from the President of Peru, when in 1985, he announced that the country's debt - service payment would be limited to only 10% of export earnings and such would only be paid to those creditors which were prepared to continue to make positive net transfers. The fear of this action spreading to other debtor nations prompted the drafting of the "Baker Plan", whose central aim was "adjustment with growth", However, economic conditions in the industrial nations did not improve enough for the plan to be implemented.

Thus, the debt problem which was thought to be merely temporary, and would be solved by economic expansion, initiated in the developed countries, has now been recognised quite widely as requiring a differnt strategy.

The question of the managebility of the debt is often looked at from the point of view of the banks or the debtors. Concern in the creditor countries tend to focus on whether western governments and the international institutions can prevent the liquidity of the developing countries from causing an international baking crisis while concern among the debtor nations focuses on whether they can continue to depress living standards of GDP growth rates in order to keep current on their interest payments.

A number of proposals have been put forward in the creditor countries for dealing with the debt problem; the most comprehensive, being the "Rohatyn Proposal", which is to the effect that existing loans should be spread out to 25 - 30 years at much lower interest rates. The proposal calls for the establishment of an international agency to be called the "World Assistance Corporation" - WAC where new bonds, with a guarantee of western creditor governments and the oil producers' capital surpluses, will be issued

and the proceeds of this transaction, used in taking the loans off the banks and/or the new institution (WAC) could acquire the bank credits in exchange for long term low interest loans of its own.

The Rohatyn Proposal is built on the experience with the 1975 re-structuring of New York City debts to banks in a situation which was quite similar to that of developing debtor nations today. In the case of the New York debts, the Municipal Assistence Corporation was established to issue long term bonds with a guarantee of the state of New York, to service these bonds. The proceeds bought in part by the creditor banks and the losses from the restructuring were written down over a 6-7 year period.

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There is also the "Kenen Proposal" which 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 capitol subscription. The "Kenen Proposal" allows for the restructuring of the less developed countries, debts owed to banks for 10-20 years, also at a reduced rate, but such restructuring can only occur if there exists a stand by agreement

between the IMF and the debtor nation. Also the interest rates and terms would be differentiated among the borrowers. According to the proposal, the scheme is voluntary. Banks do not have to rediscount their claims with the IDDC, but their option to do so would be restricted with the discount facility being available only for a specified period.

Other suggestions include the repudiation of external debts with its attendant economic reprisals from the creditor nations, unilateral decision on the part of the debtor nation to peg the debt-service ratio to a given percentage, an option Nigeria tried during the peak of the Structural Adjustment Programme; and the option which this project is concerned with - the debt conversion option.

Blackwell and Nocera are of the opinion that it is an innovative way to reduce the debt burden of heavily indebted nations. The different schemes which have evolved include mainly, offers by debtor nations to buy back their debts at a discount or to convert them into other assets such as bonds or even commodities. These schemes have taken off to a greater extent as a result of the worsening debt situation. The likelihood of the banks recovering their debts in full have decreased and they have become

more than willing to take a loss through selling the debts or trading it for a domestic investment. Blackwell and Nocera, argue that

> the growth in the volume of debt-equity swaps have been fueled by an increasing recognition in debtor countries that foreign investment can take an important contribution to economic growth, by a flourishing secondary market in the country's debt obligations among the international banks and by the current global trend towards the conversion of debt into negotiable securities.

While one does not dispute these facts, the question still remains are the objectives for which the respective countries adopted the scheme being met?

The practice and failure of the scheme in the countries that have adopted it have not been critically examined. Brazil, for example, which has encouraged debt-for-equity swaps since the 1970s, was so burdened by the debt service problems that it suspended interest payments on its debt in 1987. Mexico, in which a transaction organised by Nissan Motor Company in 1986, began to flirt with the idea of debt conversion in April 1986, but had aborted the scheme by July, 1987 In the case of Nissan Motors, a transaction by the company in 1986 in order to expand the operations of its subsidiary in Mexico, has been described in many

press articles and has become a "classic case study" of debt-equity conversion. According to several of these articles, the transaction took place as follows:

i. With the help of Citicorp Latin America Investment Division, Nissan bought $60m of Mexican government debt in the financial market at a price of $40m

ii. Nissan redeemed the debt certificates at the Mexican Central Bank, receiving an equivalent of $54m in Mexican pesos, at the official exchange rate

iii. Nissan used the Mexican Pesos acquired in this transaction to increase the capital of its subsisdiary in Mexico.

All parties benefited. The commercial bank that sold the debt to Nissan via Citicorp reduced its exposure in Mexico by $60m, albeit at a loss of $20m. This represented an effective discount of 24%. Nissan was able to acquire pesos at an effective discount 26% (exclusive of the transaction fee). The Mexican government was able to convert some of its liabilities in foreign currency, and in so doing, captured a part of the discount, equivalent to the difference between the face value of the loan and the amount paid for its redemption, that is $6m or 10% of the original loan. Other transactions did take place, but rather than improve the debt position of Mexico, the debt increased from its 1982 magnitude of $87.6 billion to $105.0 in 1987. Other countries like Argentina have abandoned

the scheme.

Despite all these glaring failures, one is tempted to ask if there contains in Nigeria's guidelines exceptions that would provide for success.

1.5 Methodology

In carrying out this research, emphasis was more on secondary data, especially from the Central Bank of Nigeria and papers delivered at seminars and workshops organised by the Government and other bodies. Due to lack of concensus on the nation's external debts much effort was expended in collecting authentic data.

Data was then presented in tabular form from where analysis was made.

It should be noted that, not much as regards its working, have been published, even where externsive work has been carried out by individuals and/or organisations. As such, most of the materials used in this project, were not easily obtained.

Chapter Two

ANALYSING THE TERM DEBT AND EQUITY

"Debt" by Publilius Syrus in 50 BC "is the salvery of the free". In other words a debter is not only in perpetual bondage to his creditor until he retires all his Debt, but he also breathes the air of insecurity characterised by harrassment.

Indeed, he who goes borrowing goes a-sorrowing - a naked picture of third world nations and their pathetic predicament.

Debt in financial management is defined as a comtractual financial obligation which one party owes to another. The party owing the obligation is technically called the Debtor while the party to whom the obligation is owed, is called the Creditor.

Debts can be short, medium or long term in nature and includes overdrafts, promissory notes, bonds, loans etc.

Equity on the other hand denotes proportionate corporate ownership. It generally represents company ownership capital and is divided into units of shares which technically are referred to as ordinary shares.

A firm that therefore finances it's operations with equity capital has all returns earned form the

operations accruing to the share holders either in the form of retained earnings which increases the net worth of the firm or in the form of dividends which are distributed to the shareholders.

On the other hand, a firm which finances its operation through debts, has an obligation to service such debts, depending on the terms of the debt by implication therefore not all returns from operations of the firm accrue to the shareholders. A portion of all the returns is set aside to service the debts. Moreover, while it is a known fact that the primary interest of the corporation's shareholders is on the return they receive on their capital, such receipt or dividends is not a contractual entitlement of the equity shareholders. For a firm that finances it's operations partly with debt, there exists a contractual obligation to service the debt, which takes the form of periodic interest payment and appropriation from profit of a fixed amount to sinking fund reserve.

Debt in the Capital structure of the firm expose it to basic types of financial risks. First is the risk of insolvency which could result in liquidation and secondly, there is the risk of variability in earnings and dividend streams. Such

variability is more pronounced in years when earnings are so low and a major proportion is used for interest payments, thereby leaving a smaller proportion to the shareholders.

2.1 Debt Conversion

Debt - equity conversion sometimes referred to as debt equity swap, debt capitalization or securitization is simply the exchange (Sales, Purchase, Conversion etc) of claims on debtors. In a broad sense, it is the exchange of monetary instruments e.g promissory notes for tangible assets or other financial instruments. Essentially debt conversion involves exchanging external debt for domestic debt or equity. The redemptor, if he is not the original creditor, uses foreign exchange to purchase a country's debt at a d discount, either from the original creditor or in the secondary market. He then negotiaties with the agency charged with the responsibility of managing the conversion program in the debtor country, usually the Central Bank, to exchange the acquired debt for local currency or local debt.

The regulations governing the ways in which countries permit the swap of their commercial bank debt for equity in particular sectors of their economies differ importantly from country to country,

even within individual countries, conditions applied to such transactions can vary according to the purpose for which the swap is undertaken, monetary policy considerations and other factors, whatever the differences in the often arcane regulations and the actual forms of such transactions, most debt-conversion schemes conform to a basic pattern. First, a bank sells at a discount (of say 35 percent) an onstanding loan made to a public sector agency - or sometimes to a private sector enterprise - in an indebted country. Second, an investor, often a multinational manufacturing company buys the loan paper at the discounted price and presents it to the Central Bank of the indebted country, which redeems the loan at face value or at a modest discount (of say 10 percent) in domestic currency at the prevailing market exchange rate. Third, the investor acquires equity in the indebted country using this domestic currency, which it has in effect purchased on terms that are more favourable than could have been obtained through regular foreign exchange market transactions. Recently, the first and second steps of this process have often been telescoped together as some banks encouraged by chances in US banking regulations have swapped their own credit for equities in the debtor countries.

2.2 Basic Types of Debt Conversion

2.2.1 Relending: The logical first form of debt conversion is relending. The original borrower of a rescheduled foreign currency loan will, in many instances have repaid the loan punctually but the Central Bank will have been unable to transfer the foreign currency. In such cases, the Central Bank in the debtor country will have received the local currency repayments punctually but the Central Bank did not have sufficient foreign currency to pay the creditor in the agreed currency (of course one can also say that this means that the Central Bank over valued the demestic currency).

The result, in any case was that the foreign creditor became the owner of a foreign currency deposit with the Central Bank instead of receiving his repayment. A large portion of commercial banks 'blocked' loans in debtor countries are in the form of such Central Bank deposits. In relending the Central Bank allows the foreign bank to use these deposits to fund a new loan to a borrower in the country.

In this way, the foreign bank would extend a new loan to a borrower in the same country denominated again in foreign currency (after all, the Central Bank deposit was also denominated inforeign currency) but

disbursed by the Central Bank in the local currency equivalent of the foreign currency amount. The bank would be free to choose the type of new borrower - public or private sector for instance but the terms of the loan would not be harder than those of the original deposit with the Central Bank.

2.2.2 Debt for Debt - This scheme provides for swapping creditors in order to eliminate claims on a certain country and to concentrate claims in another country. Discounts associated with loan sale's varied widely from 10 to 90 per cent. Debt for the major debtor contries in the Western hemisphere traded at between 20-40 per cent discount, while the discounts for countries with severe debt problems in Africa, Bolivia, Peru, and others ranged between 60 - 90 per cent. Debt for debt conversion is normally carried out for purposes of liquidity, risk reduction, tax and other purposes.

2.2.3 Debt Equity Conversion The most talked about form of debt conversion is debt equity conversion. In debt equity conversion, the local currency proceeds of the conversion are used to pay up on local currency denominated equity in local companies. From the debtor's countries point of view, the essence of this conversion is to direct these foreign direct investments

to priority areas for private sector investment. The local company which receives the local currency in exchange for the shares to be issued may use the proceeds only for local expenditure; payments of local suppliers, repayments of local currency, loans, payroll etc. The Central Bank will be especially careful to avoid that the local currency proceeds are used to buy foreign or currency imports that would amount to "round - tripping" which is the paramount risk of all conversion. From the point of view of the foreign company contemplating a new, or additional, investment in the equity of a subsidiary in the debtor country, debt-equity conversion implies a substential lowering of the cost of the equity portion of it's proposed investment.

The savings to be realised i.e the savings in the hard currency cost of the equity to be paid-up will roughly equal the percentages of the discount in the secondary markets for the types of debt which the Central Bank will allow to be converted into equity. Depending on the country concerned, these savings may be between approximately 20 - 70 per cent. For an exact calculation not only the secondary market price of the debt to be converted matters but also the fees payable to the Central Bank - frequently depending on the degree of priority accorded to the proposed

investments to bring in "fresh" i.e directly transferred funds and of course, the costs of documentation and the banks arrangement fee.

In countries where an official debt-equity conversion system exists with standardized approval procedures a debt-equity conversion transaction may be worth while for as little as US $500,000 An essential point of debt-equity conversion is the repatriation rights accorded to the equity investment which results from the conversion. As a general rule payments of dividends and repayments of principal following liquidation or sale will be allowed at a rate which corresponds to the payments of interest and principal on the loan which was the subject of conversion. There are, however, many differences in regulation between countries with a debt equity conversion system.

2.2.4 Foreign Currency/Local Currency Debt Conversion

In this case, the Central Bank issues, in exchange for the foreign currency debt obligation. The Central Bank would allow such obligations to be used for instance, for the repayment of local currency debt owed to it. Depending on the local money or capital, the obligations could be sold for cash. Such conversion will be especially attractive to local business men who wish to make use of foreing currency reserves to strengthen the financial position of their

companies from the Central Bank's point of view the instrument stimulates the repatriation of flight capital.

2.2.5 Debt for Restricted Use Local Currency

Depending on the conditions of local currency debt obligations issued as discussed above and on the development of a local currency money or capital markets, these obligations may besold for local currency cash without restrictions. In a more direct procedure, the Central Bank may agree to pay the local currency proceeds of conversion directed into a local currency account on condition that only certain types of payment may be made from it. An example of this is where an organisation of international developmet aid, humanitarian aid, or other local non - commercial social purpose agrees to receive local currency in an account with a trustee bank from which payments may only be made for, for instance payroll and local suppliers.

2.2.6 Debt for Export In several highly indebted countries, governments have allowed exports - particularly exports of non - traditional goods or exports outside of official regulations to be paid in part with their own foreign currency debt. Obviously, where there is a steady cash alternative, the exporter will not be interested in this rather cumbersome procedure. For

the exports of goods which would otherwise not easily take place, or for new, additional exports, the system has obvious attractions. Also, certain groups of creditors who do not find other opportunities to use their blocked foreign currency claims may not put pressure on a debtor government to agree with debt for exports arrangements.

2.3 Problems of Debt Conversion

The main problems of debt conversion largely relate to a number of adverse macroeconomic implications of a debt conversion programme. Some of the problems are summarised below.

Debt conversion can have a significant impact on the monetary and fiscal policies of the country redeeming the debt, particularly if a substantial volume of swaps takes place. The monetary effect will depend on how the domestic side of the transaction is financed. If the government finances the conversion through the consolidated banking system there will be an equivalent monetary expansion and possible inflationary pressures. Table 2.1 shows that in four of the major indebted countries, the conversion of as little as 5 per cent of outstanding debt to commercial banks could lead to an increase of 33 - 59 per cent in the domestic money supply.

Table 2.1

Potential monetary impact of converting Debt to equity through the creation of money

Country	Total Debts Outstanding to Commercial Banks (in billions of US dollars 1	Money Supply (M) (in billions of US dollars) 2	Potential effect on M of 5 percent conversion (in per cent)
Argentina	31.3	4.5	+35.8
Brazil	78.8	12.1	+32.6
Mexico	73.7	6.3	+58.5
Philipines	14.1	2.1	+33.6

Sources: (1) Bank for International Settlements (data are for end 1986 and include short-term and other debts that might not be eligible for debt conversion);

(2) IMF Staff estimates for September 1987 for Brazil and for end 1986 for the other countries as reported in international financial statistics (line 34)

Even if the authorityes of the debtor country take a different approach and decide to finance the swaps directly by selling government bonds to the private sector, they may not avoid difficult policy chopes. Financing debt conversion by drawing on domestic capital markers could well result in substantial crowding out by placing upward pressure on interst rates, thereby squeezing out domestic

economic agents. Furthermore the limted size of the domestic capital markets in most major debtor countries would appear to offer little scope for absorbing the amount of public debt that would be required for substantial debt conversion. Domestic monetary authorities would, therefore, face limitations with regard to the volume of debt equity swaps that they can reasonably accomodate.

On the fiscal side, the replacement of foreign liabilities with domestic obligations - whether to the consolidated banking system of the private sector - may result in an increase in the domestic - currency debt service obligation of the government to the extent that the domestic real interest rate is higher than the rate applied to the external debt. This cost, as well as the financial implications of the early repayment of external debts, must be taken into account in the government's financial programme.

Another aspect of the draw back of debt conversion is that they require more than one exchange rate to be maintained. This would naturally lead to arbitrage which, if not checked could deplete official foreign exchange reserves. To see the mechanics of this, one can use a simple exporter - importer model of trade as follows: In order to secure official foreign

exchange, importers exhibit a tendency to over-invoice while exporters tend to under-invoice, thus giving rise to capital flight. Such capital is then brought back into the country at a preferrential exchange rate offered by debt Naira swaps. Under such a "round tripping" official foreign exchange reserves get used up through capital flight while returning capital is used to liquidate debt. Debt conversion also has a tendency to cause round-tripping if multinational companies siphon their business earnings out of the country rather than retain them within, and thereafter return the capital to the country through swaps aided by preferential exchange rate. Despite the fact that Chile operates a foreign exchange auction system, it has been found that this merely moderates but does not eliminate the inducement for round tripping because the arbitrage pressure is only shifted from the foreign exchange market to the market for 'coups' i.e rights to conversion which are auctioned off to domestic banks.

From an accounting stand point, a swap of equity for debt has little or no effect on a country's net liability position. In most cases, the claims of the rest of the world on the country are merely reclassified, that is there is no net capital inflow if the debt is redeemed at face value. There would

be some capital inflow at less than face value or if the country imposed a condition that debt swap be accompanied by new direct investment. Through a debt equity swap a country simply exchanges one form of external liability for another - a debt with fixed service and continuing repayment obligations for direct investment. However, one way the balance of payment's could be affected is if the payments abroad of dividends or capital associated with the equity investment exceed the interest and principal payments that would have been due on the redeemed external debt.

All debt-equity swaps, whether they involve the conversion of public or private debt, are significantly influenced by the policies of the government of the indebted country concerned. The government screens potential investors and decided which ones it will allow to engage in debt conversion. It can decide to redeem the debt paper at less than face value, thereby reducing incentives to the foreign investor to engage in particular transactions. More importantly when a government specifies the sector into which the local currency proceeds of a debt conversion can be channelled, it is in effect pursuing an investiment programme that is not guided by purely market signals. The investment activities associated with such a

programme may not reflect an efficient allocation of resources and could, therefore lead to distortions.

The advantages of debt conversion depends on the degree of "additionality" present in the programme. The degree of "additionality" refers to the ability of debt swaps to attract foreign equity investment and flight capital which otherwise would not have come to the country. Thus the advantages associated with debt conversion programme depend on the degree of additionality, in the absence of which only modest benefit would result form debt-equity conversion because the country could still achieve much same result by the usual debt rescheduling scheme.

Critics of debt conversion swaps are convinced that such swaps would restrain the flow of "new" money and investments into debtor countries and thereby slow down the rate of investment. Concern that debt conversion merely substitute for the flow of "new" money for direct investment has led some countries, such as Argentina, to formulate their programmes in such a way that debt swapped for equity would have to be accompanied by "new" money.

Debt conversion tends to increase fears about the possibility of a radical change in the structure of business ownership in favour of foreigners such fears tend to generate political sensitivity about the proposed programme.

2.4 Merits of Debt Conversion

Debt conversion as a debt management tool serves to reduce a country's stock of outstanding debt and lighten the debt service burden without the use of the country's scarce foreign exchange resources. Note that outgoing payments (dividends) would be linked to the profitability of investiments, rather than to a rate of interest that may be determined largely by factors beyond the debtor country's control. Thus the risk of not meeting an international repayment obligation is shifted from the borrower to the foreign investor. To the extent that this shift reduces net repayment abroad and to the extent that foreign exchange earnings from the resulting new export or import - substituting industries increase, a debt conversion can help alleviate the debt - service burden of an indebted country.

Successful debt-equity swaps arrangements have the potential of improving resource allocation in ensuring that funds are diverted to projects with relatively high returns. In a debt - ridden economy, such projects could have been starved of funds with consequantial loss of funds earlier invested.

For foreign creditor banks, who were in danger

of losing their credit to indebted countries through debt repudiation, the scheme is a saviour! It will enable them to off-load some of their liabilites to other investors even at a loss.

Broadly therefore, debt conversion could serve as a tool for stimulating inward capital investment flows with the attendant beneficial affect on the level of economic activities and employment. A debt conversion scheme can also assist the recapitalization of the private sector. In other words, a debt conversion programme could become a vehicle to promote investment led economic growth. A debt conversion programmes can provide an incentive to the exchange held abroad by nationals. Finally a (DCP) can generate revenue for government at the time of conversion and from tax on profitable investments to which redemption proceeds are put.

It is important to state here that these cost/benefits differ from country to country depending upon what obtains there.

2.5 Experiences of Other Countries

Under this we shall discuss the experiences of five countries mainly Less Developed Countries (LDCs) with debt capitalization schemes which have accounted for virtually all of the estimated US $12 billion in

swaps since 1982. The countries include Chile, Brazil, Mexico, Philippines and Argentina.

Chile has been described as one of the first few countries to formulate comprehensive foreign investment laws allowing for debt conversion and also tied this to its privatization programme later in 1986/87. A mechanism has actually been evolved for converting external debt into local debt instruments that are sold in the local capital market and the proceeds invested locally eligible investors can be the original holders or purchasers of external debt who can also include Chilean residents or nationals. The main steps involved in converting external debt into local debt are the following:

a. A foreign holder of external Chilean debt submits the debt to the issuing public entity which exchanges it for a local, peso-payable instrument of equal face value!

b. The investor selles. The local debt instrument in the local market, usually at a discount and the proceeds of this sales are then used for local equity investment, in a specified project. Under the amendments introduced in 1985 and 1986, the Central Bank's Compendium of Rules for International Exchage permitted Chilean residents investor a free scope for

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the use of local currency proceeds from debt conversion except to remit the returns from the investment externally. A non-resident investor is, of course, allowed to undertake direct investmenf and repatriate the capital after ten years while dividends could be remitted after four years at the rate of 25 per cent a year.

Under the current privatization programme in Chile, the shares of state entreprises not made available to company employees or to the pension funds are placed on the stock exchange at fairly low values, The proceeds from debt conversion can be used by the seller to purchase undervalued equity in state enterprises. It has been estimated that during the first seven months, of 1986, debt conversion amounted to US $330 million of which US $200 million was due to transactions by Chilean resident investors. Under chapter 18 of its compedium of Rules, the Central Bank of Chile maintains a quota on debt conversion by residents which was reduced recently from US $60 million to US $40 million monthly. By this, the Central Bank of Chile aimed to check the effects of debt conversion on domestic money supply and exchange rate.

Since the latter 1970s, Brazil has encouraged debt-for-equity swap through tax incentives. A proposal for debt conversion is, however, considered and approved by the Central Bank on a case-by-case basis. Local investment of the converted debt has been mainly in operating companies and financial institutions but current Brazilian regulations do permit the use of brokered debts. Investors that are eligible to invest could be local or foreign holders of the debt. Two main steps are involved in the Brazilian debt conversion; Firstly, a request for debt conversion is submitted to the foreign capital Registration unit of the Central Bank of Brazil, once an approval by the Central Bank is received, the investor formally registers the investment with the Government and a "voluntary" foreign exchange contract is simultanelusly entered into through an authorized exchange bank within 15 days. The currency is, of course cruzado which is the local currency.

Increased encouragement was provided in 1983 when the Brazilian government introduced eash payments of between 5 and 10 percent of the face value of the debt to investors underaking the conversion to equity of principal or interest on loans or long-term import financing. Records indicate that by the end of 1985,

debt for equity swaps had totalled US $1.3 billion while an additional US $600 million was expected to have been swapped during 1986. By February 1987, Braxil was proposing to negotiate with its creditors a proposal for capitalization of interest payments which would essentially convert a temporary moratorium into a formally agreed policy of interest relief. Creditors would be asked to accept a portion of total interest payments due (perhaps as much as 50%) in Cruzado reserved for reinvestment in Brazilian entreprises.

Debt conversion in Mexico which began in April 1986 has since taken the form of debt-for-equity swaps in which holders of public sector Mexico debt could **convert debt into equity holdings of Mexican entreprises** (i.e new project expansions, and privatized companies). The amount of debt so converted is of course regulated by the Ministry of Finance and Public Credit. After being restricted initially to foreign bank investors, foreign companies which purchased the debt in the secondary market were recently allowed up to 15 percent ownership in Mexican campanies in exchange for an equivalent amount of foreign debt repayment. Until January 1998, no remittance of profit or repatriation of capital would be permitted under the recent debt re-organisation agreement reached with commercial bank

creditors, The Mexican authorities were contemplating the introduction of a mechanism which would enable Mexican residents participation in the debt conversion programme. By end of July 1986, Mexico had achieved twenty-three debt-for-equity transactions totalling US $300 million. By the end of the year, the Finance Ministry had concluded 50 swaps contracts involving US $650 million in public sector debt and had pending another 30 applications involving US $300 million. A new 0.25 percent application fee was recently imposed in order to help achieve the $1.5 - 2 billion a year conversion target. Also, through the use of treasury accounts rather than currency the government has been able to moderate the inflationary impact of the conversion.

The "Operating Manual for the Capitalization of Credits and Substitution of Public debt by Investment" governs Mexico's debt-equity-conversion programme. According to this manual, the holder of restructured Mexican public sector debt may apply to the Ministry of Finance and Public Credit for a conversion of the debt. The Ministry then decides on whether to approve the application and the amount of discount to be charged at the time of conversion depending on probable benefits to the Mexican economy. Such discounts could vary from 3-8% with the lower discount charged to new projects

exporting over 80 percent of its output. For approved conversion, the Central Bank provides local currency in exchange for the foreign denominated loans excluding the discount.

Holders of Philippines Government debt (i.e foreigners or residents), may invest directly or through a fund in the equity of Filipino Corportations, in which case they get involved for a fairly long period of time. Circular IV of the Philippine Government governs all such investments. The main steps involved in coverting an external debt into local debt are as follows; a debt holder perceives an opportunity which may be due to frash capital requirement for existing ventures, divestment of non-performing companies by local banks, investment in new ventures, or privatization of Government Corportations. If the investment is considered vital, for example, an investment in an export oriented company, it is regarded as a schedule 2 investment by circular IV while others are schedule 3 investments. Presently, schedule 2 investments require purchase of Philippine government notes (DINs) which, for reasons of their relatively recent origin, could require the investors to buy them in the open market before they can invest. The Philippine

investment notes (PIN) which can be regarded as the latest idea on the debt conversion scheme was born as a mechanism to break the deadlock in the rescheduling of that country's debt whereby estimates had shown that, by reducing the apread on the interest rate, a 15 year rescheduling would save Philippines about eight percent for every dollar rescheduled which is about $100 million a year. Under the PIN scheme, potential investors in the Philippines would be sttracted since they would avoid the 5 percent to 10 percent which Central Bank charge on converting dollar debt into pesos under the converting scheme. By end - March 1987, progress had been made on the Philippine debt-to-equity programme since deals worth US $70 million had been approved while some other US $275 million were pending.

About US $20 million was accounted for by the direct conversion of loans by American Express into a 40 percent interest in a local financial institution. New authorizations were said to be occuring at a rate of US $10million a month. The Philipine programme has really been hampered by heavy governmental fees and restrictions concerning new capital investment. Indeed in the privatization programme government has been unwilling to allow foreign investors equity holdings above 40 percent. The Philippine scheme did not allow

for stock market investment. Indeed, virtually all projects have been for green field schemes or expansions in preferred economic sectors. On the pure debt-for-equity swap, however, there have been proposals for investment in the Philippine stock market.

In 1985, Argentina converted about $500 million in debt-equity swap and stopped after six months. A new programme, which has been worked out permits the conversion of Argentina debt into equity, provided that investors match on a one-to-one basis, coverted debt with "fresh" money. The realized funds would then be used to invest in growth - oriented projects. Eligible investors, namely foreigners and Argentina nationals, can be from the private sector or official institutions. However, the latter can only invest 50 percent of the fresh money component. Foreign creditor banks are expected to be the principal investors in the debt conversion scheme.

In terms of stages involved an investment project is first submitted to the Ministry of Economy for review and approval in accordance with the April 1987 debt-to-equity guidelines and foreign investment laws; a bid is then submitted to the Central Bank for the allocation of amount of debt permitted for conversion in a given month. Action process was

scheduled to begin in August, 1987. The proposed level of debt permitted for conversion would be $1.9 billion; once the allocation is received foreign debt and "fresh" money are converted to local currency and then invested into a project in form of equity or long-term debt financing. It has been provided that once a debt had been converted, it cannot be repatriated for at least 10 years.

Chapter Three
ANALYSIS OF DATA

3.0 The genesis of Nigeria's debt problems - The sources, magnitude and trend in Nigerias external debt.

The sources, magnitude and trend in Nigeria's external debt outstanding from 1970 to 1987 are illustrated in Table 3.1 The size of Nigeria's external debt was very low in the period up to 1977. Even at the end of the civil war in 1970, Nigeria's external debt outstanding was only ₦488.8 million (US $684.3 million). Thereafter, external debt declined sharply to ₦214.5 million (US $308.9 million) in 1971 and then rose only gradually to ₦496.9 million (US $762.9 million) at the end of 1977. Up to this period, debts were contracted in relatively small amounts and were largely to supplement domestic resources for the provision of infrastructural facilities and agricultural projects.

Following the emergence of the glut in the international crude oil market in 1978 with the attendent strains on the balance of payments, external reserves and government finances, Nigeria, for the first time had recourse to borrow in larger chunks and shorter maturities from the Internation Capital Market (ICM) at higher and variable interest rates.

A number of ICM jumbo loans were negotiated in 1978 and 1979 for balance of payments support purposes and for the establishment of a domestic steel industry.

Many more such ICM loans were raised especially as funds from bilateral and multilateral institutions became increasingly inadequate to the needs of government. Consequently, ICM loans rose rapidly from ₦1.0 billion in 1979 to ₦5.5 billion in 1982 and to ₦40.5 billion in 1987 when it constituted 40.2 percent of total external debt. In the same period, state governments joined the band wagon of external borrowing.

However, the single largest and most insidious source of increase in Nigeria's external debt and the ensuing debt crisis is accumulated trade arrears which emerged in 1982. Subsequent debt service difficulties had led to the refinancing of some of the arrears. Total trade arrears grew rapidly from ₦2.0 billion in 1982 to ₦47.6 billion or 47.2 percent constituting the single largest debt source.

Following from the trend described above, Nigeria's external debt outstanding rose from ₦1.3 billion (US $2.2 billion) in 1978 to ₦10.6 billion (US $14.1 billion) in 1983 and rose rapidly to ₦100.8 billion (US $23.4 billion) respectively in 1986 and 1987 following exchange rate depreciation and as at 31 December 1988 Nigeria's total debt stood at US $30.5 billion.

3.1 The Causes of Nigeria's Debt Burden

The present debt problem can be partly attributed to the dominant position of the oil sector in the economy and partly to the gross mismangement of the available resources during the oil boom period. Oil revenue aided rapid expansion of government expenditures. The productive base of the economy was however not sufficiently developed and diversified because of some institutional constraints. The pattern of investment shifted to construction and services to the detriment of agriculture.

The degree of the country's dependence on the oil revenue was first noticed in 1978 and later in 1981 when there was a dramatic slump in oil demand and sales. From a daily output of 2 million barrels at $40 per barrel in 1980 production fell to 0.63 million barrels per day and output was being sold at $35.5 per barrel in 1982. Since then oil price has been on a downward trend. This is indicated in Table 3.2

The demand of industrial countries for all Nigerian products did not grow as rapidly as per capita income did. Studies have shown that the prices of non-oil commodities in the World Market were also on the downward trend. Imports of consumer

goods mounted rapidly during oil boom era. At the same time import of capital goods and industrial raw materials surged in an effort to acheve rapid economic development.

Table 3.2

Monthly Crude Oil Prices in Some Market
($ per barrel of the Nigerian Bonny Hight)

Month/Year	Spot Market	Gulf Coast Market
January 1986	29.90	22.59
February '86	18.00	16.49
March, 1986	15.15	14.71
April, 1986	12.50	14.77
Septemner'86	14.00	13.75
November '86	14.52	NA

Source: UBA, LAGOS, Monthly Business and Economic Digest, April/May 1986, December, 1988

Note: 1989 Budget Assumed $14 per barrel at 1.355mbd

While the prices for Nigeria's exports fell the prices of imported manufactured goods rose astronomically. Developmental efforts which manifested themselves in accelerated imports of machinery and equipment, fuels, materials, technology led to growing deficits in the balance of trade. Even in

years that balance of trade surpluses occurred, there were balance of payment deficits as the country spent more overseas than it earned. The country paid huge sums of money for shippin, insurance, profits and interest to foreign owned firms. Balanace of payment deficits even on current account had thus become chronic by 1986. The resultant balance of payment difficulties and dwindling reserves and government finances led the authorities to resort to ICM medium-term jumbo loans with higher interest rates and involuntary accumulation of import arrears. The shift in the term - structure of Nigeria's external debt and shortened loan maturities had created the problem of bunching of debt service obligations. Bunching in turn created the problem of default and the rapid build up of payment arrears.

A large part of todays debt also came from credits granted between 1980 and 1983 when Nigeria exprienced favourable foreign exchange position. Part of the credit went into electricity, mining, industry and agriculture. Another part flew away from the country or never actually got into the country. Another part of foreign credit which was given to the private sector was used to finance some entreprises which could hardly yield any returns because of technological obsolescence. Consequently

such business could not be relied upon to bring the balance of payment into equilibrium.

The pressure on the external sector of the economy was aggravated by some extraneous factors. These factors included the unregulated external borrowing by both the Federal and State Governments for projects which hardly took off the ground and over-invoicing of imports and false foreign payments documentation all of which aided the siphoning of the country's scarce foreign exchange earnings abroad. Besides, the Odama Committee observed that the cost of government contracts were deliberately inflated with the result that the cost of construction in Nigeria was about three times the cost of executing similar projects in East and North America and four times of the cost in Asia. The committee also noted the growing practice for the different arms of government to extend autonomy to the area of budgeting. This practice preclude overall appraisal of budgets and financial discipline in the country from 1979 to 1983.

As the balance of payments position deteriorated, the reserves of foreign exchange got depleted and external borrowing surged further leading to a sharp rise in the country's debt service burden.

By 1986 the sheer volume of external debt had

assumed such a magnitufe that the obligation of debt servicing posed some threat to economic growth. The intensification of the problem since 1986 is as a result of the effect of global recession. As a result of the rapid growth in external debt, Nigeria's capacity to service debt has deteriorated. Interest and armotization of medium and long term external debts as a percentage of export, commonly called the debt service ratio increased from 0.7 percent in 1980 to 17.8% in 1983 and to 33.2% in 1985 (see Table 3.3) Table 3.4 also shows that 37 percent of the export earnings was earmarked for debt service in 1989 budget; an indication that debt service ratio is getting higher.

It was for this reason that some people have advocated foreign equity participation to encourage the inflow of capital. Foreign capital could contribute to the growth of the economy and repayment of foreign loans can fbe made without much hardship on the economy provided there is proper debt management procedure.

3.2 The Magnitude and Severity of the Debt Burden

The magnitude and severity of the debt burden of Nigeria is more forcefully demonstrated by the examination of certain debt ratios. As shown in

Table 3.5 all the ratios have risen rapidly especially since 1982, indication that the debt burden has increased substantially.

Table 3.3

Nigeria's External Debt Outstanding and Total Debt Service 1976 - 1987

	Total Debt Outstanding		Value of Export	Total Debt Service	Debt Service Ratio
	₦ Million	$ Million	₦ Million	₦ Million	%
1976	374.6	593.8	6709.8	34.4	0.5
1977	496.9	762.9	7630.7	25.6	0.3
1978	1265.7	2163.8	6064.4	160.8	2.7
1979	1611.5	2824.6	10836.8	182.9	1.7
1980	1866.8	3444.8	14077.0	101.6	0.7
1981	2331.2	3667.7	10470.1	518.6	5.0
1982	8819.4	13124.1	8722.5	775.2	8.9
1983	10577.7	14130.7	7502.5	1335.2	17.8
1984	14536.6	18034.1	9088.0	2640.5	29.1
1985	17290.6	17297.5	11214.8	3718.0	33.2
1986	42229.5	18631.3	8513.0	2502.2	29.4
1987*	86550.8	23445.1	30239.9	3590.6	11.9

Source: Federal Ministry of Finance & Central Bank of Nigeria

*Estimate as at end of October 1987

Table 3.4

Projected Foreign Exchange Receipts and Expenditure for 1989 in $ billion

Receipts		Expenditure	
From oil source	4.129	Supply to FEM	4.475
From public non-oil source	1.232	Debt service	2.000
From private non-oil source	1.318	Reserves	0.204

Source: UBA, Lagos monthly Business & Economic Digest, Vol.12, No.1, January 1989, p.4

Table 3.5

Nigeria's Principal Debt and Debt Service Ratio 1980-1987 in Percent

Principal Ratio	1980	1981	1982	1983	1984	1986	1986	1987
Debt Export	13.3	22.3	101.1	141.0	160.0	154.2	486.9	333.
Debt GDP	3.8	4.5	16.9	17.4	21.2	21.9	51.0	94.
Debt Service Export	0.7	5.0	8.0	17.6	29.1	33.2	29.4	11.

Source: CBN Exonomic and Financial Review Volume 26 No.2, June 1988

For instance the debt/export ratio rose from only 13.3 percent in 1980 to 486.9 percent in 1986 before it declined to 333.3 percent in 1987. The ratio of debt to the gross domestic product at factor cost rose monotonously from only 3.8 percent in 1980 to 94.1 percent in 1987. Similarly, the debt burden as measured by the ratio of debt service to exports of goods and services rose rapidly from 0.7 percent in 1980 to a peak of 33.2 percent in 1985. Thereafter, it fell to 29.4 and 11.9 percent in 1986 and 1987 respectively. This ratio would have risen above 65 percent since 1986 but for payment defaults and subsequent debt restructuring and debt rescheduling. The heavy debt burden has disrupted economic development and has created other serious socio-economic problems. Heavy

debt service payments and attempts to minimize balance of payments deficits and prevent the depletion of external reserves had led to very drastic curtailment of imports. For example the value of imports which rose by 47.4 and 42.0 percent in 1980 and 1981 respectively declined by an annual average of 15 percent from 1982 to 1986. At ₦5.5 billion in 1986, merchandise imports were only 42.4 percent of the 1981 peak of $12.9 billion. Import compression led to severe reduction in development projects and industrial production. These in turn led to curtailment of domestic production, scarcity of goods and services and spiralling inflation. With the exception of 1985, real GDP growth rates were negative from 1982 - 1986. Poor economic performance worsened the unemployment situation and aggravates social problems.

The accumulation of import payment arrears and default on debt service payments especially since 1983 threatened credit worthiness and solvency which culminated in the refusal of foreign correspondent banks to open lines of credit for Nigerian importers in early 1986. Nigeria gradually began to regain its credit worthiness on the adoption of an IMF and World Bank - supported Structural Adjustment Programme - SAP

3.4 The Management of External Debt

Nigeria considers the management of her external debt as an important economic issue. Both the Central Bank of Nigeria and the Federal Ministry of Finance manage the external debt on behalf of the nation. The main objective of the management is to match the country's foreign borrowing with the long run capacity of the country to pay. Consequently procedures and guidelines as to who can borrow abroad and the maximum amount that can be borrowed are prescribed. The Central Bank of Nigeria also ensures the timely repayment of both the principal loan and interest charges as and when due.

Thus debt management is the administration of the National Debt, providing for loan repayment, payment of interest and arranging the refinancing of maturing bonds. It also involves raising loan at the cheapest interest rate and the consideration of debt servicing capacity of the nation.

As a result of the huge external debt, government in an effort to manage the debt has taken some measures to contain the situation with a varying degree of success. Some of these measures are as follows:-

i. Embargo on new loans:- This involves temporary

stoppage of further external commitments in the form of new loans until the debt position improves. This method is not aimed at reducing the burden of servicing debt but rather to prevent additional burden. It should be recalled that since 1984, an embargo has been placed on new government loans from abroad except in respect of projects that are considered in the interest of the economy (this embargo has since been lifted). Moreover, loans whose terms are exceptionally favourable especially interms of interest rate and long repayment periods are also accommodated. However, foreign capital is necessary compliment in the development process and so what is needed is not absolute ban but judicious utilization of bonded funds.

ii. Satutory Provision of Maximum level of Commitment:- Immediately after the civil war in 1970, it became necessary to raise some external loans to support the rehabilitation of the war damaged facilities. At this time, the government was conscious of the optimal level of indebtedness, consequently, the rehabilitation, reconstruction, and development decree was promulgated in 1970 which limited the level of indebtedness to a maximum of ₦1 billion. This was adhered to until 1978 when Decree No.30 of 1978 was promulagated raising the ceiling to a maximum of ₦5 billion. This ₦5 billion ceiling fixed was not adhered to.

iii. Issuance of directives by Federal Government:- In 1962, the Federal government issued a directive asking each state government not to exceed a maximum of ₦200 million limit as external loan outstanding. Moreover state governments were to ensure that they maintain financial prudence by not utilising more than 10% of their revenue on debt servicing. The federal government then threatened to deduct at source the equivalent of debt service obligations before the balance of their allocation would be released.

iv. Refinancing of Trade Arrears:- The growth of short-term liabilities especially in the form of trade arrears became a problem beginning from 1982. At this time also, Nigerias foreign creditors had started to refuse the openings of new lines of credit. It therefore become necessary to seek debt relief by re-financing the trade arrears. Consequently, agreements were reached to finance arrear in respect of confirmed letters of credit (L/Cs) outstanding as at 13th July 1983. Under the agreement, a total of ₦2,112 million worth of letters of credit were financed. Inspite of these refinancing, the arrears continued to mount and this increased the level of indebtedness.

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The main feature of the agreement reached included six months of grace and repayment periods of 30 months beginning from January, 1984. Interests was fixed at 1½ above LIBOR (London Inter Bank exchange Rate).

Full repayment of the re-financed arrears were however completed in 1986. The agreement interms of the unsecured, unconfirmed letters of credit include the payment of interest at 1% above LIBOR with effect from January 1984; maturity period of six years including a grace period of 2½ years and the redemption of the promisory notes in 14 equal quarterly instalments with effect from 1986. The notes could also be redeemed in local currency based on terms to be agreed on with the Nigerian authority.

The terms of agreements were acceptable to the uninsured creditors and so far a total of $3,186.6 million worth of promisory notes have been insured to this class of creditors. In the spirit of the agreement, a total of $32.4 million worth of such notes have been redeemed in naira. However, the authorities have temporarily suspended such redemption exercise because of some problems and abuses until a thorough assessment has been made. The uninsured creditors who had demanded that Nigeria first reach an agreement with the IMF has not accepted in principle to refinance the rescheduled debts.

v. Re-scheduling of Debts:- Similarly, a relief measure in the form of rescheduling of external debt has been worked out with private and official creditors. The negotiation with the London Club of private creditors which commenced during the second quarter

of 1986 was achieved and an agreement was reached to reschedule a total of $3.8 billion of principal repayment and arrear on L/Cs falling due between 1986 and December 1987. The terms included 1½% interest payments above LIBOR and maturing of 4 - 8 years grace periods. Moreover new money amounting to $320 million was made available between 1986 to 87. Similarly agreements was concluded with the Paris Club of official creditors involving a total of $6.8 billion in debt relief. These involved the rescheduling of principal interest on medium and long term debts due to this group between September 1986 and December 1987, as well as short term claims of insured creditors on arrears up to December 31 1983.

The success of rescheduling exercise was not unconnected with the agreement Nigeria reached with the IMF on the Structural Adjustments Programme. As a result of this accord, a standing arrangement involving SDRs 650 was granted. Although, Nigeria does not intend to draw on this facility, it enabled her push ahead with the rescheduling exercise.

Overall, the debt management strategy adopted prior to 1980, were appropriate and if they had strictly been followed, the debt problem today would not have been so serious.

Although the recent relief devices such as refinancing and rescheduling are very much relevant as strategies to ameliorate the current debt service burden nevertheless, they do not provide a permanent solution to the debt problem. It is in this regard that various ideas were being tossed around, one of these options was debt conversion as a means of solving the debt crisis permanently. Debt conversion or the 'securitization of debts' in debt equity swap will therefore be looked at more extensively as a means of permanent debt burden reduction in the subsequent pages.

3.5 Examination of Debt Conversion Scheme - The Federal government accepted the principle of debt-equity swap in 1988, soon after the introduction of the Structural Adjustment Programme (SAP).

3.5.1 Objectives of Debt - The objectives of the debt conversion programme are:

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

ii. To improve economic environment attractive to foreign investors.

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

iv. To stimulate employment generating investments in industries with significant dependence on local inputs.

v. To encourage the creation and development of export - oriented industries thereby diversifying the export base of the Nigerian economy.

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

3.5.2 Membership of the Debt Conversion Committee

The membership of the debt conversion committee is as follows:

i. The Central Bank of Nigeria - Chairman and Secretariat.

ii. Federal Ministry of Finance and Economic Development - member.

iii. Cabinet office - member

iv. Federal Ministry of Justice - member

v. Federal Ministry of Industries - member

vi. Honourable Minister of State for Special Duties - office of the President - member

3.5.3 Functions of the Debt Conversion Committee (DCC)

The primary functions of the Debt Conversion Committee (DCC) include the following:

i. To design and implement an efficient Debt Conversion Programme (DCP) in Nigeria;

ii. To establish clear and concise approval criteria and precedures;

iii. To review and approve applications and transactions within ressonable specified time;

iv. To continually monitor and review the progress of the programme and the investment project approved under it.

3.5.4 Debt Conversion Programme Guidelines

In what follows, guidelines covering rules and regulations, application, conversion and monitoring procedures for a Nigerian DCP is presented. The guidelines may be reviewed and amended from time to time by the Debt Conversion Committee (DCC) without necessarily affecting the status of previously competed transactions.

3.5.4.1 Rules and Regulations Eligible Foreign Debt

At the initial phase of the programme, the only class of debt that would be eligible for conversion shall, in the mantime, be 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 may be 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 shall rest with the debt conversion committee and will be taken in the light of developments under the programme.

3.5.4.1.2 Eligible Transaction Categories

In the application of the naira proceeds from debt conversion, the only three categories of application that would be entertained by the committee would be:

i. Conversion to cash for the purpose of making a gift/grant to Nigeria entities;

ii. Conversion for expansion or re-capitalization of investments in privatized entreprises;

iii. Conversion for investment in completely new projects.

3.5.4.1.3 Priority within Eligible Transaction Categories

Within the eligible transactions stated in

3.5.4.1.2 above, the following economic activities will be given priority in the following order:

i. Investment in production processes based on at least 80 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.

3.5.4.1.4 Minimum Size of Transaction

In order to minimize 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 3.5.4.1.3 (ii) and (iii) above the minimum amount of debt to be considered under the scheme shall be $0.25 million (one quarter of a million United State dollars) in first instance and

$25000 (twenty-five thousand US dollars) in subsequent redemption. In the case of conversion to cash for the purpose of making a gift, there shall be no minimum limitation.

Eligible Participants

All legitimate holders or assignees of designated debt(s) including Nigerians and foreign nationals whether coporate bodies or individuals, resident or non - resident, shall be eleigible 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 on FEM or in other way from Nigeria.

The entreprise(s) financed with the redemption proceeds is (are) registered as Nigerian entreprises under existing company laws at the time of the transaction.

3.5.4.1.5 Volume Control

The debt conversion programme shall be 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 converted are in accordance with

national priorities especially the policies on inflation and accelaration of industrial and agricultural development.

To keep DCP within the frame-work of the SAP, a volume control shall be applied in the form of annual and monthly ceilings. Such ceilings shall be kept under constant 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 DCC be carried over and added to the following month's specified limit.

3.5.4.1.6 Protection of Foreign Investment

Any approved investment made from the proceeds of conversion under the Nigerian 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.

3.5.4.1.7 Remittance Restrictions

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 preferrential terms of repayment to an investing redemptor over other creditors contrary to the terms and conditions of

existing debt rescheduling arrangements, the following limitations shall be placed on remittances of redemption proceeds and incomes arising thereof:

i. Interest income, profits/dividends, patent licence fees, and other invisibles 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 proceed.

iii. Repatriation of capital after 10 years shall not exceed 20 percent per annum.

3.5.4.1.8 Transaction Commission

A transaction commission payable in US dollars and equivalent to 2.5 percent of the discounted value of the debt to be converted shall be payable to the Central Bank of Nigeria (CBN) by the redemptor. The US dollar commission shall be payable to CBN account with the Federal Reserve Bank of New York (NY), or any foreing Bank as may from time to time be designated by the CBN.

3.5.4.1.9 Financing of Off-shore Costs of Projects

The Naira proceeds of Nigeria's DCP shall be applicable only to the local cost of the projects and shall be provided by the redemptor. The ability to provide the off-shore costs shall be 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.

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

3.5.4.2.1 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.

All such applications shall be made to the Chairman of the DCC at the Committee's Secretariat located at the Central Bank of Nigeria, Tinubu Square, PMB 12194, Lagos.

The Secretariat shall acknowledge in writing of by attested cable to the applicant or his agent(s), the receipt of completed application witnin three (3)

working days at the date of receipt of the application.

Application for approval in principle will be processed on case by case and on first come first served basis.

The committee will meet 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 receipts of such application.

The committee shall not be under any obligation to give reasons or justifications for approval or rejection of any application and its decision shall be final.

3.5.4.2.2 Required Information

The application to the Debt Concersion 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 incorporations; 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 BCP countries (if any).

iv. Undertaking of acceptance of and adherence to the guidelines contained herein.

v. Benefitciary or recipient of conversion proceeds and whether it is an existing organisation or a new company to be spefifically 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.

3.5.4.2.3 Verification of Applicants Particulars

The Central Bank of Nigeria through its usual correspondents channels shall verify the information supplied by the applicant.

3.5.4.2.4 Interview

Should the need arise, the applicant and/or his agent(s) shall be invited for interview on the terms and condition's of conversion.

3.5.4.2.5 Conversion Procedure - Auction

The method of debt conversion shall be by auction. However, the DCC can, at its discretion approve an application for conversion on its own merit.

3.5.4.2.6 Eligible Bidders

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

3.5.4.2.7 Conversion Procedure

An approved prospective redemptor or his agent(s) shall submit bid form(s) to the DCC at its secretariat located in the CBN giving particulars of the promisory note(s) debt instrument(s) to be redeemed. The redemptor or his agent(s) may submit up to two alternative

bids at an auction: If both bids are successful, the more benefial bid to Nigeria shall be taken as his bid for the auction.

3.5.4.2.8 Bid Schedule

Bid forms will be provided by the DCC Secretariat at the CBN, Tinubu Square, Lagos.

Bid will be received up till 11.00am and the auction will take place at 12.noon on last banking day of each month or any other designated day. The auction amounts to be redeemed and relevant conditions will be announced ten banking days before the date of the award.

Bid process will be handled by the DCC Secretariat.

3.5.4.2.9 Bidding

Bids will be delivered to the DCC secretariate at the CBN and such bids will specify the discount offered as percentage of the face value of the debt to be redeemed.

The DCC secretariat reserves the right to reject any irregular bid.

3.5.4.3.0 Award

Bids will be ranked in decreasing order of discounts offered.

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 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 telephine 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 US 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.

3.5.4.3.1 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 redemptor's bid price in the calculation of the naira proceeds.

3.5.4.3.2 Delivery of Debt Instrument for Conversion

The redemptor(s) or his agent(s) will deliver

the promissory note(s) debt instrument(s) for conversion to Chase ManTattan Bank within 10 working days of the auction in which his bid is successful. If a redemptor fails to deliver the debt instrument(s) to Chase within the stipulated time, he shall forfeit his allocation in the auction.

Provision of Redemption Proceeds:

Upon the fonfirmation of receipts of promissory Note(s) debt instrument(s) by Chase ManRattan 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 redemptor. The redemptor or his agent will be promptly informed.

3.5.4.3.3 Blocked Account and Release 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 to the redemptor's bank according to the cash needs of the approved project(s) as approved by the LCC

3.5.4.3.4 Cancellation of Redeemed Promissory Note(s)/Debt(s)

After redemption, the DCC will advice Chase ManRattan 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 ManRattan Bank shall issue a fresh promissory note in the amount of the redeemed balance to the redemptor.

3.5.4.3.5 Approved Status

Pursuant to the provision of sub-section 14(2) of the SFEM Decree, the DCC shall within 14 days of the conversion of dollar denominated promissory notes into naira, issue 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 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 projects.

3.5.4.3.6 Monitoring - Designated Redemptor's Bank

The blocked conversion proceeds held at the CBN shall be released to the designated redemptor's bank in amounts approved by the DCC from time to time. The redemptor's bank shall open only one special account for every redemptor into which funds released from the blocked account shall be credited for the

prosecution of the approved project(s). The redemptors bank shall furnish the DCC with monthly reports on each debt conversion account operated by it. Such reports shall include all the import and other foreign exchange transactions of the entreprise/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.

3.5.4.3.7 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 entreprise/company in which redemption proceeds have been invested should lodge information about all their import and other foreign exchange transactions with the DCC.

3.5.4.3.8 Documentation

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

3.5.4.3.9 Periodic Report by DCC

The Debt Conversion Committee shall submit to the Federal Government monthly, and quaterly reports highlighting the operations of the scheme and the operational problems encountered with recommendations to improve in effeciency and effectiveness of the programme. Periodic review and report shall be made on the projects financed with the proceeds of debt conversion.

Sponsors of approved projects under the programme shall submit Annual Report and Audited Accounts on their operations to the DCC

3.5.4.4.0 Non - Compliance

Transaction in violation of the guidelines stated herein or condition's set by the debt conversion committee or against the Laws of the country will be deemed null and void and will be subject to the penalties provided under the foreign investments Laws of Nigeria and the Decree Establishing the Debt Conversion Programme and all relevant laws.

Transactions not executed in accordance with the approval shall be null and void for the purpose of repatriation either or profit/dividend or capital.

The debt conversion committee may set and

modify execution procedures for controlling and supervising operations pursuant to the debt Conversion Programme in accordance with the priorities of the programme and the Decree establishing it .

With the guideline drawn, the management of external debt took a new turn on November 30, 1988 when some creditors holding Nigeria's medium-term trade debt promissory notes totalling some $450m assembled at the premises of the Central Bank of Nigeria (CBN) for the country's maiden debt swap exercise. At the first auction session $40 million worth of denominated promissory notes were converted into equity in four sectors viz manufacturing, Agric, cash gifts and grants exploration and mining at an exchange rate of ₦5.3364 to the American dollar. See Table 3.6 below

Table 3.6

Debt Conversion System - Sectoral Analysis of Successful Applicants - Auction No.1 on November 30, 1988

	No. of App.	Amount($)	Amount(₦)	Percentage
Manufacturing	2	17,500	57.6331	43.7500
Agriculture	4	16,600	55.6705	41.5000
Cash gifts & grants	1	4,5	10.0858	11.2500
Exploration and mining	1	—	4.3332	3.5000
T o t a l =	8		127.7226	100.0000

Source: Financial Post, December 11-17, 1988

Of a total of 40 bidders that participated at the auction, seven were successful and one partially successful, following a marginal discount rate of 36% adopted by the CBN. This rate was against the leading offered discount of 58% made by an applicant for the redemption of $4.5m This leading rate contrasted sharply with the minimum offer of 10% made by four potential redemptors.

The second auction session of debt conversion programme took place on 19th December 1988. A total of $30m worth of debt stocks were traded-off, $10m less than in the first auction. At the auction, a total of 33 redemptors were in attendance. Of 33, 17 were successful and a total of $27,791,119 was redeemed while the 18th was partially successful and redeemed $2,208,881 out of his $13,099,368 intended for redemption. During this auction a marginal discount rate of 37.2020 percent was used. This rate was 1.2020% higher than that of the first auction. The leading rate was 45.20% as against 58% of the first session. However, the minimum rate offered was again 10%

A break down of the amount redeemed showed that the manufacturing sector had 11 redemptors with a total of $12,434,719 while Hotel and Tourism had

one successful redemptor with $10m. Agriculture on its own had 6 redemptors with a total value of $7.565,300 In terms of the number of successful bids, the result of the second auction mirrors a remarkable improvement when compared with the seven successful bids in the first auction. See Table 3.6 below

Table 3.6

Debt Conversion System

Sectoral Analysis of Successful Applicants Auction Number 2 on 29 December 1988

Sector	No. of App.	Amount($)	Amount(₦)	Percentage
Manufacturing	11	12,434,719	39,583,358	41.4490
Hotel & Tourism	1	10,000,000	31,984,175	33.3333
Agriculture	6	7,565,300	23,727,435	25.2177
T o t a l =	18	30,000,019	95,294,968	100.0000

Source: The Nigerian Economist, January 17 - 30

In ordinary language, redemptor who offers a discount of 45% is offering his promissory notes to Nigeria at 55% price. Hence every Naira redeemed, Nigeria is given a discount of 45 Kobo and she is required to pay 55 Kobo for every one Naira worth of foreign debt redeemed. In this manner, the redemptor who offered 45.2001% at auction with tendered $2m promissory notes will now receive $1,096,000 instead of the original $2m. When converted at the current

exchange rate of ₦5.3530 to one US dollar and the redemptor will receive ₦5,866,877 instead of the $10,706m. By simple arithmetic, Nigeria will be paying less than the face value of any redeemed instrument under the programme.

At the third auction, the debt conversion committee (DCC) granted approval in principle to a total of 69 applications. That brought the value of the total applications granted approval in principle to stand at about $702.5m. Of this number, the committee approved 23 of these applications on the 31st of March, 1989. The first of such meeting in the year. At the third session $25 million was auctioned and redeemed. Also the committee extended the period within which the redemptors are expected to deliver their redeemed promissory notes to Chase Merchant Bank from the previous 10 working days and the period within which the transaction commission should be paid from 5 working days to 10 working days.

As for the fourth auction ₦125m was put on sale on 31st March 1989. This was equivalent to $16.40m at the exchange rate of ₦7.5875 to the dollar operating at the time. However, activities at that auction was so much on the low side that only ₦11.96m was eventually redeemed by 3 redemptors. The first

time an amount put on sale was not cleared by redemptors. This could only be explained by the wait and see attitude adopted by the other potential redemptors and the violation of the regulations governing the debt conversion auction by some potential and willing redemptors.

On the whole, by the fifth auction, about $113,113,731 has so far been redeemed and only one billion dollars is earmarked for conversion this year.

The bidding of proceeds of debt were based on the rate of discounts offered by each of the redemptors while the allocation of proceeds were ranked in descending order, starting with the highest face value of the surrendered debt. Each successful applicant got the Naira equivalent of the redeemed debt less the relevant discount at the prevailing FEM rate. The amount so redeemed is put in an account with CBN. It would not yield any interest and it is to be released in tranches to the redemptor as may be required for the financing of local projects.

By simple arithmetic, debt converted by the fifth session is a meagre 0.37% of the $30.5b As stated in the guideline, the auction is supposed to hold at the end of every month, but we are witnesses to the fact that eleven (11) months after the programme

kicked off only seven (7) auctions have taken place. At this pace it is not likely that the $1b mark can be achieved before the year runs out which would have amounted to 3.2786 percent reduction. This of course is a pointer to the fact that even the government has some reservations about the scheme.

On the whole $4.8b of the external debt is earmarked for conversion which will mean 15.7377 percent reduction. But these are mere speculations - we are concerned with the actual. Even if this is achieved without abandoning the scheme midway like Brazil we cannot say that debt conversion is a panacea for debt burden. Moreso experts have said that relief would be experienced only if we convert 0.5 to 1.0% of the debt owed ICM because ICM loans are hard loans and reduced ICM debt - burden can be freed to finance investing spending. We must bear in mind that large scale conversion carries with it an unavoidable consequence - inflation.

Other associated cost of implementing this programme by Nigeria include the following:

As foreign organisations and individuals increase their shares in Nigerian entreprises the political and economic independence of Nigeria is at stake.

Policies and programme are now being manipulated to suit the economic interest of foreigners.

The return of the so-called technical partners that has followed the debt conversion has negated all the achievements of the last two decades in the pursuance of self - reliance in technological development especially the strategic areas like steel, machine tools, agro-allied industries etc.

As the governor of CBN, A. Ahmed remarked recently, government has taken note of criticism against NEPD and "there are indications that further modifications to the decree would be made in due course". Already, investments in industries like jewelry, clothing, clock repairs and rice milling which used to be exclusively reserved for Nigerians are now opened to foreigners for a maximum participation of 40 percent. Thus debt conversion has definitely returned the ownership structure of entreprises to pre - 1972 position. Debt convertion is an open invitation to foreigners to take over the commanding heights of the economy.

Planning is therefore constrained by the foreign domination of vital sectors of the economy. The country cannot plan what it does not own. If planning means mobilization and allocation of resources

for development, it is difficult to see how it can be done effectively in an economy that is controlled by foreigners. As Professor Onimode put it, "the history of planned economic development reveals that planning cannot be successful unless and until the commanding heights (that is basic industries, transport, communications, banking and finance) are in the public hands". Thus the first element in the planning crisis is going to be trying to mobilize and allocate what belongs to the foreigners.

Owing to the massive Naira depreciation since SAP began, the nation has lost from the scheme while the foreign creditors have gained. The currency exchange rates have changed significantly between the time the external debt was contracted and the time of debt equity conversion.

Swaping external debt for equity shares in Nigerian companies has not solved the foreign exchange crunch of the country as it still experiences foreign exchange constraint in importing spare parts, industrial raw materials, machinery and equipment etc. Hence low capacity utilization in our domestic industries still continue.

Furthermore government is under pressure

to review the Land Use Decree as a way of permitting foreign equity participation in the agricultural sector.

Finally, high proportion of income generated by domestic activity GDP is being paid to foreigners in form of interest, dividend, profit, and service charges leaving very little as national income (GNP). This has further reduced the nation's capacity to service her external debt.

Chapter Four

4.1 SUMMARY AND CONCLUSION

The debt crisis is a manifestation of a fundamental problem in the international financial system. The high external indebtedness of Nigeria has resulted from the decreasing export earnings against the background of rising import bills, poor economic management and misuse of resources, corruption and collosal waste of public funds. Debt conversion was introduced in 1988 for the purpose of settling international debts which the nation could not retire. It was hoped that debt-equity-swap would enable the country to pay it's foreign debt in local currency which would be invested in Nigeria.

Debt conversion has benefited foreign creditors in several ways. They can now recover their money from a country which previously defaulted although at an amount less than the face value of the promissory notes. It has offered the foreign creditors the best opportunity to gain full control of an economy which they lost in the aftermath of indigenisation program in 1972 and 1977

Debt conversion has ensured that the wind of deregualtion blew from the commodity market through the foreign exchange market to the interest rates components of the money and capital markets. Embarking on DES has ascribed undue emphasis to the role of foreign capital in development process.

Moreover since the debt conversion programe commenced only about 2 - 3% of total world debt has been successfully secritiezed which amounted to approximately $12 billion. Many countries that adopted it have already abandoned it due to lack of success and as with the case of Mexico it's debts have even risen to a higher level after the adoption of the programme. Mexico as at 1987, was listed amongst the "10 most highly indebted nations" of the world.

Finally, how conducive can an economy that finds it difficult to pay its debts be to a foreign investor? What incentives could now be provided that were not in existence prior to the conversion, that would now attract him? These are some of the questions that debter nations consider and which make them go beyong considering only economic issues to consider political and social issues bothering on foreign domination especially at the insistence of the creditor nations that they have to adopt the option.

At the current rate of exchange of the naira to the dollar, a one third conversion of the country's external debt is more than sufficient to give the foreign creditors a hundred percent ownership and control of all the federal government owned companies and parastatals.

Since the country started to implement the scheme of debt-equity swap in 1988 her economic and political

dependence has increased. Nigeria that is claiming the leadership position in Africa has set bad example for other under-developed countries by implementing DES. It is because of the demerits mentioned in chapter three and because the scheme is not being implemented at Nigeria's terms that this project is calling for its scrapping. DES has been forced down our throats by the foreign creditors. The foreign investors have gladly come to take over the commanding heights of the Nigerian economy, through debt-equity swap. DES should not be operated at the expense of the economic and political independence of Nigeria. The goals and spirit of the Indigenisation Decree should not be compromised.

4.2 SUGGESTIONS

What is needed is a set of policies that reduce interest charges and level of indebtedness. Otherwise, it will be nearly impossible for Nigeria to raise the level of domestic investment and embark, once again on a path of sustained economic expansion. In my opinion; debt relief in some form or other is essential; this could take several forms including voluntary action by the creditors, or initiatives on the part of the debtor countries.

The immediate outlook for a comphrehensive, negotiated settlement of the debt problem is not encouraging and, if more progress is to be made I believe Nigeria and other debtor nations may have to act collectively, in a united manner (such as a "Debtors' Cartel"), or reach an implicit understanding to follow a policy of "default leadership", or failing that, in some cases take unilateral action.

The need for unilateral action by the debtor countries arises from the fact that creditor governments have not fully accepted the idea that they share responsibility for the debt crisis and no commercial bank has accepted publicly that when loans go bad it is natural to expect that they will not be paid. Nor have creditor governments and banks accepted that they have an obligation to bear part of the burden of adjustment by subsidizing interest rates or reducing the level of idebtedness through some formular of debt forgiveness. The principal concern of creditor countries to date has been to prevent a possible collapse of the international financial system. In fact there never was much danger of a collapse in the world financial system. The debt at risk is only a small fraction of the combined GNP of the creditor countries.

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