

**Conversion of Official Bilateral Debt:**

**The Opportunities**

**and**

**the Issues**

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## Conversion of Official Bilateral Debt: The Opportunities and the Issues

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## I Introduction

Even as for many middle-income developing countries, the debt crises of the eighties are rapidly becoming a problem of the past - with several of the previously severely indebted middle-income countries, like Chile and Mexico, experiencing dramatic increases in new capital inflows and foreign exchange reserves - many of the severely indebted lower- middle-income countries (SILMICs) and lower-income countries (SILICs) are still struggling with large debt overhangs, that are major obstacles to their growth and development prospects.

As many of the countries in these two latter categories (SILMICs and SILICs) owe a large proportion of their external debt to official bilateral creditors, mechanisms such as debt conversion of that debt, can be one very useful tool for reducing their debt overhang; furthermore, important efficiency gains - from a developmental and/or growth perspective - can be achieved, if the use of local currency linked to the debt reduction is productively channelled.

In what follows (Section II), we will examine first the need and the potential for official debt conversion in heavily indebted LMICs and LICs. Then we will describe current practice in the Paris Club (where official bilateral debt is rescheduled and/or reduced) regarding such conversions. We will briefly review existing experience with official debt conversion.

Section III will examine lessons from the commercial debt conversions, mainly carried out in middle-income countries.

Section IV will evaluate potential benefits and costs of official debt conversions, for both debtors and creditors. Amongst potential benefits, the role of debt conversions in reducing debt burdens, catalysing new flows (both private and public) and ensuring efficiency gains will be highlighted. Amongst the problematic effects, the risk of possible inflationary impact will be examined, and policy suggestions made to deal with such a potential problem.

The conditions under which official debt conversions are particularly beneficial will be stressed.

Section V will address technical issues, such as transparency of operations, ownership of converted claims and need for financial intermediaries.

Section VI is devoted to conclusions and policy recommendations. Suggestions are made for actions and possible further research for the World Bank and other

international institutions, as well as for actions for creditor and debtor governments.

## II The need, the potential and the reality of Official Bilateral Debt Conversion (OBDC)

### 1. The need of OBDC

As can be seen in Table 1, the total level of external debt stocks for all developing countries has grown very rapidly, between 1982 (when widespread debt crises exploded) and 1991. Growth of debt stocks has been particularly rapid in the SILICs whose total debt outstanding and disbursed (DOD) has more than doubled from \$79b in 1982 to \$175b in 1991. Total interest arrears of the SILICs have also increased significantly during this period, from \$1.3b in 1982 to \$12.9b in 1991, reflecting the growing incapacity of severely indebted lower-income countries to service their debt. Such large arrears have many undesirable effects for both debtors and creditors.

Two factors make the SILICs' debt a greater burden than for other highly indebted regions. One is the far more severe poverty of those countries, which implies that contractions of output and income linked to excessive debt overhang are particularly damaging in terms of human welfare. Another is the greater structural weaknesses of those economies, as well as their greater difficulty to adapt to changes in the international environment. As a result, of these structural weaknesses and in some cases of mistaken policies, export performance has been disappointing in the eighties in the SILICs, with an average decline of exports of 2 per cent per annum, leading to a further deterioration (than would have otherwise occurred) in debt service ratios and debt/export ratios (see Table 2). Thus, in the late eighties, both debt service and debt/exports ratios were higher in the SILICs than they had been either in 1980 or 1982 (see again Table 2). Indeed, SILICs' debt service ratio was in 1989 still double the 1980 one, whilst debt/exports ratios were almost five times as high.

This situation is in contrast with that of the severely indebted middle-income countries, and especially the upper middle-income ones. Firstly, their total DOD has started to decline in 1991 (see again Table 1), mainly as a result of declines in the private debt owed (which has fallen quite significantly since 1988), reflecting the impact of Brady deals, as well as fairly large amounts of

debt conversions, mainly for equity but also for development purposes (for more details see Section III below). Secondly, as can be seen in Table 2, the export performance of SIMICs during the eighties has been far better than that of the SILICs, with an average positive growth rate of 3.5 per cent in the 1982-1989 period. As a result, debt service ratios have declined quite substantially during the eighties, even though they are still at a fairly high level.

An important element explaining the increase in all developing countries' debt stock, since 1982 (and particularly for the SILICs) is the very rapid rise of bilateral DOD. For the SILICs, bilateral debt rose from \$32b in 1982 to \$80b in 1991, representing in the latter year over 45 per cent of the total stock of debt of these countries. For the SIMICs, bilateral debt has also grown extremely fast, from \$35 billion in 1982 to \$108 billion in 1990, though declining somewhat in 1991. This rapid rise in bilateral debt of all SIDC has occurred despite the bilateral cancellations of ODA debt amounting to over \$8 billion between 1983-90 for the SILICs, and despite the successive application of Toronto, Venice, Houston terms and now "enhanced Toronto terms" in Paris Club agreements for SILICs and SILMICs. The increase has been due principally to the effect of exchange rate changes since 1985 and due to the interest capitalisation practices of the Paris Club.

A further source of concern is the increase in multilateral debt, especially in the case of the SILICs, whose outstanding debt obligations to multilateral creditors rose from around \$11b in 1982 to almost \$35b in 1991 (see again Table 1); that of the SIMICs also rose very sharply. It is not clear what can and should be done to reduce the burden of multilateral debt/debt servicing, given the need to safeguard the creditworthiness of these institutions in international capital markets, that allow them to exert valuable leverage for raising private funds from capital markets, with publicly financed capital funds of a significantly small size than the private funds raised. However, the large burden of multilateral debt service (and the difficulty of reducing it) increases further the need for action in reducing and/or converting bilateral debt, of both SILICs and SILMICs.

These trends clearly suggest the need for bilateral debt reduction/debt service reduction beyond that envisaged in the "enhanced Toronto terms" for SILICs and beyond that already granted for SILMICs. In this sense, export credit agencies now need to accept the same realities that commercial banks have recognised and engaged not just in cancellation but also in conversion options on a scale

which would reduce bilateral debt to realistically serviceable levels. Debt conversion options should particularly be used not just in cases where debt reduction has been insufficient, but also where they would imply other gains (including efficiency ones) and where undesirable effects (e.g. on inflation) are marginal or can be easily counteracted by debtor government policy.

As regards official bilateral debt, a number of measures for debt reduction have and are being implemented for the SILICs but there is evidence that for an important number of those countries progress is still insufficient.<sup>1</sup> It is disappointing in this context that neither the British proposal (known as Trinidad Terms) made in September 1990 by John Major nor the Dutch proposals made by Minister Jan Pronk were adopted by the Paris Club. The consensus reached in the Paris Club in December 1991 (and already applied to Benin and Nicaragua) dilutes the Trinidad Terms quite considerably, even though signifying progress over previous Toronto terms. In these "enhanced Toronto terms", creditors can opt for: (i) cancellation of 50 per cent of eligible maturities being consolidated; (ii) halving interest rates on non-concessional debt; (iii) stretching export credit and concessional debt repayments further; and (iv) capitalising reduced interest rates in a way which would result in equivalence in NPV terms with the other options.

As regards bilateral debt of SILMICs (severely indebted lower- middle-income countries), the Paris Club agreed in September 1990 on the lengthening of grace periods and maturities, to countries in that category following three criteria: low per capita income; a high ratio of Paris Club debt for commercial bank debt; and a heavy debt and debt service burden as measured by the ratios of debt to GNP, debt to exports and debt service to exports.

## 2. The Paris Club 10 per cent clause

Also, as regards SILMICs in that category, the Paris Club agreed in September 1990 the introduction of a debt conversion clause, which says that: "creditor countries can, on a voluntary and bilateral basis, swap part of the claims for debt-equity swaps, debt-for-nature swaps and debt-for-development swaps for up to 10 per cent of bilateral official or officially guaranteed non-concessional loans, and (where relevant) for up to 100 per cent of ODA loans; there is also a value limit (\$10 million or \$20 million, depending on the case), which can be used if it is higher than the 10 per cent of non-concessional bilateral debt". In December 1991, the same clause was extended by the Paris Club to the SILICs. Initially, debt conversion efforts were focussed on commercial debt, with swaps

of official bilateral debt practically non-existent; indeed, there were limitations on creditor governments selling their debt.

However, the balance of emphasis is rapidly shifting towards bilateral official debt conversion, both for equity and development. Such operations potentially open debt conversions for other categories of countries (low-income and low-middle-income), for deals whose scale could be large, and which could be negotiated more easily and quickly with creditor governments.

By early 1992, amongst the countries that has already has this clause approved by the Paris Club were: Benin, Congo, Cote d'Ivoire, Ecuador, Egypt, El Salvador, Honduras, Jamaica, Morocco, Nicaragua, Nigeria, Peru, Philippines, Poland and Senegal.

At the time of writing, relatively limited activity had actually taken place in finalising official debt conversions in the framework of the "10 per cent clause". However, a number of transactions are reportedly being considered or about to be implemented, including the following:<sup>2</sup>

- Poland has presented a detailed request to its creditors for funding of a \$3bn Environment Fund, with the "10 per cent clause". This was discussed at a large conference with creditor governments in mid-1991. Reportedly, the US, and France have made commitments to such a Fund.
- In Egypt, the French government is reported to have accepted to convert up to \$10 million of it bilateral debt, and use it for co-financing (with the World Bank), the Social Emergency Fund. France and other creditor governments are reportedly considering a programme of official debt-equity conversions.
- For Morocco, the Netherlands and other creditor governments are considering the possibility of debt-equity swaps with their Paris Club debt.
- For Nigeria, different creditor government are reportedly considering using D-E-S conversions to support privatisation.
- Canada is examining the possibility of converting official debt for funding additional UNICEF high priority spending in Bolivia.

It should be noted that certain European and North American creditor governments have, even before September 1990, been selling (or converting) this Paris Club debt, with the aim of improving the balance sheet of their export credit agencies. Because these operations were not allowed in the Paris Club

framework, they were not publicised. However, they are interesting because they pioneered D-E-S with official debt, showing that it is feasible for an export credit agency both to take equity in LDC companies and/or to sell official debt to private investors. One creditor agency converted its debt claim on Mexico into equity in a private steel company, which it later sold, recovering full face-value of its pre-converted debt claim.

### 3. The US Enterprise for the Americas Initiative

Slightly before (June 1990) the multilateral "10 per cent clause" initiative was launched by the Paris Club, President Bush proposed a US Initiative for the Americas. This Initiative had three pillars; trade, investment and debt reduction.

As regards debt, the US Initiative proposes - for Latin American and Caribbean eligible countries - that stocks of concessional debt (PL-480- and AID) be significantly reduced; interest on the remaining debt in this category can be paid in local currency into an environmental fund, if an eligible country has entered into an Environmental Framework Agreement; otherwise interest will be paid in US dollars. Thus, this programme encourages a commitment to allocate domestic resources to the environment in exchange for debt reduction. Initiatives have recently been approved in the US Congress to broaden the local use of interest payments, more generally to development purposes, and specifically for child development.<sup>3</sup>

Within this clause (already approved by the US Congress) the US government has started both cancelling portions of PL-480 debt, and allowing that interest on residual stocks be collected in local currency. ECLAC<sup>4</sup> reports cancellation of large portions of US bilateral debt, for Guyana, Honduras, Nicaragua, Haiti and Bolivia (countries whose US bilateral debt is mostly concessional), as well as smaller (in percentage terms), cancellations of Jamaica's and Chile's bilateral debt obligations. Implementation of the environmental fund is gradually beginning; thus, Chile - the first country to be granted this concession, in June 1991 - was, at the time of writing, in the process of defining its environment framework agreement.

As regards non-concessional debt, owed by eligible LAC countries to the EXIMBANK and Commodity Credit Corporation, the Initiative for the Americas contemplates that sale of a portion of this debt would be undertaken to facilitate debt-for-equity, debt-for-development or debt-for-nature swaps; these swaps would imply both a conversion and a reduction of such debt.



Legislation to approve such operations has been seriously delayed. Potential problems may also arise, for approval of new appropriations to fund new reductions in PL-480 debt.

#### 4. Other official debt conversion initiatives

Outside the framework of the Paris Club, other interesting deals with bilateral official debt have been carried out or are being considered.

First, some developing countries, and especially Mexico, have pursued an active strategy as creditors to reduce official claims via debt conversions on Central American and Caribbean countries. Some of these operations were used for example, by Mexican investors to purchase a privatised company in Honduras, to lease land on which to grow grain in Nicaragua, and to build new hotels in Costa Rica.

Second, the official debt claims of Central and Eastern European countries and the ex-USSR against developing countries can be converted. An example is provided by the sale of ex-German Democratic Republic claims on developing countries to commercial firms engaged in importing raw materials. The commercial firms are reported as recovering full face value through imports of raw materials, from countries such as Zambia; this seems very undesirable from the LDC perspective, as it implies full pre-payment of official debts, in circumstances that Zambia is not even servicing the rest of its bilateral debt in full.

### III Lessons from commercial debt conversions

As part of debt management techniques, conversions of private commercial bank debt have been extensively used since 1985 in a number of developing countries (mainly middle-income ones) as a means of reducing debt, promoting foreign investment, encouraging privatisation and furthering the achievement of other development objectives.

#### 1. Debt-for-equity swaps

As can be seen in Table 3, the estimated total volume of commercial debt extinguished through official ongoing commercial debt conversion programmes in the 1985-1990 period reached US\$33.6 billion; this represents around 15 per cent of the total commercial debt of all heavily indebted countries; for the

countries listed in Table 4, commercial debt conversions also represented 15 per cent of the total commercial debt they owed in 1985. Tough debt conversions clearly did not lead to overcoming the debt overhang of most heavily indebted countries (HICs) - with the exception of Chile, whose debt conversion programme was a major factor in eliminating the country's debt overhang, as via this mechanism almost 70 per cent of 1985 commercial debt was converted, see Table 4 - they did make a meaningful contribution to such debt reduction in several of the heavily indebted countries. As can be seen in Table 4, in both Argentina and Philippines, debt conversions reduce over 30 per cent of those countries' 1985 commercial debt stock; for all other countries, 1985-90 debt conversions represent less than 20 per cent of 1985 commercial debt stock.

It is interesting to emphasise the evolution of volumes of commercial debt conversion. After a rapid expansion of debt conversions in 1987 and 1988 (see again Table 3), some countries began slowing down or suspending such conversion in the face of concerns such as domestic monetary implications of these operations. In other countries (especially Chile) debt conversions grew rapidly, till their very success reduced the stock of available debt to sell. The revival of debt equity swaps in 1990 in countries like Argentina, Mexico and Philippines was largely linked to privatisation. This was partly in response to the potential adverse inflationary effects of debt conversion programmes; the advantage of using debt conversions for privatisation is that such operations do not lead to monetisation of foreign debt. Both the fiscal and monetary expansionary impact of conversions is avoided if publicly-owned enterprises are privatised and the equity is swapped for debt. Furthermore if privatisation leads to increases in efficiency, in loss-making enterprises, the debtor government would gain from a reduction in the need to subsidise the public enterprise. If the government swapped debt for equity in currently profitable enterprises, the reduction in the central government's income from those enterprises could have a future negative fiscal impact.<sup>5</sup>

Another factor explaining recent expansion of debt conversion programmes is that several recent bank debt restructuring agreements (especially in the context of the Brady Plan) contain commitments of debtor countries to engage in debt-equity swaps.

The increased use of market-based debt reduction techniques (and especially debt-equity swaps) has been facilitated and in turn, has contributed to, a marked growth in the size of the secondary market. According to the data

presented in Figure 1, total volume of trading of LDC debt reached in 1990 around \$100 billion. (NMB, the largest European traders, estimate trading volumes reached at least \$150 billion in 1990). This is in sharp contrast with levels in 1983 or 1984, when trading in LDC debt reach only \$0.5b. Besides a dramatic increase in volume of trading, and closely related to it, there has been a streamlining and simplification of procedures; in particular, the documentation for carrying our swaps has been significantly simplified and standardised. The fact that all post-Brady bonds are really perfectly tradeable and assigned documents has played a major role in facilitating - and expanding volume of - transactions. Given that deals were initially complex to arrange on the commercial debt secondary market, its impressive development since the mid-1980s may show important potential for official debt trading to increase significantly (and to become operationally simple) especially for swapping debt for equity or development.

A review of the different country experience with commercial debt conversion and of the literature<sup>6</sup> on the subject seems to lead to the following three broad conclusions:

1) The economic effects of debt conversions are very heterogeneous amongst countries, and sometimes in different periods within the same country. Factors which seem to contribute to more positive results include: a) stable macro-economic environment, with low fiscal and quasi-fiscal deficit, b) the existence or parallel development of domestic capital markets, which can attenuate or eliminate monetary effects, c) clarity of objectives pursued with the programme, d) carefully designed debt conversion programmes which gear it to meeting objectives (e.g. debt reduction, encouraging additional foreign direct investment) and controlling problems, e.g. excessive monetary expansion, misuse for round-tripping of funds.

2) Debt-equity swaps have, if the policy framework, the circumstances and the programme design are right, yielded some valuable positive results. These have included:

a. Major reductions in commercial debt, so significant that they contributed in the Chilean case in a very important way to reducing the debt overhang, and thus helped the country's return to international capital markets; in all the other cases however, the reduction of debt has been far less meaningful (see again Table 4). However, in the Mexican case, the country has (like Chile) now

returned to the international capital markets; debt conversions played some (though not a major) role in achieving this objective.

Both debt reduction and the resulting (in some cases) renewal of capital inflows led to a reduction of negative net transfers or to their reversal.

b. Investment promotion and return of capital flight. An important bonus resulting from debt-equity conversions has in several cases been its contribution to help attract foreign direct investment. There is debate in the literature about how much FDI attracted is additional, because the answer depends on the assumptions upon which a counter-factual is based, that indicates how much foreign capital would have entered in the absence of the conversion programme. However, especially in some countries (and here again Chile and Mexico are leading examples) there is ample evidence to suggest that conversions have contributed, both directly and indirectly, to accelerate the pace of foreign investment. The subsidy granted had an important influence on persuading particular investors to come into those countries, who may otherwise not have come. Policy-makers in countries like Chile stress that the favourable publicity concerning the country's economic performance, favourable business climate, and economic openness generated by Chile's early adoption of debt conversion played an important indirect role (via for example favourable exposure in the international financial press) in promoting FDI flows to that country. This "Kick-starting" of FDI flows to countries where previously both foreign and domestic investment was depressed is a very valuable bonus of some debt conversion programmes, which could be replicated hopefully in other, relatively poorer countries. Two caveats are important. First, debt conversion will be effective in helping catalyse FDI and possibly other private flows (e.g. portfolio flows) if they are part of a policy package that make the country attractive to such flows. Second, there may be some trade-off between applying selectivity criteria to enhance the positive development and macro-economic effects (e.g. demanding new flows to accompany debt conversion, as was done for example in Argentina, and/or restricting the sectors for which debt-equity swaps can be used as was done for example in the Philippines) and the magnitude of the debt conversions carried out.

Debt conversion was also used to facilitate the return of capital flight. The Chilean experience is also interesting, as a special window was opened, for residents; this facility gave a smaller subsidy than that for foreign investors but offered an implicit tax and legal amnesty. The programme was very successful in attracting returned capital flight.

c. Export promotion and import substitution. To the extent that the additional FDI attracted by debt conversions goes into tradeables sectors (and especially if they bring with them know-how, additional markets, more efficient technology), this will help promote production of foreign exchange earning and/or saving activities. There is some evidence that an important share of FDI entering through debt conversions (especially in countries like Mexico and Philippines, whose governments had assigned this objective as a priority one) has gone into such activities.

d. Privatisation, as pointed out above, debt conversion programmes have increasingly boosted privatisation programmes by providing an additional source of demand for equity in the companies involved. In some countries (e.g. Chile) the debt conversion programme reduced debts of state-owned enterprises, making such companies more attractive to potential private shareholders.

e. Strengthening private sector finance. In countries like Chile, Brazil and Ecuador, the debt crisis coincided and largely caused financial problems and/or crises for the domestic private sector, especially the financial sector. Debt conversion programmes helped strengthen the private sector, particularly by lowering excessive levels of debt. This seem to have contributed to a recovery of domestic private investment.

As regards the positive effects described in d. and e., an important caveat should be made. It is important that there is a high degree of transparency in such operations, to avoid excessive subsidies going in a hidden way either to foreign investors buying shares of privatised companies or to the domestic private sector, including cases where no subsidies were needed, as was reportedly the case in several debtor countries.

3) Though debt conversion programmes have important beneficial effects for debtor economies, they also have problematic effects, which can be partly or totally counteracted by efficient programme design and implementation. The potential problems include: a) Monetary and fiscal effects, with inflationary potential. These are meaningful if the swaps are large, if debt is exchanged against local currency, if this increase in money supply is not regulated carefully in time, and if compensatory measures (fiscal and/or monetary) are not taken. If the scale of conversion is small (in relation to the money supply) the problem is not meaningful, especially if the rate of expansion of the money supply and the magnitude of the fiscal deficit are small. However, experiences like the Brazilian one illustrate that in a context of high

inflation, and high budget deficit, conversions can accentuate an already serious problem. If the conversion is made against bonds, placed in the domestic capital markets, the monetary impact is diminished, but there may be a negative effect on increased interest rates. b) Net effect of conversions on Balance of Payments. There is a risk that the net effect on Balance of Payments could be negative if the converted debt was previously not serviced in its totality, if there was considerable round-tripping and/or the foreign investment is not "additional", and if the flow of profit remittances and capital abroad is higher (on a net present value basis) than the interest and amortisation payments saved by the conversion. c) Debt-equity conversions normally imply an important subsidy, either to a foreign investor or less frequently to a resident; this could lead to an inappropriate allocation of resources, unless the operation is considered to imply important net efficiency gains. The magnitude of the subsidy can be regulated by the Central Bank, either through a market (via an auction) and/or through administrative measures, such as fixing a lower value for the local currency swapped per unit of debt.

## 2. Debt-for development swaps

The resurgence of debt-equity programmes, discussed above, has been accompanied by increased interest in other forms of conversions, which can be broadly called debt-for-development swaps. Most publicity and a large share of the operations have been focussed on debt-for-nature swaps. However, some pioneering operations in broader debt-for-development swaps have been carried out; for example, six banks, from three industrialised countries, have donated to UNICEF their outstanding debt obligations in the Sudan valued at more than \$20 million. These operations allowed for funding of high priority clean water projects in the Kordofan region, with positive effects both on health and the natural environment. UNICEF is currently negotiating further donations.

Commercial debt-for-development swaps can be classified, depending on whether they originate in purchase or donations. Most frequently, international charitable organisations, or developed-country government purchase commercial debt on the secondary market, which are then converted into local currency. In other cases, banks have donated debt to an international charity or NGO, with the condition that the debt be "paid" in local currency, in a previously agreed programme, for conservation or social purposes.

The total face value of commercial debt-for-development transactions identified reached only around US\$500-600 million. The scale of total commercial debt-for-development swaps is not only incredibly small in relation to the total commercial debt of developing countries, but also in relation to debt-equity swaps (see Table 3). The magnitude of commercial debt-for-development swaps only represent 1-2 per cent of total commercial debt-for-equity swaps. Commercial debt for development swaps have clearly, at least until now, not made a meaningful contribution to reducing the external debt overhang. However, they have contributed marginally to such a reduction (which is positive).

As regards the benefits and costs of debt-for-development swaps, a review of the experience indicates that perhaps the main benefit of such deals is that it can place emphasis - both within the country and internationally - on high priority sectors, such as social spending. By attracting attention (via usually highly publicised operations), to particular high priority programmes, these swaps may serve as a catalyst for larger shifts, in debtor government priorities and/or in donor and other international agency, priorities. Particularly where such high priority areas have been relatively neglected, this will imply important efficiency gains from a broad development perspective. Furthermore, given favourable publicity, the multiplying effect in local currency of donor or creditor effort, and the assurance that the international agent's contribution will be channelled to high priority spending, debt-for-development swaps may encourage additionality of foreign exchange flows, which would otherwise not have entered the country.<sup>7</sup>

The net foreign exchange flow effect of debt-for-development swaps tend to be far more favourable than debt-equity swaps, as in the former there is no outflow of profit remittances and capital amortisation of offset the reduction in debt service payments, as occurs in the latter. This assumes that D-D-S operations are also carefully regulated by Central Bank authorities to avoid attempts at abusing such operations for "round-tripping". It should be stressed that from a debtor country perspective, debt-for-development swaps are more favourable if there is a clear net foreign exchange saving. This occurs particularly if the country was or was about to start servicing that debt. If the country was not, and was not about to start, servicing that debt, then the main gain occurs in a shift of spending to high priority sectors.

Given the relatively small magnitude of most commercial debt-for-development swaps so far, risks of undesirable inflationary impact have been relatively

marginal. This is particularly true where inflation and budget deficits are low, and where local currency proceeds from debt-for-development swaps are regulated in time (e.g. via issue of bonds, as in Costa Rica). Furthermore, if there is a net foreign exchange saving from the D-D-S, this will generate a contractionary effect on the money supply, when it is used for higher imports. D-D-S are more attractive from a macro-economic perspective for countries with relatively low inflation, and which are servicing (and planning to service) most of the type of debt being swapped. For countries with high inflation, special efforts need to be made, to compensate or sterilise the additional fiscal and/or monetary effects, if these are meaningfully large.

#### IV Potential benefits and costs of official debt conversions on debtor and creditor economies

In analysing the impact of official debt conversions, we have one major advantage and one disadvantage. The advantage is the vast experience of commercial debt swaps (especially debt-equity) and an important literature analysing this. The disadvantage is that the experience with official debt conversions is very limited.

Debt conversions, with all their benefits and costs, represent only one more tool for an economy with a debt-overhang. As such it is very much a complement, and not a substitute for, other more important macro-economic policies, such as monetary and fiscal ones. Indeed, these countries that have in the late eighties managed their macro-economic policies best, (e.g. Chile) on the whole also benefited most from debt conversions.

##### 1. The effect on the debt overhang

A major difference between commercial and official debt conversions seems to be that debt reduction in the latter seems far more clearly additional to what would have otherwise been obtained, than in the former. Increasingly for commercial debt, countries have other options (especially via Brady deals, but also via options such as debt-buy backs) than debt conversions to achieve the aim of debt reduction. In the case of bilateral official debt, because of the way in which the "10 per cent clause" has been introduced (as a bilateral, voluntary clause, to be agreed after the multilateral deal is reached), debt conversion seems to imply additional debt reduction than the country would otherwise obtain. Naturally debtor country negotiations must take care that



implicitly debt reduction via the "10 per cent clause" is not granted as a substitute for deeper debt reduction deals in the Paris Club. Similarly, care must be taken that any debt reduction linked to debt conversion does not imply a reduction in other aid flows (relevant if debt reduction is funded from aid budgets, without additionality) and/or that it does not lead to reduction in new export credit guarantees (the latter being less likely given limited magnitude of 10 per cent clause). The effect on net resource transfers as well as on debt stock is relevant here. As regards the Enterprise of the Americas Initiative, debt conversions there would also clearly seem to be additional, as if the debt is not reduced via this mechanism, it would not otherwise be reduced at all.

The effect on debt reduction will be similar if the conversion is for equity or for development; however, in one case, part of the claim will be swapped into a contingent foreign liability (equity), whereas in the other case, part or all of the claim will be swapped into local spending. Thus the net Balance of Payments effect will be different.

2. The efficiency gains to the economy; increased investment, and return of capital flight, privatisation and increased social and environmental spending

Clearly the effect here will differ for an official debt conversion for equity and for development; however, what is common to both is that effects on increased foreign investment, privatisation, social spending, etc., may imply additional efficiency gains.

As discussed in Section III, commercial debt-equity swaps, mostly in middle-income countries, are broadly seen to have attracted additional foreign investment, though there is debate in the literature about how much additionality there was. The reasons why debt conversions have attracted additional investment seem twofold: a) they provide an important bonus up-front, thus both reducing risk by lowering the initial total expenditure and increasing reward, by contributing to create a better rate of return (reportedly foreign investors respond more positively to up-front pre-investment advantages than to post investment advantages, such as tax concessions): b) debt equity programmes seem to have a very important positive indirect signalling effect, that the government is keen to promote foreign investment and is carrying out a number of measures for this objective. There must be some doubt whether the same effect will take place to the same extent

in lower-middle and low income countries, where there may be additional problems that detract foreign investors, (e.g. lack of physical infrastructure, limited education, etc), and where there may be (or seem to be) more limited investment opportunities. However, if a country is keen to attract FDI, and has taken a number of measures already to improve the business climate, it seems that official debt conversion could provide a valuable catalyst (both directly and indirectly in terms of signalling) to attract such foreign investment. In SILICs and SILMICs where there has been capital flight on a significant scale, official debt conversion could encourage the return of part of that capital. This could also offer a positive signal to foreign investors.

As regards return of capital flight, commercial debt conversion has provided a powerful incentive for local residents to repatriate capital, in countries where nationals have been allowed to participate in debt-equity swap transactions.

To ensure beneficial effects for the national economy (and the Balance of Payments), it is important that national authorities take appropriate measures to avoid or limit "round tripping". This can be done (as in Chile) by controlling and modifying the volume of allowable debt-equity swaps by nationals and by monitoring the parallel exchange rate and allowing local residents to hold attractive local securities, as an incentive against round-tripping; it can be done using more direct controls (as in the Philippines) to verify the use of swap resources, by examining invoices, receipts, sales agreements and other relevant documents, and by requiring that funds not used for a project were invested in non-transferable, peso Central Bank bills.

It should be emphasised that the fact that a debtor country has appropriate controls and/or mechanisms in place to avoid "round-tripping" will increase government creditor government willingness to allow their debt reduction to be used for debt conversion.<sup>a</sup>

Debt conversions can imply significant efficiency gains for the debtor-country by facilitating privatisation and increased social as well as environmental spending. As regards privatisation, care must be taken that the price at which the state company's shares are sold in the context of the debt conversion is not too low and is transparent (for more detailed discussion, see Section V).

### 3. Potential inflationary impact

Clearly inflationary impact is the most serious real and perceived constraint for debtor governments wishing to implement an official debt conversion.

There are two cases where official debt conversions would have marginal or no impact on inflationary pressures. When external debt is used directly to acquire domestic physical assets (either companies in debt-equity swaps or more rarely, is set aside in debt-for nature swaps), there is no current element of the transaction to increase domestic demand or expand money; there is therefore no inflationary consequence. There is another clear cut case when debt conversions will not have a significant inflationary impact; this is when their scale is very small, especially in proportion to the total money supply. It would seem that the small scale argument is particularly applicable for debt for development conversions.

A final caveat is important. Inflationary impact of debt conversions is a far more serious consideration in countries already having high inflation levels, as well as high fiscal (and/or quasi-fiscal) deficits. If the country has very low inflation, a low fiscal deficit, and some spare capacity and an elastic supply response, some limited additional expansion of the money supply would not be so problematic. Furthermore, to the extent that debt conversions generate important efficiency gains to the economy in a fairly short period, the improved supply response may reduce future inflationary impact.

More generally, the analysis of the potential inflationary impact of an official debt conversion programme must take place in the context of a consistent macro-economic programme, with growth and inflation targets.

To assess the monetary impact, a realistic assumption needs to be made of whether the country would have in the next few years, been servicing that part of its official debt, if the debt conversion did not take place. The issue is whether the government could afford (given its other pressing foreign exchange needs) to service that Paris Club debt. Some useful indication can be provided by the country's past record.

If a country would have serviced its debt (had the debt conversion clause not been applied), it is necessary to take a dynamic view of the net impact on monetary expansion over time. As debt is converted, service payments are reduced in that year and in the future, leading to a decline in net monetary expansion. In the first year, there will be (if the debt is swapped for new

investment or increased government development spending, and this is not compensated) an expansionary monetary effect; however this will be partly compensated by the lower money expansion as government financed debt servicing is reduced; as the years pass (and the "savings" on money expansion grow, with every year's debt servicing, and with the hypothetical need to amortise the debt when it becomes due), the programme of debt conversion can have a net cumulative zero impact on monetary expansion, and later can become negative.

Some of the variables discussed above can perhaps more clearly be presented in diagrammatic form (see Figure 2).

Finally, there is a contractionary indirect effect on the money supply rarely mentioned. If part or all of the foreign exchange saved (because of lower debt servicing) is used to finance imports, then the consolidated banking system will absorb private sector money, reducing the net monetary expansion effect. Furthermore, the imports financed by these foreign exchange savings are likely to attenuate supply bottlenecks and reduce future inflationary pressures.

If in the initial years of a debt conversion programme, the monetary expansion would be feared to be excessive, the financial authorities can take a number of measures to reduce, neutralise or sterilize the effect. This is illustrated by the case of Chile, where in spite of a major debt-equity programme in the second half of the eighties, inflation remained modest by the country's own historical as well as by regional standards.

The Central Bank can firstly regulate the redenomination rate, to define how much local currency it spends per unit of debt swapped. Secondly, it can issue long-term bonds in exchange for the debt swapped, with the principal being amortised fully upon maturity. This method delays and distributes the monetary consequences of debt conversions by transferring the cost of servicing the debt to the private financial markets in the short run. However, by competing in the capital markets with the private sector, the government may push up interest rates; furthermore, interest payments on the bonds created for the debt conversion constitutes a drain on fiscal resources. In spite of these long-term costs, such mechanisms do moderate inflationary impact. However it requires a comparatively well developed domestic capital market that can absorb these long term public bond issues and an overall limited fiscal deficit, so government paper is an attractive option. Another mechanism to neutralise monetary impact is the monthly quota of swaps, which limits the amount swapped and thus curbs monetary effects, quotas can be decreased if necessary.

In the case of debt for development swaps, the inflationary impact would usually manifest itself via increased fiscal spending. Such spending can be compensated (if necessary) by reducing other (less high priority) government spending and/or increasing government revenues, (e.g. via higher taxes). Additionally, long-term development bonds can be placed on private capital markets, as in countries like Ecuador and Costa Rica.

Particularly if the debt conversion is likely to become large, it is crucial for the debtor government to better budget for them in its overall macro-economic programming, and design the programme to reduce or eliminate excessive monetary affects. If these conditions are met, and the rest of the macro-economic programme is feasible, no excessive inflationary impact should result.

#### 4. Net Balance of Payments effect

As countries rescheduling their official bilateral debt and using official debt conversion programmes are severely foreign exchange constrained, a crucial effect of debt conversions is on foreign exchange cash flow.

An important distinction arises between debt-for-equity and debt-for-development swaps. For the latter, the effect is more positive as there is no outflow of profit remittances and capital amortization to offset reduction of debt service payments as occurs in the former. Particularly if the country was or was planning to service that debt, the net foreign exchange effect is likely to be very favourable.

It is difficult to estimate the net present value of future net foreign exchange flows, resulting from debt conversions as there are so many uncertainties in such projections. In a debt equity swap programme, the net effect will depend on:

(a) whether that part of the debt was going to be services; (b) whether or in what proportion the direct investment coming in will be additional (and/or will help generate other, future additional investment); (c) providing (a) is affirmative, whether the likely future debt servicing would be smaller (in net present values terms) to the likely future repatriation of profits, dividends, and capital, which the foreign investment will given rise to; and (d) whether "round-tripping" is small or can be controlled by government efforts (this partly depends on the magnitude of the bonus received, as a very large bonus may make the temptation of "round-tripping" harder to resist).

Partly the net foreign exchange effect of debt conversion programmes can be improved by debtor government regulations. However, the real, as opposed to the projected, outcome will also depend on the country's future evolution. If, as occurred in Chile, the overall economic situation improves as the debt conversion programme evolves, fears of negative effects on the Balance of Payments, as a result of high profit remittances can prove largely unjustified.<sup>9</sup>

If a Balance of Payments crisis occurs in a country which had a large debt equity conversion programme, then this may lead to increased profit remittances and capital repatriation, exacerbating the foreign exchange crisis.

Therefore, the positive effects of debt conversion can be enhanced if they are part of an overall deal that assures sufficient debt reduction and/or rescheduling to free the economy of excessive debt overhang effects and if they are accompanied by a policy package that makes sustainable growth in the debtor economy more feasible.

As regards debt development swaps, the net foreign exchange impact of official debt conversion will depend on:

a) whether that debt was being serviced or not; b) whether the debt reduction is funded by additional special contributions or whether it is funded from existing aid budgets; and c) whether "round-tripping" is small or can be controlled.

For many HILMICs, debt conversion may be the most likely way to get a reduction in their stock of debt; it would therefore have potential indirect Balance of Payments benefits, if it contributed to the restoration of new private financial flows.

We have focussed mostly in this section of effects of official debt conversion on debtor economies. It seems worthwhile to mention briefly that such conversions can also have positive effects for the creditor economies and governments. Firstly, there is the general point that debt conversions (which imply additional debt reduction) improve the overall value of the residual portfolio of debt after reduction well beyond that which could be sustained if debt burdens are not reduced.<sup>10</sup> Secondly, in the case of official debt equity conversion, export credit agencies (ECAs) will sell their debt; should the price of the debt at which they sell be higher than the expected net present value of future debt service payments on that debt, then they will make a profit. Although this is clear in economic terms, it may be obscured in

practice by the accounting and provisioning regulations of some ECAs, which do not at present recognise a realistic price for their LDC exposure, maintaining a fictional value for the debt well above its real economic value.<sup>11</sup> This seems particularly the case for ECAs, which are basically government departments, and far less the case for ECAs with a greater degree of autonomy and financial responsibility, forced to value the debt at realistic prices (that is reflecting past and likely future servicing ability). It is important that for all ECAs accounting and provisioning regulations do not become a barrier to economically correct decisions, which favour both creditors and debtors. Thirdly, in the case both of ODEC and official debt development conversion (ODDC), if the operations imply important efficiency gains for the debtor economy, which might not otherwise accrue, this could increase further the likelihood of future debt service payments by the debtor. This would occur for example if ODECs would result in an acceleration of privatisation in cases where this leads to better utilisation of productive resources, or if ODDCs result in improving the quality of development expenditure and investment in human capital. Fourthly, in the case of ODDC, the creditor government would have far greater certainty that debt reduction granted through such a mechanism would be targetted for high priority government spending (e.g. in health, education and nutrition) than if normal debt reduction is granted; this guarantee justifies additional debt reduction than would otherwise be granted, which is therefore in the interests also of the debtor.

Finally, indirect benefits to creditor economies are likely to include enhanced trade, export, investment and other economic benefits if debtors' economies recover as a result of debt conversion. Also, creditor governments can use ODC as a way of funding international public goods, such as protection of the natural environment, with international externalities.

## **V Technical issues of official debt conversions**

The fact that official debt conversions offer so many interesting opportunities to debtors and creditors alike, and the fact that the 10 per cent Paris Club clause has been approved for so many countries would seem to indicate that these conversions would develop significantly in the next few years.

Several technical issues arise, which need to be dealt with, so as to enable and/or speed up implementation of these conversions. Some of the most relevant

ones will be briefly outlined here; they refer more to ODECs than ODDCs as the latter are technically simpler.

**Transparency and Competitiveness:** five "prices" are involved in undertaking ODECs which determine the net gains and losses to debtors and creditors of such transactions: (i) the secondary market discounted price of the debt being converted; (ii) the redemption price i.e. the proportion of face value that the debtor agrees to convert into local currency; (iii) transaction or conversion fees and taxes which are levied by government to capture parts of the discount benefit; (iv) the price in local currency of the asset to be acquired; and (v) the special sweeteners that are offered by debtor governments to encourage investment through ODEC. On the basis of experience it is essential that where official debt conversions are concerned, all these prices be clearly transparent and equitably applied across the board to all official creditors to avoid perceptions of inequitable treatment which could disrupt relations and to avoid excessive subsidies to foreign investors. Such conversions need to conform to clear policies and objectives which are codified and equally transparent.

**Legal and Technical Problems:** Official debt claims are highly varied, much more so than private commercial bank claims. This is not a problem if claims are to be cancelled as in ODDs. It is if the claims are to be converted to equity. (It is interesting that some creditor governments see this as a major obstacle, while others seem to overcome these problems with ease). Claims are structured differently for each source of credit within and across a wide range of creditor countries. In their present form they are not particularly easy to assign or transfer to third parties. Many of the clauses in agreements whose implications for conversion are not yet fully understood. A detailed understanding of the nature of ECA and other types of claims (aid, military credits, commodity credits, government-to-government loans, etc.) is essential. To avert an excessive amount of complexity it is possible in many instances to novate or to exchange existing claims for promissory notes with standard features which reflect the maturities and coupon obligations of the existing bilateral claim. The Paris Club could be instrumental in standardising such exchange instruments in the event that official debt sales in secondary markets and bilateral debt conversion are likely to grow in volume.

A particular complication arises in the case of insured ECA claims which usually provide less than 100 per cent indemnities leaving the original policyholder with an unindemnified portion of 5-25 per cent but with full



rights and obligations which ECAs are bound to protect in their rescheduling or conversions. In some instances the policyholder remains the titular "owner" of the full claim and has the responsibility of attempting to secure full recovery even when the ECA has paid out the indemnity. Dealing with these "tail" claims has proven to be a major legal and technical problem in circumscribing the flexibility of ECAs wishing to consider debt reduction or conversion. In some instances the "tails" have had to be bought out at face value, in other instances at negotiated discounts which are generally above the secondary market price. There is no easy and general answer to this problem except for creditor governments to provide tax or other incentives to "tail-holders" to sell their claims at discounts either to ECAs or to specialist intermediaries trading in debt.

**Ownership of Converted Claims:** Several OECD creditor government which have through the 1980s undertaken large scale programmes of public asset divestiture in their own countries are reluctant to become shareholders of corporations in debtor economies. Neither are debtor governments particularly anxious to have them as shareholders. Unlike banks or other private creditors, governments and most ECAs which are government departments, cannot directly undertake official DES operations on their own account. They are therefore left with the following options in converting official debt: (i) sell their claims directly in the secondary market and withdraw from further involvement; (ii) sell their claims on a negotiated basis to their own state-owned entities and have them pursue ODEC opportunities in SIDCs; or (iii) transfer official claims from the primary source (e.g. ECGD in the UK or Hermes in Germany) to the equity investment promotion arms of these governments which specialise in developing country investments and which already have large portfolios in SIDCs.

The third option is perhaps the easiest and most practical for almost all creditors. In deploying it creditor governments again have two choices. Either the investment agency (e.g. CDC) acts on its own account after having the debt claim transferred to it from the ECA (e.g. ECGD) at a mutually agreed transfer price. Alternatively, the investment agency can be asked to act as trustee in managing the government's foreign asset portfolio through equity conversions.

**Needs for Financial Intermediaries:** An important operational issue for ECAs is whether they should rely mainly on specialised intermediaries in SIDC debt markets in undertaking their conversion operations or whether they should attempt to develop their own in-house capabilities. There are concerns on the

part of ECAs that use of intermediaries may involve conflict of interest issues since the intermediaries are such large players on these markets. There are also concerns about the level of advisory fees and transaction costs levied by financial institutions which become a significant factor in calculating the costs and benefits of conversion programmes to creditors and debtors. The question to be addressed in considering this issue is whether there is a case for the interim development of a specialised sub-market in trading official claims (which need to become increasingly standard and liquid in their structural characteristics). Specialised market making, bid-offer pricing, settlement services and transactions knowledge would certainly be required to make the market work. It could possibly later become a fully integrated part of the private secondary trading market when private and official debt claims become almost indistinguishable in their trading features.

#### **VI Conclusions and suggestions for future action**

We can conclude that official debt conversions, though not a panacea, can become an important tool both for debtor and creditor governments, for contributing to reduce debt burdens and achieving efficiency gains in the debtor economies. The fact that, especially for SILICs, bilateral debt forgiveness multilaterally agreed in the Paris Club is quite significantly less than what some creditor governments (especially the British and Dutch) had defined as desirable, increases the need for conversion of official debt. In the case of official debt development conversion, it is important that the additional debt reduction granted for this purpose is not funded out of existing aid budgets so as to ensure an additional foreign exchange saving for the debtor economy.

Though debt for equity transactions have absorbed the vast bulk of swaps involving commercial debt, a pattern which is likely to continue, hopefully conversions involving official debt will direct a greater proportion of funding into social sector development, poverty alleviation and environment conservation programmes. This can be clearly justified in purely economic terms, as spending in the social sectors has very high rates of return; in several cases (if they have international externalities), they can also be international public goods.

Official debt development conversion would seem well suited for funding basic social services. Additional local currency resources could be accommodated

relatively easily within existing programmes or through replication and expansion of on-going programmes. To encourage bilateral debt conversion programmes on a significant scale, it may be desirable to develop specific proposals to attract and accommodate additional resources. These could be based on programmes already developed in a general sense, but still requiring resources, such as for example the National Programmes of Action derived from the Action Plan adopted at the 1990 World Summit for Children or on programmes developed specifically for official debt conversions, such as the Polish Environmental Fund.

In all these cases, debtor governments need clearly to take the lead. However, they may require technical assistance, from institutions like the World Bank, IMF, UNCTAD, UNICEF and others. This could be helpful for: 1) preparation and/or improvement of the social and/or environmental programme; 2) setting up, improvement or adoption of an appropriate debt conversion mechanism, that maximises positive effects and minimises problems. Special emphasis needs to be placed on ensuring that undesirable macro-economic effects do not occur; 3) negotiating debt reduction with creditor governments bilaterally or multilaterally, (via a special support group or via the Paris Club). The support of creditor governments (some of which may wish to take a lead) is of course crucial.

In the case of official debt equity conversions, there are a number of technical problems to be overcome (several of which were discussed in section V), and there is a need to facilitate/create market operations. International institutions like the World Bank and others such as UNCTAD clearly have an important role, not just in studying and clarifying these issues but also in providing support for developing well structured market mechanisms, both in creditor and debtor countries. Collaboration and consultation with private financial intermediaries will be important.

The potential for ODECs may be very large. If linked to privatisation of state enterprises, it would have the advantage of being broadly non-inflationary. ODECs would be particularly well suited for heavily indebted countries with large bilateral debts that have a large public enterprise sector and are in the course of privatising it; ODECs could also be suitable for helping fund economic infrastructure building, traditionally carried out by the public sector, but now increasingly carried out (totally or partly) by the private sector using "build-own-operate-transfer" (BOOT) technologies. ODEC could also be very attractive to LIMICs and LICs that have made great efforts at

stabilisation and structural adjustment and stabilisation, but have not as yet been able to attract significant FDI. Hopefully, ODECs could provide (via the implicit subsidy, additional favourable publicity, etc.) the additional incentive to kick-start such FDI, as occurred during the late 1980s in some middle-income countries.

ODECs may end up by being far larger in volume than ODDCs, because of some of their attractive features (they imply larger commercial returns for export credit agencies; if used for privatisation, their inflationary impact is smaller or non-existent); however, it would be unfortunate if ODECs were to excessively pre-empt the valuable complementary role which ODDCs can play.

- 1 For good discussions, see, for example, World Bank World Debt Tables  
Vol.1, 1989-1990, 1990-1991 and 1991-1992; P. Mistry African Debt  
Revisited FONDAD, The Hague, 1992.
- 2 Based on interview material.
- 3 Based on Amendment of Congressman Dod; based on interview material.
- 4 ECLAC Preliminary Overview of the Latin American and Caribbean Economy in  
1991, Santiago, Dic. 1991; interview material.
- 5 For a good, early discussion of these issues, see M. Corden and M. Dooley  
"Issues in Debt Strategy" in J. Frankel, M. Dooley and P. Wickham (ed.)  
Analytical Issues in Debt International Monetary Fund 1989, Washington,  
D.C.
- 6 For useful analysis of the issues, see, for example, M. Blackwell and S.  
Nocera "Debt-equity swaps" IMF Working Paper, February 1988, Washington,  
D.C., and several articles in Analytical Issues in Debt, op.cit; for a  
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10/1991/1; R. Ffrench-Davis and R. Bouzas (ed.) Conversiones de deuda  
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Argentina; M. Mortimore "Debt-equity swaps" CEPAL Review, September 1991,  
Santiago; for an analysis of the Chilean experience and lessons  
therefrom, see, for example, Larrain, F. and Velasco, A. (1990) "Can  
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Programme" M.Phil. thesis, IDS, Sussex; J. Aravena (1991) Debt Reduction  
Schemes, Theoretical and Empirical Issues for Chile, CIACO, Louvain.
- 7 Interview material.
- 8 Interview material.
- 9 Indeed, in Chile reportedly foreign investors have significantly  
decreased their profit remittances in the early nineties, because the  
Chilean economy is seen so successful and profitable. Based on  
interviews in Central Bank of Chile.
- 10 For a clear justification of this, see "Market-Based Debt Reduction for  
Developing Countries: Principles and Prospects" by S. Claessens et al  
The World Bank PR Series No.16, 1990.
- 11 For a detailed discussion, see P. Mistry and S. Griffith-Jones Interim  
Report on Conversion of Official Bilateral Debt. Mimeo. October 1991.

TABLE 1:

GROWTH IN DEBT STOCKS OF SIDCs(Amounts in billions of US Dollars)

	<u>1982</u>	<u>1985</u>	<u>1988</u>	<u>1991(E)</u>
<b><u>SILICs:</u></b>				
Total DOD:	79.12	116.74	160.91	175.35
Interest Arrears:	1.25	3.09	8.00	12.89
Bilateral DOD:	32.06	49.45	75.10	80.43
Multilateral DOD:	10.61	16.76	26.77	34.73
IMF:	3.23	5.56	5.83	6.30
Private Guaranteed:	18.32	24.11	32.24	29.18
Private Unguaranteed:	2.90	3.33	3.09	2.88
Short-Term Debt:	12.00	17.53	17.88	21.83
<b><u>SIMICs:</u></b>				
Total DOD:	346.15	418.46	485.13	486.54
Interest Arrears:	4.53	4.81	15.59	40.50
Bilateral DOD:	35.23	62.58	90.58	99.59
Multilateral DOD:	15.94	24.35	41.71	53.87
IMF:	6.97	12.99	14.71	17.54
Private Guaranteed:	183.49	223.00	255.34	220.69
Private Unguaranteed:	61.70	50.96	29.17	23.10
Short-Term Debt:	48.82	44.57	53.62	71.76
<b><u>Other SIDCs:</u></b>				
Total DOD:	55.00	50.00	69.00	65.00
<b><u>Memo: All LDCs:</u></b>				
Total DOD:	846.00	1,046.00	1,282.00	1,351.00
Interest Arrears:	6.10	8.67	25.64	55.50

Source: WDT 119-92.\*

\* The WDT has been used as the basic data source for this and other tables. The estimates provided for 1991 for the SILICs in this Table are higher than those projected in WDR because available data from other sources suggests that WDT has underprojected the 1991 DOD (it has consistently underprojected the latest year's estimates in the past). The 1991 estimates for SIMICs remains unchanged. The SILIC-SIMIC breakdowns do not unfortunately include DOD for countries which do not report to the World Bank, but whose debt the WDT estimates in aggregate form (see Table 1.1 p.13 of WDT 1991-92). These include countries such as Afghanistan, Albania, Cuba, Iraq, North Korea, Libya, Mongolia, Namibia and Vietnam along with some 30 other island micro-states in the Caribbean and South Pacific. Data for these nine large non-DRS countries (excluding Libya and Namibia which are not SIDCs) provide the basis for the "Other SIDC" line shown above. No further breakdown is available for these countries to conform with the categories of debt shown above. Also there has been considerable movement of countries between the SILIC and SIMIC categories between 1982-91 with several former SIMICs now classified as SILICs (e.g. Egypt and Nigeria).

**TABLE 2:**

Categories of countries	Structural features		Growth of exports 1982-89 (% p. a.)	Debt indicators					
	GNP p/cap (% 1988)	Infant mortality (Deaths per 1000 live births, 1987)		Debt service ratio			Debt/export ratio		
				1980	1982	1989	1980	1982	1989
Severely indebted low-income countries (SILICs)	288	102.8	-2.0	10	20	23	96	214	493
Severely indebted middle-income countries (SIMICs)	1632	55.0	3.5	36	49	29	196	297	294

TABLE 3:

VOLUME OF DEBT CONVERSION BY COUNTRY, 1985- 1990<sup>1/</sup>(US Millions)

	1985	1986	1987	1988	1989	1990	TOTAL
ARGENTINA	469			764	1180	7038	9451
BRAZIL	537	176	336	2095	942	483	4569
CHILE	323	974	1997	2927	2767	1096	10084
COSTA RICA		7	89	44	124	17	281
ECUADOR			127	261	31	42	461
HONDURAS			9	14	47	32	102
JAMAICA			4	5	16	23	48
MEXICO		413	1680	1056 <sup>2/</sup>	532	435	4116
NIGERIA				70	304	217	591
PHILIPPINES		81	451	931	630	378	2471
URUGUAY				104	53		157
VENEZUELA			45	49	544	716	1354
<b>TOTAL</b>	<b>1329</b>	<b>1651</b>	<b>4738</b>	<b>8320</b>	<b>7170</b>	<b>10477</b>	<b>33685</b>

SOURCES: Central Bank of Argentina, Central Bank of Brazil, Central Bank of Chile; Mexico, Ministry of Finance; Central Bank of the Philippines; Bank of Jamaica; Central Bank of Venezuela; and IMF.

<sup>1/</sup> Face value of debt converted under official ongoing schemes. Figures do not include large-scale cash buy-backs and debt-exchanges.

<sup>2/</sup> Does not include an estimated \$6-8 billion related to prepayment at a discount of private sector debt since August 1987 signing of an agreement to restructure FICORCA debt.

\* \* \* \* \*

TABLE 4:

DEBT TO COMMERCIAL BANKS; CONTRIBUTION TO ITS REDUCTION BY DEBT-CONVERSION PROGRAMMES (US\$b)

	(1)	(2)	(3)
	STOCK OF COMMERCIAL BANK DEBT, 1985	VALUE OF DEBT CONVERSIONS 1985-1990	(2)/(1)*100
ARGENTINA	25.3	9.5	37.5
BRAZIL	67.1	4.6	6.9
CHILE	14.8	10.1	68.2
MEXICO	71.4	4.1	5.7
NIGERIA	4.9	0.6	12.2
PHILIPPINES	7.6	2.5	32.9
VENEZUELA	23.6	1.4	5.9
<b>TOTAL</b>	<b>214.7</b>	<b>32.8</b>	<b>15.3</b>

(<sup>1</sup>) Refers to long-term commercial bank debt; Source: World Bank, World Debt Tables 1990-1991.

(<sup>2</sup>) Based on Table 1.



FIGURE 2:

CONDITIONS UNDER WHICH DEBT CONVERSIONS ARE MORE OR LESS DESIRABLE

	INITIAL LOW INFLATION I	INITIAL HIGH INFLATION II
Debt that would be serviced	<u>Very</u> desirable	Desirable, but monetary impact needs to be regulated, for large operations.
Debt that would not be serviced	III Desirable, only if spending priority changes essential to justify programme for efficiency gains.	Only desirable if conditions in both II and III are met.