PN-ABP-768
84045

UGANDA'S EXTERNAL DEBT

AND

DEBT CONVERSION POSSIBILITIES

Prepared by

John B. Ross

The Debt-for-Development Coalition, Inc.

April 20, 1993

The Government of Uganda with the financial support of the World Bank successfully concluded an IDA external debt buyback. Uganda's Ministry of Finance indicated that $153,215,093 or 89% of total eligible debt was extinguished through this mechanism. (The exposure of the American International Group (AIG) was not included in the list of eligible creditors as the Government and its financial advisors assumed that this debt would be handled outside of the IDA debt buyback.)

While the IDA buyback was a definite success, Uganda still has an external debt problem. The private external debt extinguished through the buyback significantly exceeded the officially reported Ugandan debt in the World Bank Debt Tables and the total private commercial debt that the Ministry of Finance reported as of June 30, 1991. Uganda, however, still has some remaining private creditors. In addition to AIG and other foreign creditors, there are apparently several locally-based private firms that hold U.S. dollar denominated claims against the Government of Uganda. Because of uncertainty over the amount of interest arrears the exact total of these claims is not now known, but the Government of Uganda has indicated that the total of the remaining private hard currency denominated debt amounts to tens of millions of dollars.

While the IDA debt buyback extinguished more private debt than had been previously reported, the list of buyback participants includes only one commercial bank with a total of less than $2 million. Commercial bank claims of $40.3 million appear on table 1; the latest World Bank Debt tables reported an even higher total. The private financial advisers to the Government of Uganda said that all of the other commercial bank debt as well as some other private claims were taken care of outside of the IDA buyback. While it is difficult to know with any certainty, it would not be unusual if some of these claims which the Government of Uganda and its financial advisors consider extinguished are presented for payment in the future.

The Government of Uganda has a major bilateral external debt problem. As noted in the footnote in table 1, a very significant portion of Uganda's bilateral debt is not eligible for rescheduling.

Table 1
OUTSTANDING DEBT BY CREDITOR
As of June 30, 1991
(U.S. $ million)

Creditor	Outstanding	Of Which Arrears	% Outstanding
Multilateral	1,644.0	71.9	63.4
OECD Bilateral	285.5	66.3	11.0
Non-OECD Bilateral	526.3	121.8	20.3
Official Total	2,455.8	260.0	94.7
Commercial Bank	40.3	27.7	1.6
Non-Comm. Bank	95.9	83.9	3.7
Private Total	136.2	111.6	5.3
Grand Total	2,592.0	371.6	100.0

- The 1981 cut off date for Paris Club creditors limits the rescheduling available to approximately U.S. $ 145 million, or 17.9 per cent of the $811.8 million outstandings. As of June 30, 1991, the amount available for rescheduling was less than the bilateral arrears of $188.1 million

- Source Ministry of Finance and Economic Planning

The Government of Uganda is seriously considering the development of a debt conversion program. As is typical in cases where a country has gone through a difficult period of civil unrest and economic mismanagement, private investors are reluctant to make major new investments on the basis of the relatively short period of economic reform and improved performance. (The Investment Authority of Uganda has distributed comprehensive materials on investing in Uganda to a significant -- and increasing number -- of potential investors since it began operations.) Because of the stringent economic and financial adjustment program that the Government of Uganda has undertaken, the Government is particularly desirous of seeing new investments (particularly investments that are located in the northern part of the country), creating employment opportunities, and generating foreign exchange income.

Some discussions are underway with various private creditors -- and not just AIG -- about debt conversions. The idea of achieving debt reduction, outside assistance on marketing products internationally and saving on foreign exchange is very appealing to all of the Government of Uganda officials with whom I spoke. None of the Ugandan Government officials have indicated any activities that they would not support being financed through debt conversions. The Honorable Kaijuka, Minister of Commerce Industry and Cooperatives, did express strong support for using the mechanism to increase non traditional exports and for entities that have or can acquire expertise to market products internationally.

The Government of Uganda has obtained Paris Club approval to use bilateral debt in debt conversions. A unit within the Central Bank has been assigned responsibility to work up recommendations on a debt conversion program by end of March 1993.

The Government is seeking advice on how to do debt conversions within a constrained shilling budget as well as restricted foreign exchange availability. The Government of Uganda estimates that it will pay approximately $5 million in bilateral debt payments in the remaining portion of this fiscal year and perhaps $15 million next fiscal year. The Government has been seeking judgments on the likely price, or depth of discount, that the remaining private and official bilateral external debt is likely to command on the secondary markets.

Ministry of Finance officials of the Government of Uganda indicated a willingness to consider a second debt conversion if necessary to implement the AIG project. This would be particularly true if it were possible to interest a bilateral creditor for which the Government had already budgeted for payments to sell at an acceptable discount.

The factors that the Government of Uganda must consider in developing a debt conversion program follow. This material was discussed with the head of the External Debt Management unit of the Central Bank of Uganda during the trip.

Debt Conversions: Opportunities and Limitations

The Debt-for-Development Coalition, Inc. (DDC), as an independent organization acting on its own, suggests basically a two-stage work plan for the Government of Uganda to design and implement a debt conversion initiative to supplement the recently completed IDA debt reduction program. In the first stage, the Government needs to assure that any proposed debt conversion program is consistent with its economic and financial adjustment and debt reduction strategies. In the second stage, that should begin after the basic parameters of the first stage are generally agreed upon, the Government of Uganda needs to tailor a specific debt conversion program that meets Uganda's developmental and social priorities within the limitations of the country's specific list of creditors. Then, the Government of Uganda will need to market its debt conversion program to creditors, firms interested in privatization and/or other investment possibilities and nongovernmental organizations (NGOs)

First Stage. A debt conversion program will need to address the following issues:

1. Type of Claims. Uganda has adopted a medium- term adjustment and debt reduction strategy. The IDA buyback arrangement was a major success by any measure. Now the Government needs to set priorities in terms of the classes of claims that it would like to see extinguished in what order. This effort basically involves assessing the relative burden of various classes of debt and the relative likelihood that particular creditors will be willing to sell their claims at an acceptable discount.

2. Additionality and Development Priorities. Although development priorities may vary according to different ministries or governmental agencies, the debt conversion initiative should be designed to generate additional funding for development activities that are rather clearly spelled out and that promote sustainable, long-term development.

3. Financial Terms. The debt conversion program should contain criteria for determining the percentage of the face value of debt that will be converted into local currency proceeds and the foreign exchange rates applicable to the conversions depending on the type of local currency proceeds used. To what extent will debt conversion proceeds be paid in local currency, in bonds or other financial obligations, in physical assets, etc.

4. Money Supply and Fiscal Policy. The debt conversion initiative should contain specific arrangements or mechanisms -- in terms of form and timing -- for disbursing local currency debt conversion proceeds. These arrangements need to be consistent with Uganda's overall program to control the growth of the money supply and budget deficits. For the Government of Uganda debt conversions could provide definite savings in foreign exchange.

5. Maintenance of Value. To encourage participation of private sector and social investors, the debt conversion program should protect the value of debt conversion proceeds from inflation, especially if the proceeds are made available in bonds or other financial assets. Some countries have used marketable bonds denominated in U.S. dollars but with all principal and interest payments made in local currency. Some mechanism might be structured so that local investors could obtain insurance coverage on their proceeds.

6. Roundtripping and Capital Flight. The debt conversion initiative should contain a menu of alternative mechanisms to eliminate or neutralize the negative effects of roundtripping. Roundtripping generally occurs when an investor reconverts its local currency proceeds into U.S. dollars or other "hard" currencies. In some instances, debt conversion proceeds must necessarily be used to purchase imported goods and services, without which the developmental activity could not be carried out. Private investors expect to repatriate profits within a relatively short period. Investors that do debt conversions to finance the production and export of non traditional exports often are permitted to take profits from their sales. Investors that do debt conversions for local production are often required to wait some period of time before profit remittances can begin. NGO's are usually not permitted to use proceeds to buy foreign exchange.

7. Source of Funds. Because of the constrained current operating budget, the Government may want to decide in the case of NGO investors if it will allow them to use debt conversions for existing operations or only for new or expanded activities.

8. Auditing. The debt conversion initiative may contain procedures to ensure that entities converting debt under any debt conversion program established under the initiative spend the debt conversion proceeds in accordance with the debt conversion program guidelines. It is important that any audit process be straight forward and not burdensome.

9. Marketing Strategy. Serious thought needs to be given to the various ways to implement the debt conversion initiative and market it to different types of creditors and potential investors. Some creditors may be reluctant to participate by selling some or all of their loans at an acceptable discount. It is important to be able to announce one or two projects where creditors sold their claims at a price the Government of Uganda see as acceptable. Some creditors, however, may even be willing to donate some of their loans for particularly worthwhile or highly publicized projects. In the recent Bolivian IDA debt buyback, one creditor donated approximately $11 million to an internationally-oriented NGO that had a local affiliate involved in environmental activities; other creditors sold their exposure to NGOs involved in maternal health and child survival activities. If a serious effort is undertaken to obtain donations for particular activities such as the

environment, child survival, AIDS education and prevention; outside legal counsel may need to do an analysis of the tax and accounting treatment a donor of debt may receive from a charitable gift. The analysis will help target creditors that are most likely to donate some or all of their loans.

Stage Two. The Government of Uganda needs a) to tailor a specific debt conversion program to the realities of those creditors that did not participate in the buyback and to official bilateral creditors and b) to market the debt conversion program to creditors, firms interested in privatization and other private investments and nongovernmental organizations (NGOs).

1. Debt Conversion Procedures. The Government of Uganda should adopt clear, published debt conversion guidelines that are consistent with its debt management strategy and adjustment program. One of the principal complaints for-profit and social investors register about debt conversion programs is that they often take an extremely long time to complete. Adopting clear guidelines will be key to marketing the debt conversion program.

2. Setting Priorities. The Government needs to determine if it wishes to promote any particular type of investment or if there are any particular activities that it does not want to allow to use the debt conversion mechanism. Serious problems develop when good projects are denied or the approval process drags on for a long time because some individual in Government decides that certain sectors should not be able to avail themselves of the debt conversion mechanism even though regulations permit. Of course, priorities can be changed over time, but the basic thrust of any debt conversion program should remain relatively constant over time.

3. Marketing to Remaining Creditors. A strategy must be designed to encourage the remaining commercial creditors who did not tender their credits in the IDA buyback to participate in this new initiative. The motivation of creditors interested in continuing to do business in Uganda will differ from those who are pursuing an exit strategy of minimizing losses and maximizing recoveries. Also, a strategy is needed regarding the use of bilateral credits.

4. Marketing to Investors. The Government of Uganda will have to consider ways to identify and interest potential investors that might buy Uganda's remaining debt and invest in country. Articles about Uganda's debt conversion program could be placed in major newspapers and magazines with international distribution. A second possibility is to sponsor a one-day conference or a series of conferences for interested parties that currently have local currency funding requirements in Uganda or may be in new Ugandan investments. Conferences to explain the debt conversion concept as well as whatever debt conversion program that the Government of Uganda develops could be held in the United States, Europe, and Japan.

The American International Group's Cashew and Cotton Project

The proposed cashew and long fiber cotton project proposed by the American International Group (AIG) represents an interesting case study of the issues that are likely to come up in any debt conversion program that the Government of Uganda implements.

First, AIG was eligible to take part in the IDA buyback but declined. As a matter of company policy, AIG does not want to settle outstanding claims with any borrower for less than the amount contracted. In this regard, AIG is known in the market as more determined on this point and more willing to litigate than virtually any other creditor.

AIG's management apparently has decided not to put "new money" into any project where the firm has to develop a "creative" solution to get its original money back. (Of course, AIG understands that it has to spend money to develop "creative" solutions.) In this aspect, AIG's position is probably rather standard.

Generally speaking, creditors who can not get their original credit paid as contracted are reluctant to add to their claims in an effort to recoup their funds. Because of the severity of the LDC debt problem, the boards of directors of many creditors would have to approve any new investments in countries that did not service their debt. Also, there is an accounting issue of how the firm would have to value any "new funds" invested to recoup on an "old" investment in a country that had just paid off the bulk of its private commercial debt at less than full face value. This is especially true regarding a new investment. Internal accountants as well as independent auditors would probably insist that any new funds invested to provide working capital be recorded at less than full face value.

For a project such as AIG's, the general unwillingness of creditors to put in "new money" creates an immediate issue of how to obtain working capital for any new project. Basically, AIG was seeking working capital either through other private local investors or lenders or public sector developmental entities such as the Government of Uganda, the United States Agency for International Development (USAID), the International Finance Corporation, etc.

AIG indicated that it had consulted with potential international and domestic lenders and found no interest in investing or even lending to the proposed new institution (without AIG guarantee) unless done with the whole or partial guarantee of some other highly creditable party, such as USAID. The Government of Uganda has a very constrained fiscal position. Furthermore, it is interested in promoting private investments not publicly-sponsored ones. Finally, the Government believes that its willingness to convert AIG's claims into a long term lease and approval to undertake these projects represents its appropriate share of assistance.

AIG has actively sought financing from USAID and to a lesser extent the International Finance Corporation. While both groups indicated that the project was doable and IFC was particularly complementary about the project feasibility and the financial analysis, both had questions about the "real" value of AIG's investment. Both entities also indicated that they -- or their senior management in the case of IFC -- would expect AIG to show its commitment to this project by bringing in "new" money. The IFC accepted that major firms such as AIG and commercial banks have collection or recovery programs to recover value from assets that have for accounting purposes written off and that such collections of written off loans can significantly impact reported profits. Officials stated that as company policy, AIG tends to write off doubtful assets in full and quickly. U.S. commercial banks tend to be much slower in writing off troubled credits and will write off any given troubled assets over a period of years.

Uganda, as mentioned above, reported that 89% of eligible private creditors participated in the buyback. While Uganda and its private financial advisors (fees for their services were paid for out of the IDA buyback facility) made some efforts to handle AIG and other creditors which indicated that they were unlikely to accept the terms of the buyback at the time the buyback was being marketed, they had to be careful. If many creditors thought that "difficult" creditors were receiving preferential terms, it might have caused enough creditors to stay out of the buyback to make it fail. In the case of Uganda, the buyback was not to be consummated unless a minimum of sixty per cent of eligible assets accepted the buyback terms.

Uganda and other developing country governments are likely to continue to have a private commercial external debt problems with any buyback that does not extinguish 100 per cent of eligible debt. While the IDA buyback arrangements can offer what some consider a "fair" price, refusal to participate is perfectly legal. Creditors continue to have the right to press for payment and, as AIG is in the process of doing, to seek court action to facilitate obtain payment. All of this is costly and time consuming to governments.

The private commercial claims eligible to participate in IDA buyback arrangements represent only a small portion of total debt in the countries that can avail themselves of this arrangement. As shown on Table 1, bilateral claims, especially those claims that can not now be rescheduled, will undoubtedly become the next focus of attention in trying to deal with the less developed country debt problem.

While Uganda is not attracting new investments as rapidly as they would like and while there remain a number of private creditors such as AIG which did not participate in the IDA buyback, it will be difficult to utilize this source of resources for fecalith or other investments until some accommodations are made to provide working capital. (Uganda has a number of hotels that are attractive to international tourists that might be interesting alternative investments for holders of external claims.)

USAID is allowed to work with for-profit firms.[1] While USAID is not permitted to take equity positions, it can make grants or loans with concessional rates to provide direct training and technical assistance, provide direct credit under certain circumstances usually at market rates of interest and provide some credit guarantees to private for-profit firms. The remaining commercial external debt situation in Uganda will undoubtedly occur in other developing countries, especially those that undertake IDA debt buyback arrangements.

Studies undertaken by the IFC indicate that the existence of debt conversion possibilities encourage new investments. USAID should explore whether it could reach some accommodation with private claims holders who would be willing to invest in and manage for-profit enterprises through debt conversions. By allowing outstanding debts to be converted into capital for new enterprise and by agreeing to provide working capital through grants or credit arrangements, USAID could play a significant role in speeding up the flows of new private investment into some of the poorest countries.

The IDA debt buybacks are not undertaken unless a government agrees to significant policy reform and economic and financial adjustment programs. Thus USAID would be able with limited resources to assist even further in debt reduction programs, providing important support to facilitate and shorten the time required for the often painful but necessary economic adjustment program, promoting the private sector and (if structured well) privatization efforts. In Uganda, USAID could work towards these goals in collaboration with the Uganda Investment Authority that it is already assisting. There should be opportunities for USAID and the Ugandan Investment Authority to work with the IFC, whose mission is to promote the private sector and is able to provide equity capital to for-profit ventures.

Harvey and Company currently has an arrangement with the Africa Bureau of USAID to promote venture capital operations. Harvey and Company could perform a number of highly important functions in support of this effort: a source of "new" funds required for working capital, evaluation and analysis of proposed ventures, financial engineering for good projects, a source of management expertise for agreed upon projects and/or a source of expertise for monitoring the progress of projects that are undertaken.

The Government of Uganda might need some assistance in establishing a good debt conversion programs. While as a concept, debt conversion is a rather straight forward concept, many programs have been unsuccessful. Some governments such as Mexico have gone through several versions before coming up with a program that reflects the needs and especially the necessary incentives and safeguards required by the various parties to a debt conversion. In Uganda's case, many OECD governments have indicated a willingness to sell official bilateral claims at a discount. This is a relatively new development and needs to be carefully factored into any debt conversion program that Uganda establishes.

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[1] See "Private Sector Initiative for Africa", prepared by lab at Anderson, Inc. for USAID, 1992, note pages 29 through 36.

Activities with Mr. Gordon Bradford

On the basis of the limited amount of time Mr. Gordon Bradford had to work on this project, he was relatively enthusiastic about it. He had made an appointment with the General Manager of the Nile Bank to see if some of the needed funding could be arranged through that institution. He also indicated his belief that the AID unit in which Mr. Ray Solem works could provide some limited funding very quickly. He said that he would recommend that Ray do so if the project moves ahead.

Mr. Bradford was pleased that Permanent Secretary Tumusiime-Mutebile had at the request of Keith Muhakanizi assigned Mr. Lawrence Bategeke to give special priority to the AIG project. Mr. Bategeke provided a letter of support regarding the Ministry of Finance and Economic Planning efforts to speed up the process of valuing the physical assets in Soroti.

I provided Mr. Bategeke with the valuation estimates on this project that Don Schwartzkoff had included in an official communication to Honorable Mayanja-Nkangi:

Cashew processing plant and 62 acres	U.S.	$600,000
Kachumbala ginnery		650,000
Arapai ginnery		150,000
Kyere ginnery		75,000
Kelim ginnery		20,000
900 acres: Odina citrus scheme		72,000
1700 acres: Serere Research Station		270,000
2000 acres: prison farm nw of Soroti		120,000
Soroti Hotel		120,000
35,000 acres in Kumi district balance due		

AIG has, according to SVP Schwartzkoff, obtained a default judgment in London against the Government of Uganda. Furthermore, he states that the Government of Uganda has since formally acknowledged that it owes AIG UK pound sterling 3.4 million.

From a memorandum dated 9 February 1993, from Schwartzkoff to Martin Hogg, AIG is seeking the following funding:

U.S$ 627,000 for initial capital expenditures

U.S. 50,000 for technical assistance to farmers

U.S. 536,500 a portion of which in Ugandan shillings for working capital.

U.S. 313,000 a portion of which in Ugandan shillings for technical assistance.

SubTotal $1,526,500

USh 147,000,000 (app. U.S.$ 122,500) to purchase and store March crop.

Grand Total $1,649,000