CEPAL

Review

UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN
SANTIAGO, CHILE, AUGUST 1991

CEPAL

Review

Santiago, Chile | August 1991 | Number 44

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CEPAL REVIEW No. 44

Debt/equity conversion

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The intention of this article is to provide certain guidelines and experiences in an area that has been characterized by a good deal of complexity and confusion. Numerous business publications have presented the case in favour of debt/equity conversion (DEC) programmes, usually from a simplified and orthodox macroeconomic perspective which justifies them in terms of the potential double benefit of both reducing the existing external debt (and therefore future debt service) and increasing investment (and therefore future growth) in struggling developing countries. In this sense, it is often maintained that DEC programmes offer the promise of killing two birds with one stone. In this article it is agreed that these two potential benefits are worth striving for, but a broader perspective is utilized to attempt to define at what cost and in what context those benefits can be obtained by the country implementing this instrument. Analysis of the experience of the major debtors which have implemented DEC programmes, stressing the central aspects of each programme rather than the myriad of differing details, allows some significant conclusions to be drawn.

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I

The context of debt/equity conversion

Debt/equity conversion does not take place in a vacuum and should not be analysed in one, rather it should be examined in the context of the international debt crisis and, particularly, the behaviour of transnational banks (TNBs) (Mortimore, 1989; CTC, 1991). Debt/equity conversion represents one instrument in a battery of debt conversion alternatives. To date, it has been the most important instrument in terms of the volume of debt exchanged, gaining particular force during the 1987-1990 period (Business International Corporation, 1987 and 1988, and *The Economist,* 1987).

Debt conversion became central to the international debt crisis when it became clear to debtors, multilateral institutions, creditor governments, and –most of all– transnational banks that the forced adjustment phase of that crisis was not producing the expected results. The poor results stemming from the second phase of the crisis, known as the Baker Plan or the adjustment-with-growth phase, created severe fissures in the creditor bloc between the multilateral institutions and the TNBs, between certain creditor governments and the TNBs, and between different categories and nationalities of TNBs themselves. Subsequently, in early 1989, the Brady initiative legitimized debt reduction as a new approach to the international debt crisis.

The debt reduction focus of the Brady initiative was simply a recognition of the reality 'the market' had imposed on the debt crisis. As tables 1 and 2 demonstrate, TNBs began to reduce their exposure in the highly indebted countries as of 1987, once the secondary market discounts on the TNB debt of those countries began to rocket. It may be noted in passing that the major debtors which subsequently implemented the higher-volume debt/equity conversion programmes are, with the partial exception of Venezuela, precisely those countries located at the top of the list of TNB exposure in the highly indebted countries.

Several important characteristics of the debt crisis are evident in table 1. The debt crisis consisted of two phases in terms of overall exposure: the 1982-1986 period of increased exposure, particularly for non-United States banks, and the 1987-1989 period of reduced exposure, especially for the regional and smaller U.S. banks. It is interesting to observe that the top nine banks of that country, which totally dominated the bank advisory committees that imposed the first debt strategy on these highly indebted nations (Mortimore, 1989; CTC, 1991), did not increase their own net exposure there. Indeed, they did not even succeed in convincing other smaller United States banks not to vote with their feet. It was the non-United States banks which provided most of the resources for the forced adjustment phase.

When it became clear that forced adjustment was not going to produce repayment in full and the adjustment-with-growth phase did not produce growth, the top nine United States banks proved as adept as their regional and smaller compatriots in reducing exposure in these countries. Finally, increased exposure during the first phase was concentrated in those countries which subsequently implemented debt/equity conversion programmes, whereas the reduction of exposure during the 1987-1989 period was quite generalized across the board.

In other words, the major debtors which received new money facilities during the first phase of the debt crisis corresponded closely to the major debtors which implemented debt/equity conversion

Table 1

TNB EXPOSURE IN HIGHLY INDEBTED COUNTRIES, 1982-1989

(US$ billion)

	As of December 1982				As of December 1986				As of December 1989			
	All BIS reporting[a]	Non US[b]	US All[c]	US (Top 9)[d]	All BIS reporting[a]	Non US[b]	US All[c]	US (Top 9)[d]	All BIS reporting[a]	Non US[b]	US All[c]	US (Top 9)[d]
Mexico	62.9	38.6	24.3	(13.1)	71.4	47.9	23.5	(13.5)	59.7	44.5	15.2	(11.3)
Brazil	60.5	38.5	22.0	(14.2)	67.3	43.7	23.6	(16.2)	60.9	43.7	17.2	(14.0)
Venezuela	27.5	16.3	11.2	(7.6)	26.9	18.2	8.7	(6.3)	23.1	16.4	6.7	(5.5)
Argentina	25.7	17.1	8.6	(5.6)	30.7	21.7	9.0	(6.4)	27.1	22.5	4.6	(3.6)
Philippines	12.6	7.1	5.5	(3.8)	13.8	8.9	4.9	(3.6)	9.7	6.9	2.8	(2.3)
Chile	11.6	5.7	5.9	(3.2)	14.3	8.1	6.2	(4.0)	9.3	5.8	3.5	(2.7)
Yugoslavia	9.8	3.9	5.9	(3.7)	9.9	7.9	2.0	(1.3)	7.7	6.3	1.4	(1.1)
Nigeria	8.5	6.8	1.7	(1.3)	9.2	8.6	0.6	(0.5)	7.3	6.8	0.5	(0.4)
Colombia	6.3	2.6	3.7	(2.6)	6.1	3.9	2.2	(1.5)	6.3	4.5	1.8	(1.4)
Peru	5.4	2.9	2.5	(1.3)	4.6	3.4	1.2	(0.7)	3.1	2.9	0.2	(0.1)
Ecuador	4.5	2.4	2.1	(1.2)	5.2	3.2	2.0	(1.2)	4.1	3.2	0.9	(0.7)
Morocco	3.9	3.2	0.7	(0.5)	4.7	3.9	0.8	(0.6)	4.6	4.0	0.6	(0.5)
Cote D'Ivoire	3.4	2.8	0.6	(0.5)	3.2	2.8	0.4	(0.3)	3.3	3.1	0.2	(0.2)
Uruguay	1.5	0.6	0.9	(0.6)	2.3	1.4	0.9	(0.7)	2.6	1.8	0.8	(0.6)
Costa Rica	1.3	0.8	0.5	(0.2)	1.4	1.0	0.4	(0.2)	1.0	0.9	0.1	(0.1)
Bolivia	0.9	0.5	0.4	(0.2)	0.6	0.5	0.1	(...)	0.3	0.3	(...)	(...)
Jamaica	0.5	0.3	0.2	(0.2)	0.5	0.4	0.1	(0.1)	0.5	0.4	0.1	(0.1)
Total	**246.8**	**150.1**	**96.7**	**(59.8)**	**272.1**	**185.5**	**86.6**	**57.1**	**230.6**	**174.0**	**56.6**	**(44.4)**

Source: Calculated by ECLAC/UNCTC Joint Unit (Economic Commission for Latin America and the Caribbean/United Nations Centre on Transnational Corporations) from Bank for International Settlements (BIS), *The Maturity and Sectoral Distribution of International Bank Lending*, various numbers, and US Federal Financial Institutions Examination Council, *Statistical Release: Country Exposure Lending Survey*, various numbers.

[a] These comprise the Group of Ten countries plus Austria, Denmark, Finland, Ireland, Luxembourg and Spain.

[b] Calculated as the difference between the values of all BIS-reporting banks and US banks.

[c] Covers 173 US banking organizations.

[d] The top nine are Bank of America, Citibank, Chase Manhattan Bank. Manufacturers Hanover, Morgan Guaranty, Chemical Bank, Continental Illinois, Bankers Trust and First National Bank of Chicago.

schemes. Linkage and leverage were present from the beginning.

Table 2 offers certain information which is essential for comprehending aspects of the debt crisis that served as important contextual factors for the debt/equity initiative. For the five major debtors which came to implement the most important debt/equity conversion (DEC) programmes, the original secondary market discount was initially very similar –in the range of 26 to 40%– at the time that the first programmes became operational. Towards the end of 1987, however, that situation changed dramatically (except in the case of Chile), as steep market discounts were registered for Argentine and Brazilian debt paper and considerable increases took place in the discounts on Mexican and Philippine debt. Even the prized Chilean debt paper experienced an appreciable decline during late 1987-1989. In other words, the similar initial conditions in the secondary market for major debtors subsequently underwent changes which differentiated the situation of those debtors. Those changes significantly affected the behaviour of both TNBs and the major debtors themselves.

Table 2

MAJOR DEBTORS WITH DEC PROGRAMMES: SECONDARY MARKET PRICES FOR TNB DEBT, 1986-1990

(Percentage of face value)

	Chile	Mexico	Philippines	Argentina	Brazil
June 1986	67	59		65	74
December 1986	67	56	72	66	74
June 1987	70	57	70	52	62
December 1987	61	51	50	35	46
June 1988	60	51	52	25	51
December 1988	56	43	49	21	41
June 1989	61	40	47	13	31
December 1989	59	36	47	13	22
June 1990	65	45	52	13	24
November 1990	73	43	49	17	26

Source: United Nations Department of International Economic and Social Affairs, based on bid prices according to Salomon Brothers, High Yield Department.

It is evident that TNB behaviour varied considerably according to the situation faced by each major creditor, but nonetheless, the behaviour of the principal United States banks which dominated the bank advisory committees and were the architects of the strategy for the first phase of the debt crisis was fundamental to the birth of the DEC instrument as one means of dealing with that problem. It is not by chance that these major banking organizations developed an avid interest in the DEC mechanism. Within the TNB advisory committees for major debtors, these big banks usually chaired the deliberations. At the same time they represented the interests of the myriad of other United States banks with exposure in those particular debtor countries. When the regional and smaller United States banks began not to heed the TNB advisory committee requests to put up new money and demonstrated a notable interest in exiting definitively from the problem, this provided an exceptional opportunity for the major United States TNBs which dominated the committees and had extensive knowledge of investment possibilities in those debtor countries. It is no coincidence, therefore, that these major United States TNBs also became the most active dealers in the exposures of the regional and smaller U.S. banks.

The debt/equity mechanism provided an outlet for the debt paper of the smaller United States and other banks with relatively marginal exposure in developing countries and provided significant income for the principal United States banks by way of substantial commissions charged by them as intermediaries. The loss implicit in the secondary market was taken by the smaller banks wishing to escape from the debt crisis, and it was an attraction for transnational corporations interested in investing cheaply in the country in question. The original country DEC programmes paid something close to par (in local currency) for the debt. In sum, the major United States TNBs were able to generate income from the very contradiction contained in their own strategy for dealing with the crisis –that is, that not all the banks were willing to play the role assigned to them by the major United States banks– and that contradiction accounted in good part for their initial interest in the instrument. The debt/equity mechanism was the first real innovation on the original strategy.

Coupled with the subsequent increase in the secondary market discount for TNB exposures in major debtor countries, it was the arrival of an apparently permanent state of arrears in several major debtor countries which created a new situation for the debt crisis. Table 3 shows that by 1987 fully nine of the 17 highly indebted countries registered arrears with respect to their TNB debt.

Table 3

HIGHLY INDEBTED COUNTRY INTEREST ARREARS OUTSTANDING TO TNBs, 1985-1990

(US$ billion)

	1985	1986	1987	1988	1989	March 1990	%
Argentina	0.4	0.3	0.2	1.9	5.1	6.2	36
Brazil	-	-	3.4	-	3.3	5.3	31
Peru	0.5	0.9	1.4	1.9	2.5	2.8	16
Ecuador	-	-	0.4	0.8	1.2	1.3	8
Cote D'Ivoire	-	-	0.2	0.4	0.6	0.6	4
Costa Rica	-	0.1	0.2	0.2	0.3	0.3	2
Nigeria	0.3	0.6	0.8	0.6	0.3	0.3	2
Bolivia	0.2	0.3	0.3	0.2	0.2	0.2	1
Morocco	0.1	0.1	0.1	-	-	-	-
Total	**1.5**	**2.3**	**7.0**	**6.0**	**13.5**	**17.0**	**100**

Source: The Institute of International Finance, Inc. (IIF), *Improving the Official Debt Strategy: Arrears are not the way*, Washington, D.C., May 1990, figure 1, p. 6.

Over the next two years or so, arrears more than doubled, amounting to US$17 billion in March 1990. Moreover, most of that appreciable amount corresponded to only two of the major debtors, namely, Argentina and Brazil. Evidently, the existing strategies for dealing with the international debt crisis were not working in general, and the negotiations with particular countries, like Argentina and Brazil, were obviously unproductive. The intractable nature of the crisis thus forced TNBs to pursue other avenues in search of a solution to their particular situations and problems.

Debt reduction instruments became the least bad alternative for most participants in the debt crisis. Table 4 indicates that four kinds of operations have characterized the 1985-1990 period. Debt/equity conversion has dominated the situation in terms of the volume of face value of debt converted, accounting for 40% of the total. Other initiatives, such as local currency operations (debt-for-pesos exchanges not requiring an authorized investment project) and private sector restructurings, have displayed a certain importance. Nevertheless, it is discounted operations associated with the Brady strategy for dealing with the debt crisis which presently show the most promise. The exchange of TNB debt paper for reduced-value bonds of major debtor countries seems to have become the most popular means by which those countries can take advantage of the now sizeable secondary market discount. As we shall see further on in this article, recent changes in the operation of most DEC programmes have given the major debtor countries increased possibilities of capturing a significant portion of the secondary market discount. The point to note, however, is that the debt/equity conversion instrument –an innovation utilized by the major United States TNBs primarily in their own self-interest (to earn commissions, to get a higher price for their debt and to participate in the best deals that they themselves organized)– is to a large extent being replaced by alternatives

Table 4

DEBT CONVERSION INSTRUMENTS UTILIZED IN DEVELOPING COUNTRIES, 1985-1990

(Face values in US$ billion)

	1985	1986	1987	1988	1989	1990 (prelim.)	Total	%
Debt/equity conversions [a]	0.5	0.8	3.2	6.2	4.5	8.9	24.1	40
Local currency operations [b]	0.2	0.5	0.9	4.8	3.7	3.2	13.3	22
Private sector restructuring [c]	0.1	0.3	3.5	4.3	3.1	0.5	11.8	19
Discounted operations [d]	-	-	-	1.9	1.0	8.5	11.4	19
Total	**0.8**	**1.6**	**7.6**	**17.2**	**12.3**	**21.1**	**60.6**	**100**

Source: M. H. Bouchet, *Transnational Banks and External Indebtedness of Developing Countries*, November 1990, report of the UNCTC.

[a] Debt/equity conversion necessarily involves an investment authorized by local authorities.

[b] Any exchange of debt paper for local currency. No mandatory investment is included.

[c] New arrangements negotiated directly between non-guaranteed private sector debtors and TNBs.

[d] Discount bonds, par bonds, buybacks, interest rate reductions, etc., utilized in Brady-style accords.

more beneficial to major debtors or being modified to achieve the same outcome. DEC is only one instrument in the arsenal of debt management options and is not necessarily the most important one at this point in time.

Creditors, and to a lesser extent, debtors, both have diverse opinions on their options. An important element in the success of the discounted loan sales associated with the Brady strategy is that they are favoured by the regional and smaller United States banks and non-United States TNBs (Madrid, 1990). The major United States banks which dominate the advisory committees prefer the original version of the debt/equity conversion instrument because it left them in control and –as already mentioned– provided an opportunity to generate income via commissions; it meant that they suffered smaller losses through secondary market discounts; and it allowed them to participate directly in the best deals which they themselves put together. For some debtors, however, the selectivity of the Brady initiative has proved a problem, as only five major debtors (Mexico, Costa Rica, Philippines, Venezuela and Uruguay) have been formally included. This does indicate, though, that the old "Citicorp versus Brazil" depiction of the debt crisis has lost relevance from the point of view of both the TNBs and the major debtors (CTC, 1991). With this new context in mind, we now turn to the task of analysing the practical experience with debt/equity conversion programmes.

II

Debt/equity conversion programmes in practice

Before examining, in comparative fashion, the DEC programmes of particular debtor countries, it makes sense to review, however briefly, the essence of the DEC instrument. Figure 1 assists in conceptualizing the separate segments of the operation and identifying the principal participants in it. Thus, the foreign investor, the original lender bank and the intermediary foreign bank, on the one hand, can be distinguished from the local intermediary, the original debtor and the local company receiving the investment on the other. In the simplest of DEC conversions –that is, a TNB capitalizing its own exposure through a subsidiary operating in the financial sector of the debtor country– the foreign investor, the original lender and the foreign bank intermediary would all be the same company. There were relatively few such conversions, however. More typical would be the case of a non-financial TNB utilizing a DEC programme to pay off local currency liabilities, to reinvest in a subsidiary or to undertake a new investment in the debtor country. Another salient aspect of DEC programmes is the crucial role which might be played by the domestic financial sector in facilitating the handling of the local currency proceeds exchanged for the external debt paper.

Practice has shown that DEC programmes are best analysed from three distinct perspectives: i)the investment authorization criteria: that is, how investment (specifically, foreign direct investment) is promoted and how it is channeled into priority areas; ii) financial aspects: that is, how the cake is divided among the participants; and iii) how negative impacts (i.e., inflationary pressures, speculative practices, etc.) are controlled. At a more general level, it is relevant to determine the priority of the DEC programme within the overall national debt management strategy and the extent to which national rather than creditor objectives are supreme in the design of the concrete DEC programme. Table 5 provides the information needed to carry out some of this comparative analysis for the principal DEC programmes of the major debtors. The following short analysis of each country programme will help to appreciate that table better.

Chile. This was the first major formal DEC programme[1]. The Chilean Government faced a

[1]Information for this and other national case studies comes principally from CTC, 1990 and the corresponding workshops held in Caracas and New York, plus consultant reports prepared in the context of another UNCTC/ECLAC joint effort, as well as other available sources. In the case of Chile, these included Chile, 1988; Mary L. Williamson, 1990; Ffrench-Davis, 1990; Lagos, 1989; and Fontaine, 1988.

Table 5

SUMMARY OF THE PRINCIPAL FEATURES OF FORMAL DEBT/EQUITY CONVERSION PROGRAMMES FOR MAJOR DEBTORS

	Chile	Mexico 1	Mexico 2	Philippines	Argentina	Brazil
Dates in force	V.85-[a]	IV.86-X.87[b]	VII.90-	VIII.86-[c]	V.87-IV.89[d]	IV.88-I.89[e]
A. Investment authorization criteria						
1. Eligible investors:						
Non-residents	X	X	X	X	X	X
Residents	f	g	X	X	X	
2. Acceptable uses:						
New equity	X	X	X	X	X	X
Existing equity[h]	X	X	X	i	X[j]	X
Local debt	X	X				
Country fund	X	X		incipient		incipient
3. Explicit priorities:						
Sectoral	k	X	X	X	X	
Foreign exchange earning	X	X		X	X	
Geographic						X
4. Normal FDI regulations apply?		X	X	X	X	X
5. Special restrictions:[l]						
Profits	4	5[m]	?	4[n]	4	
Capital repatriation	10	12	?	3-5	10	12
6. Matching fund requirement[o]	minor		50	0-60[p]	30	
B. Financial aspects						
1. Eligible debt:						
Public sector	X[q]	X[r]	X[s]	X[t]	X[v]	X[w]
Central Bank	X[q]	X[r]	X[s]	u	X[v]	X[w]
Private sector	x			y	X[z]	
2. Valuation of debt:						
Close to par	X[aa]	X[bb]		X[cc]		dd
Much less than par			X		X	X
3. Fees charged:						
Administrative[ee]	>10	0-25		7-24		
Tax		X				X
4. Exchange rate used:						
Official	X			X		X
Parallel		X	X		X	
5. Allocation of conversion rights:						
Auction			X		X	X
Administrative decision	X	X		X		
C. Controlling negative impacts:						
1. Inflation: quotas[ff]			1000[gg]	implicit	400	1800
2. Inflation/fiscal deficit: privatization	X	X	X	X	hh	
3. Speculative activities: company audits	X	X	?	X		

Source: ECLAC/UNCTC Joint Unit on basis of official information

[a] This programme was significantly modified in August, 1990 in such a way that investment quality rather than the quantity of debt reduction became emphasized.

[b] New applications for investment authorization were no longer received after October, 1987, however, the huge backlog of existing application s was worked off over the following years.

[c] In March, 1987 some new activities (banking/finance and the privatization of non-performing public sector assets) were added to the list of explicit sectoral priorities. In February of 1988, both the eligible debt and acceptable uses were restricted.

[d] Before 1987, a kind of debt/equity conversion mechanism existed for outstanding private sector liabilities with foreign exchange guarantees.

Conclusion of Table 5.

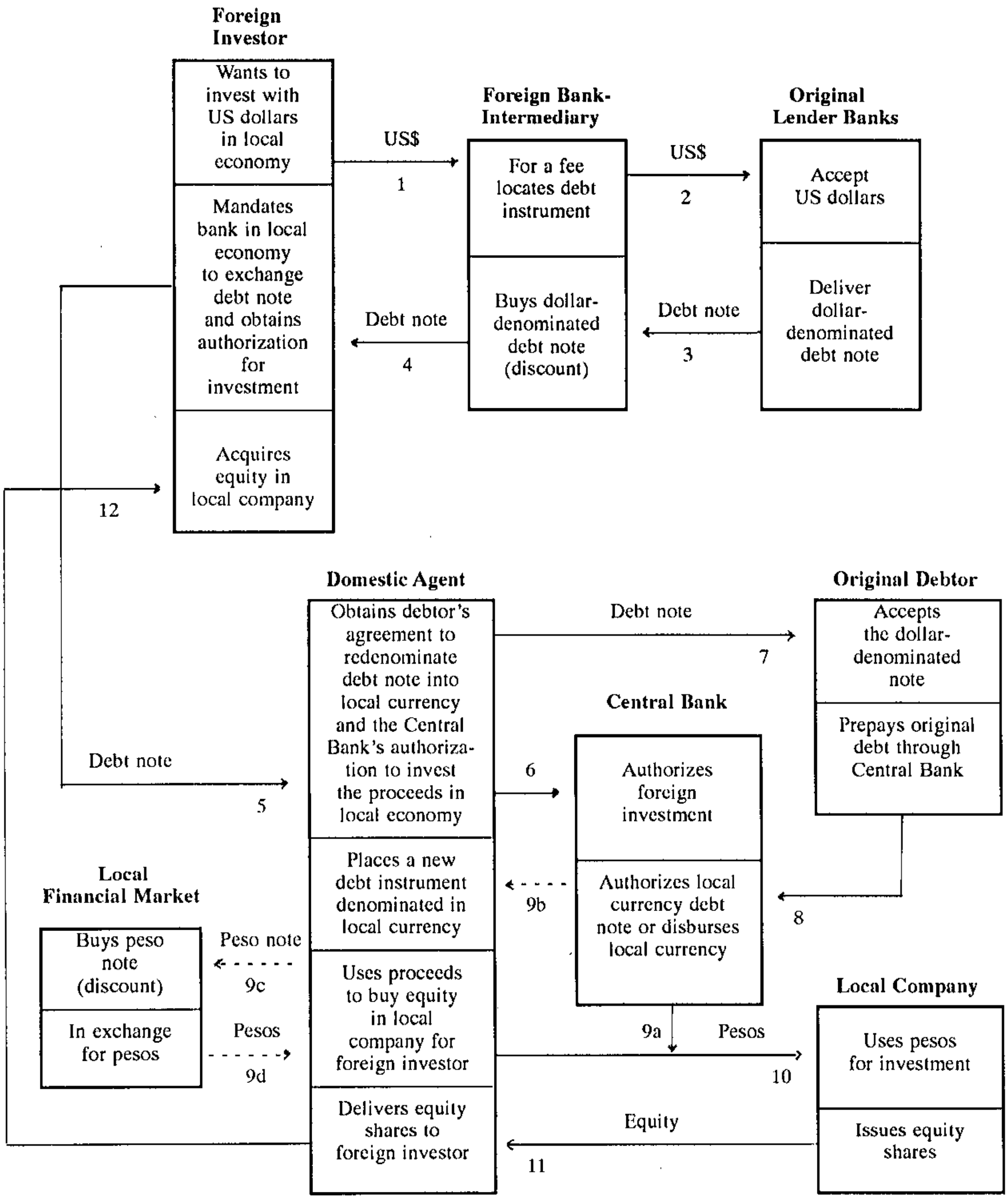
[e] Although considerable conversion look place before 1988, it was only with the establishment of a formal programme via Resolution 1460 that DEC volumes rose appreciably.
[f] Chapter XVIII of the Compendium of Foreign Exchange Rules deals with the conversion of TNB debt to pesos by nationals. No investment is required.
[g] In September of 1987, nationals were also permitted to engage in DECs, however, new applications for investment authorizations were suspended shorily thereafter.
[h] Most countries lay down limits on the purchase of existing assets.
[i] This was severely limited as of November, 1986.
[j] Limited to the original debtor in the case of private sector debt.
[k] A new, more sectorally-oriented, focus was introduced by way of the modifications of August, 1990.
[l] Expressed in terms of the number of years that external remittances are prohibited or severely restricted.
[m] Must be less that the value of the original interest payments during the first five years.
[n] For non-priority investments only.
[o] Expressed as a percentage of the value of the approved investment project.
[p] There is a sliding-scale relationship between matching funds and administrative fees, in the sense that higher matching funds correspond to lower administrative fees and viceversa.
[q] Essentially the 1985 and 1987 restructuring agreements, including new money facilities. Non financial private sector TNB liabilities do not carry a State guarantee and therefore are not included.
[r] In general terms, the TNB debt included that corresponding to the 1985 and 1987 restructuring agreements, including new money facilities; however, TNBs that did not fully contribute to the original new money facility were apparently excluded.
[s] That included in 1989 restructuring agreement. Limited to guaranteed TNB debt paper, such as the discount bonds, the par bonds and the United Mexican States paper for which there is an obligation to provide new money.
[t] Includes that referred to in 1987 restructuring agreement (including new money advances) plus all private sector TNB liabilities (whether restructured or not) except financial sector ones. Trade credits were initially included but later made ineligible.
[u] Restrictions were placed on the use of Central Bank liabilities as of February, 1988.
[v] A very wide variety of National Government, Central Bank and other public sector liabilities are included and generally referred to in the 1987 restructuring. Exit bonds were excluded.
[w] That referred to in the 1988 restructuring agreement (the multiyear deposit facility plus new money). Brazil Investment Bonds were included.
[x] Public guarantee extended to private financial sector debt of US$2.6 billion, as part of 1984 restructuring agreement.
[y] Public guarantee extended to private financial (US$1.6 billion) and private corporate (US$1.1 billion) debt as part of 1985 restructuring agreement. Reprogrammed trade credits were originally included for conversion purposes.
[z] Private external debt with exchange rate guarantees was included in a separate debt capitalization programme during 1984-87. A similar situation obtained for onlending facilities to the private sector.
[aa] The interest rate on the peso bonds received by the investor is less than a strictly market rate.
[bb] The higher the priority of the investment project, the lower are the administrative fees charged to the investor. There is a 20 per cent tax on the difference between the face value and the redemption value of the TNB debt.
[cc] The higher the amount of matching funds agreed to by the investor, the lower the administrative fees charged. Fees also vary according to the category –priority or nonpriority– of the approved project.
[dd] All debt/equity conversion carried out before the formal programme came into effect in 1988 was converted at par.
[ee] Percentage of face value of external debt converted via DEC programme.
[ff] In US$ millions per year.
[gg] The original target was US$3500 million over 3.5 years; however, that quota was reached after only 6 months of operation.
[hh] The original 1987 programme prohibited the use of the debt/equity mechanism for privatization.

relatively more difficult debt situation due to the high level of external indebtedness to TNBs and the dimensions of the crisis in the local financial sector. The national authorities took the bull by the horns and turned a pitiful bargaining situation into a strong position by gambling all on a liberal market strategy coupled with big concessions to TNB creditors, in the form of *ex post facto* State guarantees for the debt owed by the Chilean private financial sector to TNBs. Debt reduction was central to a debt management strategy which rested on a debt-for-peso exchange programme, a debt/equity conversion programme, and other operations, including debt buybacks. This active strategy succeeded in reducing the TNB debt by 1990 by about US$10 billion, or over 50% of the total. Its success in creditors' eyes was also manifest in the relatively higher price enjoyed by Chilean debt paper in the secondary market.

The DEC programme itself focussed on promoting the highest possible volume of foreign direct investment in the context of the debt reduction strategy. The very liberal and separate treatment of FDI via debt/equity conversion was characterized

Figure 1

PRINCIPAL ELEMENTS INVOLVED IN DEBT / EQUITY CONVERSION PROCEDURES



Source: ECLAC/UNCTC Joint Unit, based on World Bank, *World Development Report 1987*, Washington D.C., Oxford University Press, 1988.

by the exchange of TNB debt for pesos at close to the par value of that debt, coupled with few restrictions on the acceptable uses of the conversion proceeds, little initial concern for channeling those resources to specific activities, and an absence of explicit monetary controls or DEC conversion quotas (due to the absence of a severe fiscal deficit and the efficient functioning of the reformed local financial market). In essence, the DEC programme established a case-by-case bargaining situation between individual foreign (not Chilean) investors and national authorities of a liberal bent in which the authorities allowed the secondary market discount to serve as an incentive to foreign investors. They did not attempt to capture a significant part of that discount.

The DEC programme was exceptionally successful in improving the foreign investment climate, although it became apparent that it was in fact originally too permissive in permitting direct conversions in the financial sector and simple buyouts in that and other sectors. The only significant restriction was that limiting the use of DEC in the mining sector. Nonetheless, as the programme progressed and the original crisis lessened, national authorities became more adept at 'suggesting' investment priorities, matching fund requirements and limiting simple buyouts. As of August 1990, the DEC programme took on a much more selective character in so far as investment authorization was concerned, and investment 'quality' replaced FDI volume as the formal aim of the programme.

The results of the DEC programme up to August 1990 have been impressive in terms not only of debt reduction but also of FDI inflows, the positive economic impact, and the diversification of foreign investors. The DEC programme has accounted for US$3.6 billion of new FDI, of which US$1.3 billion was registered in 1989 alone. Almost three-quarters of that new FDI was registered in tradeables sectors such as industry (36.6%), agriculture, forestry and fishing (24.4%) and mining (13.1%), and has had a very positive impact on Chilean export performance, imparting a new dynamism to it. Finally, there was a healthy diversification of FDI by source country. Although United States investors still dominate the statistics with a little less than 40% of the FDI total via DEC, foreign investors from other countries have become relatively more evident, such as those from the United Kingdom (11.9%), New Zealand (10.6%), Spain (6.1%), France (4.1%), Sweden (3.2%) and Switzerland (2.9%). Thus, the Chilean DEC programme can be considered as very successful in terms of the aims of the national authorities. The value of the DEC in promoting FDI, coupled with the relative success of the liberal economic model (benefitting also from much improved copper prices), has permitted the Chilean authorities the luxury of spurning the Brady initiative and relying more on their privileged relation with international financial institutions, which was one of their priority aims.

Mexico. The debt crisis is usually considered to have begun in August 1982, when Mexico could not meet its external obligations. This initial ignominy for Mexico was worsened by a severe earthquake in 1985 and the steep fall in the international price of petroleum. These dire straits did not offer much of a bargaining position for this major debtor. In somewhat similar fashion to Chile, Mexico opted for a liberal market alternative; however, unlike Chile, the Mexican variant took place totally within a crisis context and therefore it was only when the principal aspects of the crisis had been to a certain extent attenuated that the trade and investment liberalization measures became more apparent. The debt management strategy rested more on restructurings combined with new money, initially, and on collateralized discounted debt exchanges, later, than on the debt/equity programme itself; nevertheless, the latter was essential in promoting a revival of foreign direct investment inflows. It is noteworthy that, while the Mexican authorities did implement a scheme (FICORCA) to guarantee the availability of foreign exchange to pay unguaranteed private sector external debts, Mexican officials did not feel obliged to extend a State guarantee to such private sector debt, which was later dealt with by heavily discounted buybacks very favourable to major groups such as ALFA and VISA.

The DEC programme appeared in two distinct phases of the TNB debt restructuring process: the 1984-1985 restructuring, in which the Mexican bargaining position was quite weak, and the 1989-1992 restructuring, in which it had strengthened considerably. One factor which assisted Mexico notably was that it was considered the test case of the Brady initiative by United States officials. Altogether, over the period 1982-1990 it reduced its TNB debt by over 20%.

Mexico implemented two very distinct debt/equity conversion programmes, which we shall refer to as DEC 1 and DEC 2.[2] The emphasis of DEC 1 was to promote FDI and channel it into priority sectors and activities. The investment authorization procedure gave preference to the privatization of State companies and to investments that produced exports from enterprises with positive trade balances, that increased productive capacity, that incorporated new technology, and that increased the level of national content, *inter alia.* Ten investment categories were defined, and a sliding scale of higher administrative fees (ranging from 0% to as much as 25% of the face value of the debt for lower-priority investment projects) was implemented. Although the FDI effected via debt/equity conversion was dealt with within the context of the existing legislation (the restrictive 1973 Law to Promote Mexican Investment and Regulate Foreign Investment), the regulations were considerably liberalized in the late 1980s. Furthermore, apparently much use was made of the DEC programme by existing subsidiaries which thus paid off local debt more cheaply.[3] Consequently, the investment authorization criteria were perhaps not as rigid as the official rules suggested. What is clear is that little attempt was made to capture a significant part of the secondary market discount, as the TNB debt was converted at over 80% of its face value on average for the life of the programme. DEC 1 was opened to Mexican nationals in October 1987, but one month later the receipt of new applications was suspended (although the accumulated balance was worked off over the following period).

In terms of results, DEC 1 did succeed in reviving FDI inflows, although apparently at the expense of certain inflationary pressures. The Mexican scheme did not count with a reformed and liberalized private financial market, as in Chile. In fact, the Mexican authorities felt it necessary to nationalize the banking sector during the initial days of the crisis. Over US$3.1 billion in FDI was registered via the DEC facility up to mid-1990. It was concentrated in priority sectors such as tourism (29.1%), the automotive industry (16.9%) and the in-bond (maquila) industry (11.5%), all of which produced significant foreign exchange earnings. The DEC-related investments in the automotive sector were central to the substantial increase in manufacturing exports from Mexico during the 1984-1990 period. Although most of the new FDI came from just one country –the United States (47.8%)– there was considerable diversification by country of origin: United Kingdom (13.8%), Germany (5.7%), Japan (3.7%), France (3.0%) and Spain (2.9%). As already noted, the Government's share in the secondary market discount did not exceed 19% of the face value of the TNB debt exchanged. The programme was shut down in November 1987, as far as new applications for investment authorization were concerned, due to the need to use existing foreign reserves for the enhanced structural adjustment programme then being initiated.

DEC 2 was implemented in 1990 in a very different context: one of a much more stabilized and liberalizing economy emerging from crisis. The new programme aimed explicitly at capturing a major portion of the secondary market discount. The key new feature was the use of the auction mechanism to distribute limited conversion rights for authorized investment projects, originally US$3.5 billion over three and one half years. The scheme was designed to take advantage of strong inflows of private Mexican deposits held in the United States, as well as continuing FDI inflows. For that reason, it was open to Mexican nationals. Although restricted to the privatization of State companies and infrastructural projects and, within those categories, limited to a maximum of 50% of the value of each investment project and available only for TNB debt with new money obligations, demand was very strong, as can be judged from the results. Over US$10 billion in investment projects has been approved and, facing this strong demand (and increasing discount), the Mexican authorities decided to liquidate their entire quota for three and one half years during two auctions held in 1990. The Government's take was the equivalent of 52% of the face value of the TNB debt exchanged (which compares very favourably with their initial expectations of 35%). It is not yet clear if a further quota will be available.

The Mexican DEC programmes have both been quite successful in terms of the distinct pur-

[2] Basic information on the Mexican programme is to be found in Mexico, 1986 and 1990a and b, and in Godinez, 1990.

[3] This was confirmed during the author's interviews with the largest foreign firms. See Mortimore and Huss, 1990.

poses assigned to them by the national authorities. DEC 1 was very useful in reviving FDI inflows and channeling them into priority areas during the crisis period, while DEC 2 performed well in terms of capturing a major portion of the secondary market discount on Mexican TNB debt. Nevertheless, the focus of the Mexican debt management strategy appears to rest with Brady-style initiatives, particularly direct discounted operations.

Philippines. The crisis suffered during the early 1980s was doubly difficult because the debt crisis was superimposed on a political crisis which was not resolved in any clear fashion until 1987. The weak bargaining position of the Philippines was manifest in the *ex post facto* State guarantees given to national private sector TNB debt as part of the first restructuring agreement in 1985 (which, incidentally, provided for the debt/equity conversion programme). The economy enjoyed more stability as of 1987; however, a continuing fiscal deficit and a permanent threat of military intervention in the nascent democratic government complicated matters. The debt management strategy rested primarily on rescheduling capital payments and obtaining new money during the first phase, and on discounted operations combined with new money in the second phase. The DEC programme was envisioned by local authorities as a 'spark plug' for investment, offering a clear incentive to investors, rather than as a principal means to pursue debt reduction (Philippines, 1986; Suratos, 1990, and Dytianquin and Sicat, 1988). Nonetheless, the Philippine authorities did reduce the TNB debt by 22.3% between 1984 and May 1990, mainly by way of concerted buybacks and prepayments.

Given the crisis conditions then experienced by the country, the original purpose of the DEC programme was to 'revitalize' the economy through investment via foreign direct investment and returned flight capital. Philippine nationals were included in the programme from the beginning. The investment authorization criteria were central to the programme, especially after the acceptable uses of DEC proceeds were tightened in November 1986. The authorities prepared a detailed list of preferred investments, giving clear priority to investment projects oriented towards exports or foreign exchange-earning activities. Although FDI undertaken by way of the DEC programme remained subject to the normal, relatively restrictive foreign direct investment rules, those rules were liberalized in October 1987, when two new categories of preferred investments were permitted: the privatization of non-performing public sector assets and banking/finance. It is notable in the case of the Philippines that a large number of investment project applications were rejected by government officials. A concern for investment quality was apparent in spite of crisis conditions.

Once a significant discount on Philippine TNB debt appeared in the secondary market, the Philippine authorities sought to capture a part of it without losing the investment quality focus of their DEC programme. Part of the October 1987 reforms entailed establishing a linked sliding scale of administrative fees (0-20%) and matching fund requirements (0-50%) for preferred investment projects. That is to say, within the category of priority investment projects, a greater contribution of fresh funds relative to DEC-related resources resulted in lower administrative fees. Given the level of the secondary market discount, most investors opted for the administrative fee, thereby providing the Government with a good share of the discount without sacrificing the investment quality focus of the DEC programme. Subsequent restrictions on the use of Central Bank and public sector debt paper as of February 1988 also reinforced selectivity in the authorization of investment projects. Finally, negative impacts were controlled to a certain extent by way of implicit DEC quotas, the emphasis given to the privatization of non-performing assets, and concern for investor identification and company audits. The Philippine DEC programme demonstrates a clear evolution from a completely investment-centred programme to one in which capturing a part of the discount assumed increasing importance.

In terms of results, the Philippine DEC produced investments (both foreign and national) of the order of US$895 million up until the end of June 1990, although it must be mentioned that annual flows began to decline as of 1988. These investment projects had a significant impact on the improved situation of the economy as they were heavily concentrated in preferred areas: export enterprises (34.9%), privatization (27.8%), priority investments (10.4%), banking/finance (9.1%) and other preferred fields (7.2%), even though only US$473 million in FDI resulted from the DEC programme (Filipinos accounted for 37.7% of the overall investment value of US$895 million). The FDI came primarily from the United States (33.8%), financial centres (15.3%), Hong Kong/ China (22.2%), Japan (16.2%), Taiwan (4.3%), Canada (3.1%) and Korea (1.6%). It would seem that the DEC programme did act in a minor way as a kind of 'spark plug' to help reactivate the Philippine economy at a time of crisis. It is equally clear that new considerations became increasingly important once a significant discount appeared in the secondary market. Even so, the overall debt management strategy relied more on other instruments, especially restructuring and buybacks.

Argentina. Argentina's situation was even more complex than that of the Philippines, in the sense that it not only combined the debt crisis with political instability, but added a lost war on top of that. This triple set of problems, plus a heavy dose of flawed economic management, has left Argentina in a terribly debilitated state. Its interest/exports and debt/exports ratios are among the highest in Latin America. Per capita GDP growth over 1981-1990 was -24,3%, that is, it declined by a quarter, and inflation remained out of control according to the statistics on consumer prices for 1989 (4 924%) and 1990 (1 833%). Speculative activities have characterized all aspects of the debt crisis, from the original contracting of TNB credits to virtually all attempts to manage the crisis (Schvarzer, 1983; García and Junco, 1987; Balino, 1987; and Calcagno, 1987). As might be expected in these circumstances, the Argentine debt management strategy has been ineffectual and the relationship with creditors has been extremely difficult and, at times, acrimonious. Although Argentina did restructure TNB debt in 1985 and 1987, so far its high level of arrears (about US$7 billion) has prevented any kind of Brady-style initiative. Its only real hope for debt reduction in the shorter term seems to be by way of an *ad hoc* privatization programme begun in 1991.

Argentina's experience with debt/equity conversion has been somewhat confusing (Argentina, 1987; Fuchs, 1990; Dreizzen, 1988, and Bouzos and Keifman, 1990). Although its formal programme resulted from the 1987 restructuring, it did have some activity previous to that programme as of 1984, in which about US$490 million of national private sector TNB debt with State foreign exchange rate guarantees was converted into equity investments, resulting in US$215 million in foreign direct investment. This first scheme had no clear investment authorization process and its results are unclear.

The formal programme was a package consisting of three elements: a debt/equity programme, a scheme for capitalizing on lending facilities in the private non-financial sector, and a mechanism for converting Central Bank rediscounts and loans to the private sector. The first element was the only one with a clear investment authorization process, and as it accounted for two-thirds of the TNB debt converted by way of this formal programme it will therefore be the centre of our analysis. The principal aim of the DEC programme, according to the local authorities, was to capture a significant part of the secondary market discount. A secondary aim was to establish a strict investment authorization process to ensure quality projects on the part of both foreign and national investors.

In terms of the first aim, it was implemented by way of an auction mechanism in which previously qualified investment projects vied for conversion rights strictly according to the discount offered. In six auctions held during 1989-1990, the average discount offered in the auctions rose from 38 to 75% (as the secondary market price of Argentine TNB debt paper plummeted). Officials tried to limit qualified projects to new capital goods, industrial plants, or activities that would improve the balance of payments. They originally demanded that investors provide matching funds in the same amount as the debt converted and that the official rather than the parallel exchange rate be used, but the lack of results convinced the authorities in September 1987 to limit the matching fund requirement to 30% of the value of the investment project and to use the parallel rate of exchange. In an attempt to control negative impacts, a conversion ceiling of US$300-400 million per year was established for the 1988-1993 period, but the programme was suspended in April 1990. Considering the inflationary environment in Argentina, it was surprising that the programme originally excluded privatization operations (characterized by their neutral monetary impact) from the DEC programme. The new *ad hoc* version, in contrast, is centered on privatizations.

It can be stated that the Argentine DEC programme was fairly successful in capturing a substantial portion of the secondary market discount on TNB debt, especially after the original disincentives in terms of matching funds requirements and the exchange rate used had been eliminated. Furthermore, of the investment projects implemented by foreign investors, slightly over half represented new investment, concentrated in relatively more dynamic sectors such as the automotive (54%), food and beverage (35%) and chemical industries. On the down side, the Argentine programme was characterized by a low volume of activity and relatively small projects, both of which prevented the programme from providing any kind of substantial and cumulative impact on the economy. Only about US$715 million of TNB debt was converted, with steep discounts for investment projects by foreigners, so that it actually represented FDI of the order of US$400 million. The *ad hoc* privatization scheme utilizing TNB debt paper is currently contemplating deals for the national telecommunications company and the national airline in the order of US$7 billion. That would make the privatization-DEC programme into a central feature of the debt management strategy. To date, that strategy has had no clear focus, and speculative activities continue to accompany new initiatives.

Brazil. This country lived less of a crisis than most others and it did not face too demanding political uncertainties, nor did it lose a war; nevertheless, its stormy relationship with creditors, especially TNBs, has complicated its macroeconomic performance and debilitated its debt management strategy. During 1990, inflation reached 2 360%, the trade balance weakened and the debt burden increased (although it is nowhere near Argentina's). Brazil's situation has generally deteriorated since it decided to do battle with TNBs by imposing a moratorium on TNB debt payments in 1987, which had severe repercussions on individual TNB accounts. The problem central to Brazil's poor economic performance, however, has been the fiscal deficit, not the relationship with external creditors.

The original debt strategy seems to have been to maintain a tough attitude, restructuring only relatively minor amounts while securing new money and trade/interbank facilities. That strategy began to falter when TNBs did not permit any agreement in 1985 and offered no new money in 1986. That paved the way for the moratorium of 1987 and, when the TNBs did not relent, the collapse of the strategy. The restructuring of 1988 involved US$61 482 million, some new money, the restoration of trade and interbank facilities and a formal debt/equity programme. The new approach did not succeed in establishing a new relationship with the TNBs, and arrears again built up the following year as the macroeconomic situation worsened. The existence of significant arrears prohibited any kind of Brady-style initiatives on the part of the creditor bloc, while Brazil demanded a radical solution (discounted operations involving the creation of 45-year bonds). The Brazilian debt strategy did not produce any significant reduction (estimated at less than 20%) in TNB debt, and it was debt/equity conversions in all their manifestations which provided the lion's share of that value.

In Brazil, debt/equity conversion has come in many forms and went through several mutations before a formal programme became active in 1988 (Brazil, 1988 and 1989; Bielschowsky, 1990; De Freitas, 1988; Wald, 1988, and De Moraes, 1988). DEC was carried out and had a certain economic significance during the 1982-1987 period through temporary or *ad hoc* mechanisms. A decline in foreign direct investment inflows convinced the authorities to offer tax incentives for the capitalization of relending operations for foreign enterprises, and US$1.3 billion was registered up until the programme was severely restricted in November 1984. Thereafter, and until the programme was suspended in July 1987, debt/equity conversions were limited to direct capitalizations only, with no tax incentive. Even so, US$2 billion worth of investment took place in this manner. These first operations in the field of debt/equity conversion took place at face value: that is, Brazil paid in local currency 100% of the original value of the converted TNB debt.

The new formal programme which came into operation in November 1987 consisted of two components both aimed at a common purpose: to capture as high a proportion as possible of the discount in secondary markets. The first element was an auction-based DEC programme which resulted in US$2 billion of conversions. The second element was a case-by-case programme limited to non-mature debt placed on deposit with the Central Bank, which produced US$850 million of conversions. Our analysis will focus solely on the formal auction programme, for which more official information is available, even though the temporary and *ad hoc* mechanisms were at least as important in volume terms as the formal auction programme.

The central feature of the formal DEC programme was the auction mechanism, subject to US$150 million monthly limits, which was based on the discounts offered. No fees were charged, but the use of the official exchange rate was considered a disincentive. In terms of the investment authorization criteria, with one exception, they were identical to the liberal foreign investment regulations. The exception was that 50% of the monthly quotas were restricted to certain areas of the country, namely, the less developed States in the areas coming under the Superintendency for the Economic Development of the Northeast (SUDENE) and the Superintendency for the Development of Amazonia (SUDAM), plus Espirito Santo and Vale do Jequitinhonha. It may be noted that the programme allowed for liberal 'accepted uses' of the resources converted; however, the purchase of shares in existing companies was not to lead to the denationalization of Brazilian companies. There were no special limits on profit remittances, but companies which had repatriated capital during 1985-1987 were supposedly excluded from the programme. Basically –until it was suspended in January 1989 due to the initiation of a new anti-inflation plan– this formal DEC programme was designed to capture a significant part of the secondary market discount and channel foreign direct investment to the poorer parts of the country.

The formal auction-based DEC programme has enjoyed some success, and some benefits have been registered. The discount arrived at in the auctions increased from an average of 17.6% to 34% during the ten auctions, meaning that Brazil ended up with about half of the secondary market discount. Furthermore, about half of the investment generated by the DEC programme went into depressed areas of the country. The investment projects were for the most part in priority areas: electric machinery (10.3%); chemicals (10.1%), paper (7%), metals (6.4%), food products (6.2%), tourism (5.8%), etc., although it is not clear how this affected exports or the availability of foreign exchange. There was also considerable dispersion as regards the country of origin of this investment: United States (29.6%), financial centres (22.3%), Japan (15.3%), France (8.9%), United Kingdom (4.9%) and Switzerland (4.5%).

In a more critical light, it is evident that the volume of transactions of the formal programme was rather pitiful for a country the size of Brazil, and the operation of the programme did not give a clear sense of direction to investors. This makeshift approach to debt/equity conversion in Brazil characterized that country's confused strategy with regard to DEC in particular and debt management in general. It is noteworthy that the volume of the formal auction-based DEC programme of 1987-1988 did not even exceed that of the restricted direct capitalization programme of 1984-1987. In addition, informal DEC of the order of US$4.3 billion has been recognized by the Central Bank authorities. If, indeed, all debt/equity conversion mechanisms utilized in Brazil did produce foreign direct investment of the order of US$4.5 billion during 1985-1989, this gives rise to a clear feeling that additionality has been low, and that TNCs used the DEC mechanisms for subsidized reinvestment purposes or as a substitute for normal foreign direct investment. Round-tripping and speculative practices seem to have been tolerated by officials even though they did not result in major new inflows of FDI or the significant reduction of Brazil's TNB debt on terms favouring national stability and growth.

The analysis of these five national programmes for debt/equity conversion demonstrates that the debt/equity instrument can be used to pursue different goals according to the situation in which the debtor country finds itself. Furthermore, an established programme can suddenly be modified to serve new aims. Tables 6 and 7 offer a summary of available information relevant to the goals of foreign direct investment promotion and debt reduction for these five programmes.

Table 6 demonstrates with considerable clarity that only one programme –that of Chile– has succeeded in turning the DEC mechanism into the principal means of promoting FDI, in a situation of increased FDI flows.[4] Eighty per cent of the value of the 1985-1989 FDI flows (which were more than double the value of those of the 'boom' period, 1978-1982) was channeled through the DEC

[4] TNBs have lauded the example of Chile. See The Institute of International Finance, Inc., 1990.

Table 6

SELECTED MAJOR DEBTOR COUNTRIES:[a] IMPORTANCE OF DEBT/EQUITY CONVERSION (DEC) FOR FOREIGN DIRECT INVESTMENT (FDI)[b]

(US$ millions and percentages)

	FDI via DEC 1985-1989 (1)	Total FDI 1985-1989 (2)	Total FDI 1978-1982 (3)	FDI via DEC (1) / (2)	Level of FDI (2) / (3)
Mexico	3 052	10 098	8 279	30	122
Brazil	4 529	7 687	11 775	59	65
Chile	3 160	3 947	1 424	80	277
Argentina	731	3 646	2 183	20	167
Philippines	473	2 306	582	21	396
Total	**11 945**	**27 684**	**24 243**	**43**	**114**

Source: ECLAC/UNCTC Joint Unit on Transnational Corporations, based on official information and IMF balance-of-payments data.
[a] The purpose of this table is to standardize available information in terms of discounted TNB debt which had been formally converted into materialized foreign direct investment, excluding the impact of any matching fund requirements or complementary investments.
[b] Includes only that portion which corresponds to foreign enterprises.

Table 7

SELECTED MAJOR DEBTOR COUNTRIES: IMPORTANCE OF DEBT/EQUITY CONVERSION FOR TNB DEBT REDUCTION, 1985-1989

(US$ millions and percentages)

	TNB debt 1987 (1)	Reduction via DEC 1985-1989 (2)	Total debt reduction 1985-1989 (3)	Percentage reduced (3) / (1)	Percentage reduced via DEC (2) / (3)
Brazil	65 700	8 559	12 900	20	66
Chile	14 800[a]	3 426[b]	9 100	61	38
Mexico[c]	74 500	4 162	8 700	12	48
Argentina	30 600	2 276	2 400	8	95
Philippines[d]	11 700	849[b]	1 700	15	50
Total	**197 300**	**19 272**	**34 800**	**18**	**55**

Source: ECLAC/UNCTC Joint Unit, on the basis of official information, and IBRD, *World Debt Tables, 1990-1991. External Debt of Developing Countries, vol. 2, Country Tables*, World Bank, Washington, D.C., 1990.
[a] This figure is for 1985, the high point for TNB liabilities within the period 1985-1990
[b] To June 1990.
[c] An important reduction in existing TNB claims, of the order of US$6 900 million (excluding additional new money liabilities) was registered in 1990.
[d] An important reduction in existing TNB claims, of the order of US$1 300 million (excluding additional new money liabilities) was registered in 1990.

programme. The Brazilian programme succeeded in channeling almost 60% of the FDI flows through the DEC programme, but it was 60% of a greatly reduced inflow. For its part, Mexico guided almost one-third of the increased FDI inflow through its DEC programme. Both the Philippines and Argentina had some success in raising FDI inflows, but their DEC programmes were not particularly important in that result. The admittedly deceptive average for these five countries suggests that while FDI inflows increased slightly, over 40% of those inflows was accounted for by DEC programmes during 1985-1989. This indicates that it is the character of individual programmes in changing national circumstances which is of importance when viewing results in a comparative manner, not the aggregates.

A similar case holds true for the goal of debt reduction. Table 7 indicates that only one country programme –again, that of Chile– succeeded in both significantly reducing the TNB debt (by 61%), and doing so in large part (38%) via the DEC programme. It is quite true that *all* other major debtors did make more use of DEC for debt reduction, but their level of reduction was minor, ranging from 8% to 20% of the debt stock. It should be mentioned that both Mexico and the Philippines implemented Brady-style debt and debt service reduction schemes in 1990, but in neither case was the DEC programme the principal instrument. Again, the average for the group gives a rather inaccurate picture of the situations of these individual DEC programmes in terms of the TNB debt reduction goal.

III

Conclusions

As is by now evident, there has been a clear tendency in the debt/equity programmes of major debtors to de-emphasize the goal of promoting direct foreign investment and to concentrate instead on capturing a significant part of the secondary market discount available on the TNB debt of those countries. That tendency accelerated as secondary market discounts grew explosively from 1987 onwards. While TNBs, especially those that dominate the advisory committees for these debtors, like DEC programmes (particularly those that emphasize FDI promotion and that convert TNB debt at something close to face value), it is clear that such programmes are no longer the best means available to capture a portion of the discount. Brady-style discounted operations are becoming more popular.

In spite of the decline in popularity of the DEC mechanism, it is important to point out that such programmes can still be useful in promoting the goals defined by national authorities, even if they are often an imposition of creditors. In order to be useful they must be carefully designed to focus on a *single* principal goal and, to the extent possible, to reflect national priorities. The analysis of individual DEC programmes –not aggregate statistics– offers a means of learning from the experiences of others. Examination of the data on DEC-based FDI flows and TNB debt reduction bears this out.

Along with the general swing in the focus of DEC programmes from FDI promotion to capturing a piece of the discount, there was a tendency on the part of most major debtors to replace crisis management with debt management. The countries which did this are those that have achieved most in terms of the political economy of debt/equity conversion. Those that have achieved least are the major debtors which have not implemented serious structural adjustment policies.[5] In a situation of macroeconomic instability, the negative impacts of DEC programmes often considerably outweigh any positive contributions, with inflation and speculative practices usually being the consequences. In these circumstances, it is probably a safer bet to focus DEC programmes on capturing the largest possible discount within the context of a serious privatization scheme, so that the impact on mon-

[5] An interesting table on policy reform in Latin America during the 1980s was presented in *Latin Finance*, No. 15, March 1990, p. 63. It was based largely on John Williamson (ed.), 1990.

etary variables is minimized. Furthermore, DEC programmes can be used to seek certain waivers from TNBs, such as those dealing with the sharing and prepayment clauses of existing loan contracts, which will be useful for posterior debt and debt service reduction agreements.

Learning from the concrete experiences of other major debtors and being alert to potential initiatives are two ingredients which have often been missing from the debtors' shelves but which are necessary for the preparation of their 'menu' of options.

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