8-26-00

THE WHITE HOUSE

WASHINGTON

August 23, 2000

MEMORANDUM FOR THE PRESIDENT

FROM: LISEL LOY

SUBJECT: Nigerian Debt

The attached Sperling/Berger memo presents 3 options for helping President Obasanjo address Nigeria's external debt. Sandy and Gene expect Obasanjo will press during your meetings for unilateral cancellation of all or part of our share of Nigeria's debt (4% of total).

Option 1: Affirm Summers' statement of U.S. support for positive consideration of future debt as early as next year, if Nigeria makes progress on reforms, reduces corruption, etc. *All your advisers, including John, Gene, Sandy, Jack, Larry, Madeleine and Lael, support this option.*

Option 2: Urge leaders of other creditor countries to support positive future consideration of debt reduction multilaterally. *Gene, Sandy, Jack, and Madeleine support this option. Larry and Lael believe it will be ineffective and potentially counterproductive. John concurs with Lael.*

Option 3: Actively support a debt swap clause in the upcoming Paris Club rescheduling agreement, to permit up to 20% of the debt to be reduced or partially cancelled via debt swaps with third parties. We would need new authorizing legislation for U.S. debt swap authority in this context, but this would be a matter for the next Administration/Congress because Nigeria's rescheduling agreement will not be complete until after this Congress adjourns. *Madeleine and Lael support this option. Madeleine recommends we communicate to Nigeria that debt swaps could result in partial cancellation of significant amounts of its debt; Lael supports the option as long as we make clear we're not seeking additional Congressional authorization. John concurs with Lael. Gene, Sandy, Jack and Larry oppose: Gene and Jack believe that given Nigeria's fiscal record, debt swaps could provoke congressional fears and set back our efforts to obtain full HIPC funding and authorization this year; Larry also fears this would jeopardize our HIPC efforts and believes holding swaps out as a cancellation mechanism is not meaningful.*

Option 1: Affirm Summers' statement (*all your advisers*)

Approve ✓ Disapprove ___ Discuss ___

Option 2: Urge support from other creditor countries (*Gene, Sandy, Jack, Madeleine*)

Approve ___ Disapprove ___ Discuss ✓

Option 3: Actively support debt swap clause (*John, Lael, Madeleine*)

Approve ✓ Disapprove ___ Discuss ✓

Can [illegible] 1/3 — cancelling [illegible] 1+2 or 1+3 can't reach HIPC # — [illegible] Cong. [illegible] Deep [illegible] 2+3? — BC

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THE WHITE HOUSE

WASHINGTON

August 22, 2000

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MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING GS
SAMUEL BERGER for

SUBJECT: Nigeria's Foreign Debt -- Policy Options

Background

President Obasanjo has indicated his intention to make debt reduction the top issue in your meetings. He has made debt reduction a prominent symbol of his quest to provide a democracy dividend for Nigeria, and is likely to press for unilateral cancellation of all or much of our share of Nigeria's debt to place pressure on other, larger creditors. Nigeria's poor repayment record and lack of cooperation with the international financial community prior to Obasanjo's tenure have left creditors -- with the sole exception of the UK -- unsympathetic to anything beyond a short-term rescheduling of the country's $24 billion bilateral external debt, $22 billion of which is in arrears. In addition, a projected $5 billion increase in oil revenues this year has weakened Nigeria's case for debt reduction at least in the near term, especially because Nigeria has demonstrated little or no transparency with respect to its use of these or other government funds.

We are currently seeking to help President Obasanjo address Nigeria's external debt and stimulate economic growth in three primary ways:

- Support for economic reform. We have offered technical assistance to encourage President Obasanjo to implement far-reaching economic reforms. The economy is already showing significant progress partly as a result of such reforms: inflation has fallen from 12 to 5 percent, foreign direct investment is projected to grow by 5 percent in 2000, and privatization receipts are projected to reach $200 million. In addition, export receipts (mainly oil) are projected to increase by 57 percent in 2000, and economic growth will increase from 1 percent in 1999 to 3.4 percent in 2000.

- Increased development assistance. We have sought to increase assistance in support of Nigeria's policy priorities. The Administration has identified almost $109 million in bilateral assistance to Nigeria for FY2000, including roughly $93 million of USAID funds targeted at health and education, HIV/AIDS, privatization, and poverty reduction. This is a substantial increase over FY 1998 and FY1999 levels of roughly $7 million and $38 million, respectively. We have also successfully encouraged an increase in highly concessional International Development Association (IDA) loans from the World Bank, with the Bank now projecting an allocation of up to $970 million for Nigeria over the next three years -- more than double the amount originally projected.

- Promotion of debt relief. We have taken the lead in the Paris Club to reduce Nigeria's current debt payments and have expressed a positive presumption of support for future Paris Club debt reduction based on Nigeria's progress in implementing reforms. With support from only the UK, we brokered a generous *rescheduling* agreement limiting Nigeria's 2000 payments to "at least $700 million" – which will save Nigeria over $1.5 billion in debt service payments this year. This is consistent with President Obasanjo's stated desire for a $1.5 billion total external debt service cap. As for debt *cancellation*, Secretary Summers communicated privately and publicly during his meeting with Obasanjo in June, US willingness to support positive consideration of debt reduction as early as next year based on a proven record of reform. President Obasanjo accepted this challenge. In addition, Secretary Summers privately offered US support for the addition of a "goodwill clause" to this effect to Nigeria's rescheduling agreement (language that would be included in the agreed minute of the Paris Club meeting), though he cautioned that such an effort could undermine support for the generous rescheduling. We believe there will be greater international support for debt reduction in the future if Nigeria uses the resources from this year's rescheduling plus higher oil revenues to finance investments in growth and poverty reduction.

Further Debt Relief

President Obasanjo appreciates your leadership on debt relief for Nigeria and Sub-Saharan Africa. Nevertheless, he will likely press you to go further – which could complicate our efforts to secure appropriations for the broader HIPC initiative. The United States holds 4 percent of Nigeria's bilateral foreign debt, all of which is owed to the U.S. Export-Import Bank. Unilaterally canceling this debt or reducing it by up to two-thirds (as under a typical Paris Club debt reduction package for which Nigeria could qualify) would require appropriations of $165 million or $110 million, respectively. Either step would substantially expand the US cost of and effectively relax the eligibility conditions for international debt relief. This could seriously endanger our efforts this fall to secure appropriations of $435 million for bilateral and multilateral (HIPC) debt relief as well as authorization for the use of IMF gold sales proceeds for debt relief under the Cologne Initiative. A number of Republican HIPC supporters last year opposed efforts to include authorization for Nigerian debt reduction in a bill authorizing US participation in the Cologne Initiative, and unilateral cancellation of some or all of Nigeria's USG debt now would almost certainly undermine their support for the current budget request.

Options: Following are three options that might extend our support of President Obasanjo's quest for debt reduction while avoiding unacceptable risk to our HIPC appropriations strategy:

1) Formally affirm Secretary Summers' statement of US support for positive consideration of debt reduction in the future. One option, supported by all agencies, would be for you to issue a statement formally affirming your support for positive consideration of Paris Club debt reduction possibly as early as next year provided Nigeria makes progress on reforms, reduces corruption, and invests increased oil revenues in core priority areas. In addition, you could offer further technical assistance to help Nigeria meet these objectives. This would affirm your personal commitment and put other creditors on notice that we intend to take a leading role in supporting Nigeria's economic adjustment efforts.

2) Urge support from leaders of other creditor countries. You could reinforce the seriousness of our intentions by committing to write to the leaders of other Paris Club creditor countries urging their support for positive future consideration of debt reduction on a multilateral basis. This would commit the Administration to a proactive diplomatic effort.

Pros:

- ***Would demonstrate a deeper level of commitment to President Obasanjo's campaign for debt reduction through active advocacy and outreach with respect to other creditors.***

Cons:

- ***Presidential-level outreach on a position that has very little international support and that we cannot be certain the next US Administration will support would weaken US credibility and possibly complicate our other Paris Club and debt relief objectives.***
- *The United States is already well out in front of other creditor countries in support of debt relief for a country that has a greater capacity to service its debts than other heavily indebted African countries, in part due to a projected $5 billion oil revenue windfall.*

3) Actively support debt swap clause in Paris Club agreement. You could express our willingness to work in the context of Nigeria's upcoming Paris Club rescheduling agreement to permit up to 20 percent of the debt to be reduced or partially cancelled via debt swaps with third parties (e.g., NGOs or private investors). These third parties would purchase debt from a willing creditor at a discount and exchange it with the Nigerian government for a negotiated amount of local currency for use in development projects or investments in Nigerian companies. It is not unusual for such a clause to be included in a Paris Club rescheduling agreement for a poor country like Nigeria.

Such an initiative would offer the prospect of some debt reduction on an ad hoc transaction-by-transaction basis as Nigeria awaits consideration of more comprehensive debt reduction. In theory, debt swap authority would open the door to retirement of up to $4.8 billion of its $24 billion foreign debt. In fact, uptake is likely to be limited even over the longer term, as swap transactions require willing third parties, take considerable effort to consummate, and require a willingness on the part of indebted governments or their companies to commit local currency funds for the project or investment in question. Nevertheless, some of Nigeria's major creditors have standing authority to participate in debt swaps for poor countries, creating the possibility --- but by no means certainty --- that some debt reduction could begin soon after the Paris Club's action.

It is worth noting that local currency commitments by the Nigerian government or its companies as part of a debt swap arrangement would not represent a net increase in domestic resources for social spending or investment and would need to be financed within the existing fiscal and monetary policy framework.

It is also important to note that we would require new authorizing legislation for US debt swap authority. This would have to be a matter for the next Administration and Congress, since Nigeria's rescheduling agreement is not due to be completed until after Congress is expected to adjourn. Current US debt swap authority covers only Latin American debt or swaps for tropical forest conservation projects. On the other hand, if authorization were obtained, debt swaps would result in no cost to the Treasury and require no appropriation as long as debt is purchased at or above the value assigned to it by Treasury and OMB (currently 17 cents on the dollar). We note that not one country with respect to which we have existing authority has ever conducted a swap with the US largely due to the fact that it is very difficult to find third parties willing to buy the debt.

Pros:

- *There is precedent in the Paris Club for countries in similar circumstances.*
- *Other creditors are likely to support such a clause if Nigeria seeks it.*
- *Would visibly respond at least in part to Obasanjo's desire for moving beyond rescheduling to debt reduction, thereby providing additional political support for a government whose success is critical to the future of the region.*
- *No appropriations are necessary and no authorization would be sought this year, thereby limiting the potential Congressional fallout for the HIPC request.*
- *This is a creative approach that permits further debt reduction without compromising the current HIPC or Paris Club eligibility requirements for international debt reduction.*

Cons:

- *Could raise Nigerian expectations for debt reduction beyond what would likely result since there is a strong possibility that US authorization would never be obtained, existing debt swap programs have attracted only modest interest, and debt swaps may provide little fiscal benefit.*
- *Lack of Congressional authorization for USG debt to be used in swaps could undermine the international credibility of the initiative, and current efforts to obtain such authorization could create risk for our HIPC appropriations requests.*
- *Debt swaps in other contexts have proven susceptible to corruption, a pertinent concern in the case of Nigeria.*

Recommendations

- Secretary Summers supports Option 1 alone. Secretary Summers believes the additional effort with other creditors in Option 2 would be completely ineffective and might well be counterproductive to any chance of agreement on debt reduction for Nigeria down the line. Based upon Treasury's experience with debt swaps (Option 3) over the past dozen years, he believes holding them out to Nigeria as a debt cancellation mechanism is not meaningful. He further believes that escalation of our efforts to seek debt reduction for Nigeria under Option 2 or signaling a commitment to seek authorization for debt swaps under Option 3 would seriously jeopardize the success of our efforts to seek adequate funding for HIPC.

- Gene Sperling, Sandy Berger, and Jack Lew support Options 1 and 2. Sperling and Lew are concerned that, with Nigeria's poor fiscal record and inability to account fully for its oil windfall, debt swaps could be seen as unjustified and unduly expansive, provoking Congressional fears that we are expanding the scope of our HIPC proposals and thus setting back our efforts to obtain full HIPC funding and authorization this year.

- Secretary Albright supports the full package of Options 1, 2, and 3, and recommends that we communicate to the Government of Nigeria that debt swaps, with third party involvement, could result in the partial cancellation of significant amounts of its debt.

- Lael Brainard supports Option 1 but not 2 for the reasons stated above. She also supports Option 3 -- as long as we make clear that we are not seeking additional Congressional authorization -- on the grounds that it provides additional flexibility in managing Nigeria's debt burden and demonstrates goodwill to Obasanjo without compromising our principles on debt reduction, undermining Congressional support for HIPC or alienating other creditors (who are supportive).

Decision

That you approve:

____ Option 1 Formally affirm Secretary Summers' statement of US support for positive consideration of debt reduction in the future.

____ Option 2 Urge support from leaders of other creditor countries.

____ Option 3 Actively support debt swap clause in Paris Club agreement.