

NIGERIA AND THE BURDEN OF EXTERNAL DEBT: THE NEED FOR DEBT RELIEF

O. A. OGUNLANA¹

Introduction

The management of Nigeria's external debt has been a major macroeconomic problem especially since the early 1980s. For many years now, the country's debt has been growing in spite of the efforts being made by the Government to manage and minimize its crushing effects on the nation's economy. Such efforts range from the various refinancing and restructuring agreements to debt conversion programme and the deliberate allocation of substantial resources towards servicing the debt. Of particular concern to the authorities, is the heavy debt burden it imposes when compared with the country's debt service capacity.

In recent years, however, some observers have held different perceptions about Nigeria's capacity or otherwise to service her debt. This is largely because of the improved income to the country arising from export of crude oil, Nigeria's major export. Moreover others have argued that bad governance, especially during the military rule, largely accounted for the mismanagement of the Nigerian economy and therefore, the people should bear the brunt. Whatever position one holds, what appears undisputable is the increasingly large debt service requirement which imposes considerable stress on the Nigerian economy even when the improved resource inflow is factored into the country's cash flows. Indeed, the issue of sustainability of Nigeria's debt profile continued to be the focus of research and public debate until the recent initiative of the Paris Club of Creditors which appears to address the issue in a more meaningful way. Even then the conditions and adequacy of the debt relief have continued to generate further debate.

The objective of this paper is to review Nigeria's external debt and the burden it imposes, and use the various indicators and prevailing global economic circumstances to justify the need for substantial debt relief for the country. This exercise is not intended to compare Nigeria's debt sustainability with those of other countries in similar debt situation, but to review the burden vis-à-vis the country's debt service capacity especially in view of the country's urgent need to reduce the level of poverty. In view of this, the rest of this paper is organized into five parts. Part I deals with literature review and analytical framework for external debt and its burden. The magnitude, trend and structure of Nigeria's debt are examined in Part II, while how and why Nigeria entered the debt trap and the various approaches adopted to manage the debt are examined in Part III. Part IV justifies the need for external debt relief for Nigeria. Some concluding remarks come up in Part V of the paper.

¹Mr. O.A. Ogunlana is a Deputy Director, Central Bank of Nigeria (CBN). The views expressed in the paper are strictly personal and do not necessarily reflect the views of the Management of the CBN.

Part I

Literature Review and the Analytical Framework

In order to finance economic development and enhance the pace of economic growth, countries especially in developing world, resort to foreign borrowing to supplement domestic savings, which are generally low, for investment (Humphreys et al 1989). Other external sources of such resources include foreign direct investment and aid. These sources are not equally desirable in terms of their growth-inducing potentials. Rostow (1971) observed that the right quantity and mixture of savings, investment and foreign aid are necessary for the developing economies to proceed along an economic growth path which was followed by the advanced economies. Obviously these are non-debt resources and therefore, indicating that debt may not be a preferred development financing instrument for developing economies especially when not from concessional sources.

Klein (1994) and Ariyo (1997) noted that a fundamental factor causing debt to rise is the reliance on external resources to complement capital formation in the domestic economy. The higher the interest payment and the heavier the deficit on the current account, the heavier the debt burden. In accomplishing the objective of financing economic development, it is important to distinguish the characteristics and implications of the major financing sources – the debt and the non-debt sources. A debt sourced finance represents funds with fixed contractual obligations which will require pledging future resources of the nation as collateral. In order to cope adequately in the long run, with servicing requirement, a nation's debt service capacity must grow at a rate higher than that of its financial risk exposure. The non-debt resources on the other hand represent funds flow without fixed or compulsory servicing obligations on the government. The magnitude and regularity of such resources however, depend on foreign investors' perception of the investment environment in the recipient country.

Available evidence particularly from Africa and Latin America shows that most developing countries take to external borrowing because of low domestic private savings in view of low per capital income and with most governments operating fiscal deficits. Consequently, the burden of external debt often aggravates the problems of under development and further discourages foreign direct investment without which the desired level and the rate of growth and development may be difficult to achieve.

External debt management which may be defined as policy which seeks to alter the stock, composition, structure and terms of debt with a view to maintaining at any given time, a sustainable level of debt service payment, has become an important issue in macroeconomic management. It involves the planned acquisition, deployment and retirement of external loans drawn either for developmental purposes or for balance of payments accommodation (Ojo 1997). According to UNCTAD, this involves functions relating to policy, regulation, resourcing, recording, analysis, control and operation activities.

Debt management can be effective and efficient or inefficient. Efficient debt management involves proper portfolio analysis which among others makes it possible

for proper schedule of maturities to be compiled and adhered to in order to avoid bunching and defaults. When appropriate schedule of maturities is in place, debt retirement is made simple and early signals are readily observed when resources are slim and defaults become imminent. This makes it possible for appropriate actions to be taken to prevent serious debt management crises from reaching critical levels.

In effect, portfolio analysis is a major activity that should be undertaken if a country is to avoid debt overhang. This involves active and continuous review of debt portfolio to quantify and monitor the level of debt outstanding and debt service to ensure optimum structure and composition of debt vis-à-vis maturities, interest and exchange rate exposure. It highlights opportunities for portfolio improvement and identifies debt servicing difficulties. This activity also involves the review of economic background; portfolio by creditor, borrower and the use of funds; the debt service projection; actual management of debt; as well as issues relating to institutional arrangements involving guarantees, procedure and information flow.

(i) **External Debt Burden and Debt Service Capacity**

External debt burden is the reflection of the difficulties and strains arising from the servicing of external debt. This may result from inability to generate enough resources to meet commitment in debt servicing. The burden is measured in terms of the proportion of current resources (income) devoted to financing past consumption. The more the resources earmarked for debt servicing the less the resources available to ensure sustained economic growth and development. Thus, when a disproportionately large share of current resources is deployed to serve external debt the burden increases. The reverse is the case when external debts can be serviced without compromising the requirements of domestic economic development.

External debt capacity shows the ability of a debtor country to internalize its debt obligation without compromising its growth objectives. It also shows the extent to which a country can service its debt obligations with its export receipts without resorting to exceptional financing, significant arrears accumulation, restructuring arrangements or some costly options which may create further distortions. If a country, as a result of unpaid arrears of debt, has to restructure its debt, adjust the economy, especially the consumption and investment patterns in order to establish an artificial savings – investment equilibrium, then it is obvious that its debt servicing capacity is low. Indeed debt sustainability remains an essential condition for economic stability.

It is important to state however that to avoid debt service stress, foreign borrowing should be invested in activities that will not only ensure high productivity, but can generate foreign exchange earnings in order to provide resources to service such debt at maturity. Moreover, the direct relationship between efficient and effective debt management and economic growth and

development is a critical reason why public debt management should be a focus of public policy.

Salop and Spittaler (1980) observed two key issues on debt capacity. The first addresses what optimal level of debt should be in order not to run into debt service difficulty. The second relates to the sustainability of debt situations and policies. The optimizing framework dominated much of theoretical literature. This concerns analysis of marginal cost and benefits of borrowing which should be equal at the optimal level of debt. This approach does not provide a simple formula that would make it possible to ascertain in more operational detail the debt capacity stance of individual country (Hjertholm, 1999).

The non-optimizing model examines the sustainability of particular debt situations and policies in the light of the expected growth path of the economy. In this case, the emphasis has largely been on foreign borrowing for investment purposes in order to fill the gap between domestic savings and investment (King, 1968, Solomon, 1977). Though simple and readily understandable, the model suffers from a number of conceptual problems and rigidity of its basic assumptions. While it focuses on investment gap, less consideration was given to whether the investment will generate foreign exchange to service debt at maturity (Mc Donald, 1982).

The borrowing country's external solvency condition was addressed in the "debt dynamic" model. Hence the consideration of value of exports which gives a more accurate impression of income in foreign currency that can be used to service debt (World Bank, 1985, Hernandez, 1988). However, because of the assumption of a time-variant growth path for exports and the rate of interest, the use of the debt dynamics model also has limitations in assessing the sustainability of a borrower's debt. In spite of the obvious weakness of the growth-cum-debt and the debt dynamic models, they still provide insight to determining external debt capacity.

Empirical evidence has however, shown that foreign borrowing go beyond -the purpose of investment and imports. It can also be used to shield consumption from fluctuations in the level of income. Also, empirical literature has identified two basic perspectives on the issue of debt capacity; both from that of the debtor country and the creditor. The central issues to watch are the characteristics of the debtor country's economy as they relate to the ability to service loans as well as the creditworthiness and country risk of the debtor. Both the creditor and debtor need to do this assessment.

(iii) Analytical Framework for measuring Debt Burden and its Sustainability

The analyses of external debt sustainability are inherently forward looking. A number of factors come into play to establish if a country will be able to service its debt. These factors include the existing debt stock and associated debt service, the prospective path of its deficits, the financing mix of the debt and the

evolution of its repayment capacity in terms of foreign currency value of GDP, exports and government revenues (Abrego et al 2001). Projections of the debt dynamics provide a link between debt sustainability and macro economic policy. The integrity of such projections determines the extent of their usefulness in establishing debt sustainability.

Several indicators have been used over the years to measure debt burden and its sustainability. The indicators are usually reported in percentages (ratios). These include: Debt Stock/Export, Debt Service/GDP, Debt Service/Export, Debt Stock/GDP, Reserves/Import and Reserves/Debt Stock. Each of these indicators has its merits and its limitations, suggesting that they should be used in combination and with caution.

The strength of any economy depends on its output and export potentials. Its debt stock vis-à-vis its export should be well balanced and sustainable. In the same way, external debt stock/GDP is a scaled measure of debt stock position. They measure foreign presence in an economy in the form of past reliance on contractual foreign capital inflow with the potential of attracting capital outflow in the future. Whether these will create debt burden in the future or not depends on the terms of the loan regarding its maturity structure, interest rate and usage.

The Debt Service/Export and Debt Service/ GDP indicate the proportion of exports and national output that are committed to servicing of debt incurred in the past. In particular, debt service/export is a liquidity measure. The debtor's ability to meet debt servicing obligation declines as the ratio increases. This directly shows that the debt is likely to be unsustainable. This situation can be costly as it can require greater adjustment to compensate for adverse balance of payments developments. For the debt service/GDP, it measures the magnitude of current domestic output used in meeting debt service commitment entered in the previous period.

The Reserves/Debt Stock ratio, though not a common measure of debt sustainability, assumes that if the total debt stock of the borrower is to be paid off with the reserves, how far would it go. The greater the ratio the more comfortable the debtor appears to be in terms of its capacity to meet its external commitments. Similarly, the Reserves/Import ratio measures the capacity of the country to pay for its imports.

The debt burden indicators suffer the limitations endemic to ordinal measurement. For instance, a country with a low ratio of debt stock/GDP may record unsustainable external debt if the value of exportable constitutes a very small proportion of its GDP. Foreign exchange resources may not be available to meet its debt service payments. Furthermore, the debt/GDP can also be influenced by exchange rate since local currency depreciation can raise the ratio while physical output and debt stock in foreign currency remain unchanged.

Also, many debt ratios such as debt stock/GDP and debt stock/exports do not convey the terms and conditions and mix of concessionality and non-concessionality in the debt. These conditions have different impacts on the magnitude of the subsequent debt service payments (Omoruyi, 2005). The greater the level of concessionality in a stock of debt, which allows for long grace and maturity periods and low interest, the better, compared with debt with short maturity and high interest rate. This is because the debt service difficulty will be minimized.

Another important dimension to measuring the burden or sustainability of external debt is the use of the net present value (NPV) of such debt in terms of the discounted value of future debt service payments. However, the problem with this is that it compares future debt service obligations with existing repayment capacity without considering the country's ability to grow. This is particularly relevant when the debt maturity period is long. Moreover, while NPV indicators may signal debt servicing difficulties sometime in the future, they do not provide information on when these problems may become pressing. Similarly, the discount rate may vary with market conditions. The NPV approach has to its advantage the capacity to do effective comparison of debt burden among countries of same level of development.

The choice of relevant denominators in establishing debt ratios is another important issue. In general, this depends on the constraints that are most binding in an individual country. The use of GDP captures overall resource constraints, export relates to foreign exchange constraints while revenue indicates government's ability to generate fiscal resources. For external debt, it is useful to monitor and assess debt sustainability in relation to GDP and export earnings while public debt in general could be related to GDP and fiscal revenues (IMF, 2000).

It is important to observe however that a review of a country's external debt sustainability with total neglect of the level and constraint associated with domestic debt servicing will be underestimating the seriousness of indebtedness and the stress of debt servicing. This is because the impact of debt servicing on the budget is independent of whether payments are due on external or domestic debt obligations. Indeed they both have the effect of reducing allocation on other expenditure heads which may be important for sustainable growth.

Some general thresholds have been considered in empirical literature for each of these ratios under the enhanced HIPC Initiative beyond which a country's debt might be considered unsustainable. These include:

- NPV Debt-to – Export \geq 150 per cent
- Export-to GDP \geq 30 per cent
- Government Revenue-to – GDP \geq 15
- NPV Debt – to- Government Revenue \geq 250 per cent
- Debt Service-to-Export \geq 15 per cent

- Debt Service-to- Revenue \geq 25 per cent

Under the Country Policy and Institutional Assessment (CPIA) in which institutional strength and quality of policies play important determining factors, classification of countries to poor, medium and strong, determines what ratio should apply for Debt Service to export as well as Debt Service to Revenue. Countries classified as strong are to observe the ratios of 25 and 35 per cent for debt service- export and debt service – government revenue, respectively.

The HIPC initiative was not intended to address the debt problems of all debtor countries. Hence its thresholds may not be applicable to all. However, the critical issue is that its eligibility criteria even for the HIPC are neither based on a comprehensive measure of poverty nor on a comprehensive measure of indebtedness. For example, the classification of Nigeria, which is poor and highly indebted by all standard, as a “blend” country rather than “IDA Only” has shown some discrimination which can partly be explained by political factors.

Some critics have argued that the use of the indicators such as debt and debt service to exports should be complemented with NPV debt-to –GDP which in itself is a good overall indicator of a country’s indebtedness. This is not only because it puts all countries at par in considering the heaviness of debt, but also it is less volatile than NPV debt-to- exports indicator and more easily available than the NPV debt-to- government revenue indicator (Sachs, 2000)

All of these issues therefore, call for caution in general application of many of these indicators to appreciate the sustainability of individual country’s debt. It further stresses the need to focus on poverty as a major basis of identifying debtor countries that should be assisted to achieve the global objectives of the MDG’s

Part II

Genesis, Trend and Structure of Nigeria’s External Debt

Prior to 1978, the level of Nigeria’s external debt was very low, standing at about \$3.1 billion and represented barely 6.2 percent of GDP. However, by 1977/1978 when Nigeria experienced a temporary decline in oil receipts, the first Jumbo loan of \$1.0 billion was raised from the International Capital Market (ICM) with grace and repayment periods of three and eight years, respectively, and a relatively high rate of interest, (LIBOR + 1.0 percent) compared with the existing debts that were largely from the multilateral and concessional sources with long maturity period and other more generous terms of repayment. At the peak in mid – 1989, LIBOR was 13.0 per cent. That loan was followed by the second Jumbo loan of \$750 million in 1978/1979.

Between 1979/1980, there was an up-turn in the global oil market which improved Nigeria’s foreign exchange inflow. The relaxation of economic policy measures and the adoption of deflationary measures prompted massive importation of goods and services which brought about rapid depletion of reserves. Shortly thereafter, the global oil

market witnessed serious glut which brought down the price of crude oil with the attendant devastating impact on the Nigerian economy.

The thinking that the oil glut would be short-lived prompted both the states and the Federal Government to engage in external borrowing. They flagrantly breached Decree 30 of 1978 which fixed the limit of external borrowing at N5.0 billion US (\$8.3 billion) and embarked on imprudent and massive external borrowing from the ICM to finance all sorts of projects. Moreover, the massive importation which prevailed and the indiscriminate issuance of import license with total disregard to the level of reserves and capacity to pay, resulted in massive build up of trade arrears for both insured and uninsured trade credits.

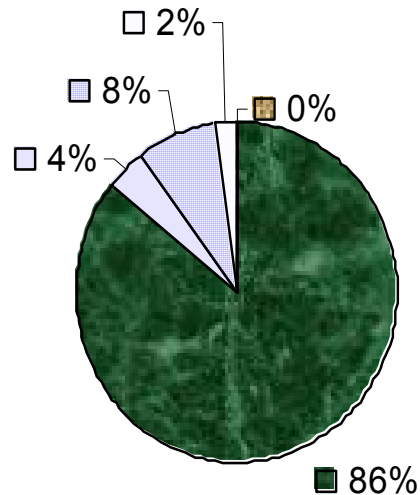
Indeed, the reality and the magnitude of Nigeria's debt problem did not dawn on the country until 1982 when creditors refused to open new lines of credit. This led the country to seek relief in the form of refinancing of the trade arrears. The first of such exercise was in 1983 covering outstanding letters of credit as at 13th July, 1983 for \$2.1 billion. By 1988, the terms of Promissory Notes issued for trade credits were renegotiated and the total value of notes issued aggregated to \$4.8 billion.

Consequently the level of external debt rose rapidly from \$9.0 billion in 1980 to \$17.8 billion and \$25.6 billion in 1983 and 1986 respectively. The level of debt had since risen to \$35.9 billion by the end of 2004 despite all the repayments, deliberate policy of drastic curtailing of further external borrowing and the various debt management strategies adopted, including debt conversion and buy-back.

These developments completely altered the structure and character of Nigeria's external debt from largely concessional sources of long maturity to short/medium with tough repayment terms. Of the total debt outstanding, the value and share of the Paris Club debt increased progressively from \$5.8 billion or 33.5 per cent in 1984 to \$21.7 billion or 66.5 per cent and \$30.8 billion or 85.8 per cent in 1995 and 2004 respectively. On the contrary, the share of multilateral debt as well as private debt (promissory notes and London Club Banks) have declined persistently over the years from a total of \$11.5 billion or 66.5 per cent in 1984 to barely \$5.1 billion or 14.2 per cent in 2004.

The deliberate policy of the government to limit further borrowing, including from concessional sources, the strict compliance with the repayment terms of multilateral loans as well as the deal regarding London Club debt which almost provided total solution to such debt, accounted for the declining trend in the stock of debt owed to these sources. On the other hand, the conditions and terms of debt rescheduling with the Paris Club imposed difficult conditions which did not only make repayment difficult, and extremely tight, but made the debt owed to this source to grow rapidly over the years. Paris Club debts are official bilateral debt and export credit which were guaranteed by various Export Credit Agencies.

Chart 1: Nigeria's External Debt by Sources as at end 2004



■ Paris Club □ London Club ■ Multilateral □ Promissory note ■ Other

Part III

(a) How and Why Nigeria Entered External Debt Trap and the Debt Management Approaches Adopted:

A number of reasons can be ascribed to how Nigeria's debt became unmanageable. These include;

- (i) **The desire to accelerate economic growth and development** – In the 1970s, Nigeria operated ambitious development plans which assumed that the huge resource inflow from crude oil would be sustained. By the late 1970s, during the first oil crisis, the momentum of project implementation could not be sustained. Moreover, Nigeria was considered to be under borrowed and with thwilling creditor banks, the country resorted to external borrowing to accelerate the pace of development.
- (ii) **The deteriorating commodity prices and the Dutch disease:** At the time of the global oil glut, most primary commodities prices also declined. This, along with the Dutch disease which afflicted many single mineral export dependent countries, necessitated the recourse to foreign borrowing which became imminent.
- (iii) **Inappropriate Economic Policies:** Nigeria, like most developing countries adopted some economic policies that were either not sustainable or poorly implemented. For instance, foreign exchange control policy was poorly

implemented in Nigeria. The fixed exchange rate policy in an environment of laxity and fraudulent use of import licensing created huge debt arising from trade payment arrears which became a significant proportion of Nigeria's external debt. Furthermore, the passage and implementation of Indigenization Decree almost totally closed avenue for foreign direct investment inflow and encouraged capital flight.

- (iv) **Poor Debt Management:** There was no debt management policy in place. Indeed, in 1980's the decree which limited the size of debt to a manageable level of N5.0 billion was disregarded, as governments at various levels engaged in foreign borrowing without caution. There was also loan- project mismatch as loans of medium term were used to finance long term gestation projects.
- (v) **Unfavourable Terms of Borrowing:** External loans from the ICM, which became significant in the early 1980's, carried high and floating interest rates usually tied to the LIBOR which itself escalated from barely 3-4 per cent in the late 1970s to 13.0 per cent in 1989. Moreover, the restructuring that was undertaken particularly for the Paris Club debts did not give sufficient breathing space and therefore, made the servicing of the debt difficult. Arrears of principal and interest were recapitalized to further compound the debt situation. Indeed, the rescheduling made debt service as well as the stock of debt to increase. For instance, the original value of Nigeria's external debt which was \$18.9 billion in 1985, increased to \$35.9 billion as at 31st December, 2004 in spite of cumulative debt service payments of about \$36.6 billion during the same period.
- (vi) **The depreciation of currencies in which debt is expressed:** The depreciation of the dollar against the British pound for instance, meant that debt held in Pound Sterling when expressed in dollars would increase even when other parameters of the debt remained the same. Between 2002 and 2004, the stock of debt increased by over \$4.0 billion as a result of currency depreciation (DMO 2004).
- (vii) **The desire to alleviate poverty:** This made the government to cut down on allocation for debt servicing with the resultant rise in accumulated arrears of interest payment as well as penalty charges which were eventually capitalized.

(b) Debt Management Approaches Adopted

When the seriousness of Nigeria's debt problem became very obvious in the mid -1980s, several measures were adopted to manage the debt. These include:

- (i) **Refinancing of trade debt:** This started with the refinancing of trade arrears in respect of letters of credit outstanding as at July 1983 amounting to \$2.1 billion. This involved repayment period of 30 months January 1984 – July 1986 with a six-month grace period and interest fixed at 1.0 per cent above the LIBOR.

Promissory notes were also issued in respect of trade arrears arising from transactions on open account and bills for collection for the sum of \$3.8 billion. The promissory note agreement involved a maturity of six years with two and half years grace period inclusive. Note redemption was expected in 14 equal installments beginning from October 1986. The difficulty in meeting these terms necessitated the capitalizing outstanding interest of \$1.050 billion which brought total commitment on the promissory notes to \$4.89 billion.

- (ii) **Negotiation with the London Club with respect to Commercial Bank debts commenced in 1986.** The total exposure of the banks amounted to \$5.8 billion and Nigeria was expected to pay \$1.345 billion per annum. The country could not meet the obligation because of cash flow problem. This resulted in protracted rounds of negotiation as Nigeria demanded the restructuring of the entire debt into a 30 years bond with a grace period of 10 years and interest of 3.0 percent per annum. Eventually both sides agreed on a revised agreement requiring that the principal amount be collateralized with US Treasury Zero Coupon Bonds; interest rate was fixed at 5.5 per cent for the first 3 years and at 6.25 per cent per annum thereafter; and banks which opted for the traditional rescheduling were required to provide 20 per cent of the amount to the option as new money. No bank opted for new money.

The agreement was successfully closed on January 21, 1992. Nigeria bought back 62 per cent of the debt and issued collateralized par bonds for the remaining 38 per cent. This allowed Nigeria to achieve a debt and debt service reduction as envisaged under the Brady Plan.

(iii) **Paris Club Debt Negotiations**

Several rounds of rescheduling were undertaken with respect to this class of debt in order to secure relief which was essentially in the form of deferral of debt payment rather than offering debt reduction. Indeed, the approach ensured rapid growth in debt stock largely as a result of the high interest rate attached. The first and second agreement (Dec. 1986 and March 1989) provided for the consolidation and rescheduling of only debt service payments which fell due within a period of 15 months. Under the third agreement (Jan. 1991), the debt was rescheduled on terms applicable to the middle income heavily indebted countries of the lower category. The December 2000 Agreement which was structured in Houston Terms provided for the rescheduling of Nigeria's debt of \$21.4 billion over 18-20 years at relatively high interest rate, but with 10 years grace period.

The latest rounds of debt negotiation culminated in an agreement in principle with the Paris Club to treat Nigeria's debt on the "Evian Terms" which allowed a 60 per cent debt reduction. This is however, predicated on a successful conclusion of a Policy Support Instrument (PSI) currently being put together for the IMF consideration. This agreement provides for a reduction by \$18.0 billion in

Nigeria's debt to the Paris Club. It also requires that the balance of N12.0 billion should be paid in two equal instruments in less than one year.

Although this offers significant relief to the country if Nigeria could strive to raise the outstanding \$12.0 billion, it does not still provide sufficient resources to meet the MDGs. Furthermore, the terms of settling the outstanding debt will seriously create fiscal strain with adverse consequences for the economy.

- (iv) **Debt Conversion and Buy-Back Programme:** This was adopted in July 1988 and designed to achieve debt reduction and reduce debt service burden, encourage capital inflow and assist in recapitalization of the private sector investment and create employment opportunities. Eligible debt for conversion was initially limited to promissory notes, but later extended to cover banks and the Paris Club debts. This method has been used to reduce the value of outstanding promissory notes from \$4.5 billion in 1991 to barely \$783.2 billion in 2004.
- (iv) **Servicing of Multilateral Debt:** Deliberate and conscious efforts were made, in spite of the poor state of the economy, particularly in the mid-1980's and 1990s, to ensure regular servicing of this class of debt. The priority attached to this class of debt is not unconnected with the consequences of default in debt servicing. These include, the stoppage of further disbursements on such project tied loans and other loans under consideration as well as the loss of credit worthiness of the country.
- (vi) **Adoption of Guidelines on External Borrowings:**
In order to avoid uncontrollable growth of external debt, the Federal Executive Council and the Council of States approved in 2001, a new guidelines on external borrowing. The guidelines specified the terms and conditions under which foreign loans could be contracted. For instance, the guidelines limit borrowings to financing of projects in the area of poverty reduction and infrastructure development which are assessed on the basis of cost benefit analysis. They must be loans from concessional sources with favourable terms of repayment.

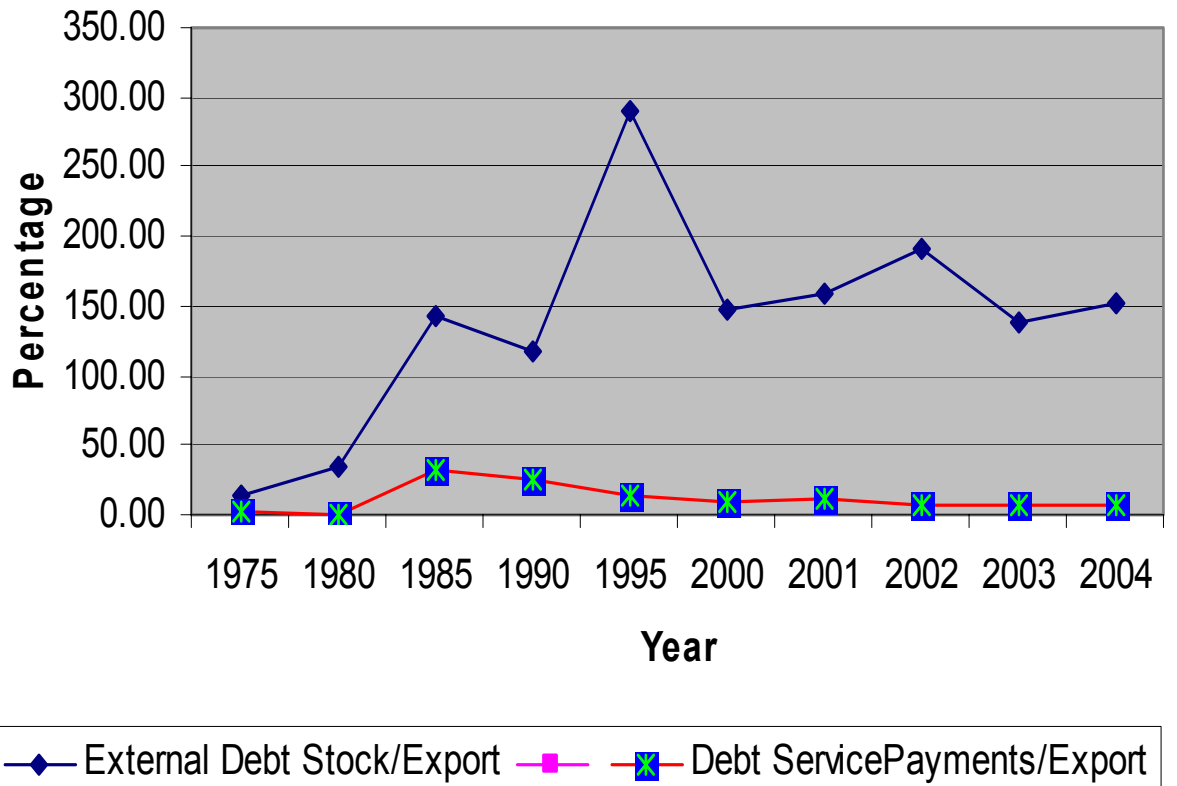
Part IV

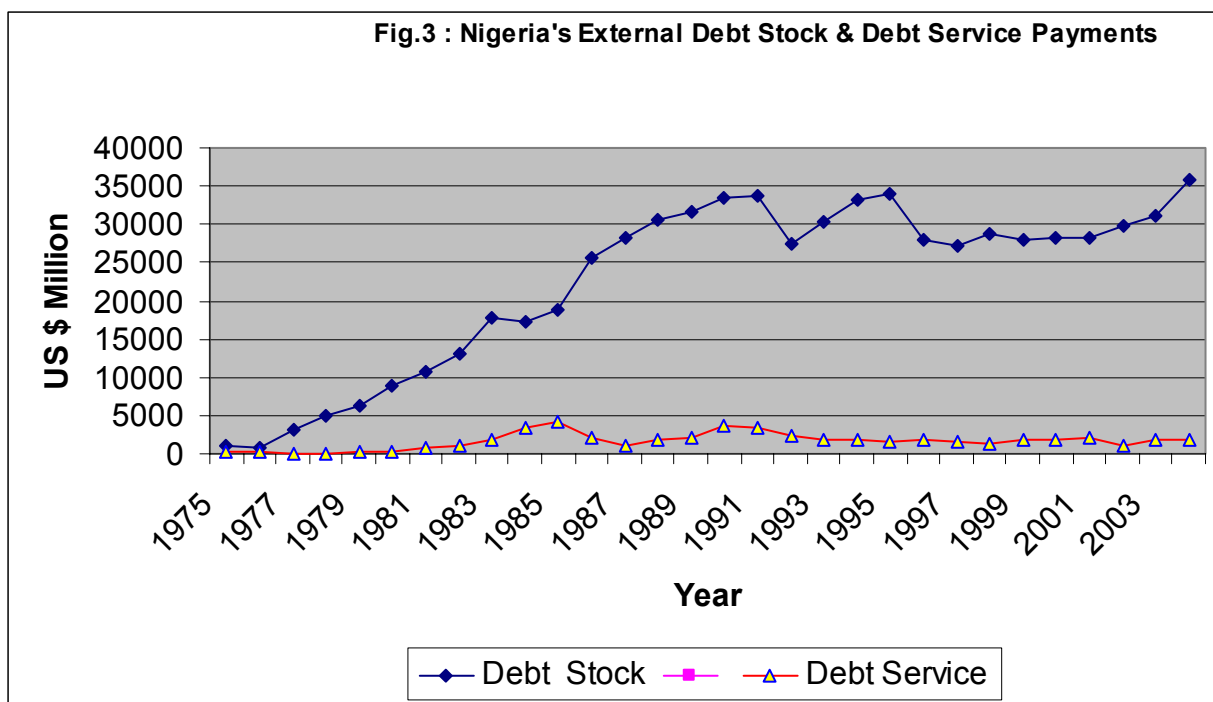
Justification for Debt Relief:

(i) Review of Major Macroeconomic Indicators

Tables 1 and 2 show the data of Nigeria's major macroeconomic and debt service indicators. The output data indicate that the country recorded average real GDP growth rates of 2.9, 1.7 and 2.9 per cent during 1975 – 1980, 1981-1990 and 1991 – 2000, respectively.

Fig 2: External Debt and Debt Service Payments to Export





During the period 2001 – 2004, the average growth in GDP recorded an up-turn to stand at 6.0 per cent. Given the large population of about 130 million with average population growth of about 3 per cent per annum, income per capital declined from the peak of \$1245.4 in 1981, to an annual average of \$426.7 during 2001 – 2004. This translated to average income of barely \$1.16 per day. The unstable general economic performance was directly connected to over-dependence on crude oil export for sustenance.

Consequently, trends in government finance, external reserves, balance of payments, export earnings and exchange rate largely reflected the fortune and misfortune of the oil sector and the heavy debt servicing which confronted the government. The poor performance in government fiscal operations as indicated by recorded deficit for most of the years was worsened by heavy commitments on external debt servicing. Federal Government accounts for about 80 per cent of Nigeria's external debt. Deficit financing of the Federal Government deteriorated in the late 1980s and early 1990s, when it peaked at 15.5 per cent of the GDP. In the last few years however, improved revenue from oil as well as fiscal discipline exhibited by the current democratic administration have moderated the trend. On the average, deficit/GDP stood at about 4.0 per cent between 2000 and 2004. Generally, the mode of financing of deficit had been quite costly to the economy in terms of inflation, low growth rate, depreciation of the naira and reduced competitiveness of the non-oil sector.

The position of external reserves and the balance of payments reflected similar trend. The stock of external reserves remained above three months of import

cover for most of the years. However, such reserves levels were sustained for most of the difficult years because of the deliberate policy of keeping debt servicing at affordable level either through rescheduling or default in debt servicing.

Similarly, inflation and exchange rates deteriorated for most of the years except for short periods when economic stability was achieved. As a result of the pressure on external sector, the naira was devalued in the mid-1980s and has suffered severe depreciation over the years. From an average rate of exchange of ₦0.8/US\$1.0 in 1985, the currency depreciated to N132.88 in 2004. As a result of improvement in the external sector and government's prudence in resource management, the rate of exchange has achieved some measure of stability in the last two years. The high price inflation of annual average of 24.5 per cent recorded in 1990-2004 also reflected the heavy deficit financing operated by the government which was largely financed by borrowing from the banking system.

(ii) **Review of Nigeria's Debt Using the Major Debt Burden Indicators**

The analysis of major external debt indicators shows that Nigeria' external debt burden is unsustainable and should therefore, be of concern to all stakeholders including the creditors.

Tables 1 and 2 also show Nigeria's debt stock rising from barely US \$1.1 billion and representing barely 3.29 per cent of GDP in 1975, to \$35.9 billion in 2004. During this period, external debt/GDP ratio rose to as high as 142.3 per cent in 1993 before declining to 57.8 per cent in 2004. Even though the current level of debt/GDP is moderate and within established threshold, the maturity structure made it quite burdensome.

Debt service payment remained generally low until Nigeria entered the debt trap. Measured in terms of export earnings, the debt service ratio rose from an average of barely 2 per cent between 1975 and 1981 to its peak of 44.12 per cent in 1986. It remained relatively high at an average of 21 per cent between 1990 and 1995. Indeed, the level of debt service payments would have been higher, but for the various debt management approaches including the costly rescheduling and outright default in debt servicing in the attempt to allocate some resources for domestic economic needs.

For example, between 1991 and 1996, actual debt service payments aggregated \$11.1 billion as against due debt service obligations of \$22.6 billion. Similarly, in 2003 and 2004, due external debt service obligations amounted to \$5.2 and \$5.6 billion, respectively against actual debt service payments of \$1.8 billion and \$1.76 billion. Nigeria's debt service ratio which averaged about 10.0 per cent between 1998 and 2004 would have averaged about 23.6 per cent in 2003 and 2004 if all due debt service obligations were met. The ratio of external debt service to non-oil export ranged from 148.7 per

cent in 2002 to 850.3 per cent in 2004, indicating that without oil revenue it would be impossible for Nigeria to service her debt.

Nigeria's external debt stock/export ratio remained high for most of the years. It exceeded the Highly Indebted Poor Countries (HIPC) Initiative threshold of 150 per cent in 1999, 2001, 2002 and 2004. It fell slightly below this threshold in 2000 and 2003, reflecting the vagaries in crude oil prices.

Moreover, the debt stock to budget revenue ratio was consistently higher than the HIPC threshold of 250 per cent. This indicates also that the debt level is unsustainable.

The above debt indicators point to the fact that Nigeria's debt situation is unsustainable and that the fiscal health of the nation is heavily dependent on oil revenue indicating that should the oil revenue fall, fiscal deficit would be too high to bear. Even though, during the recent Article IV Consultation in Nigeria, the International Monetary Fund (IMF) observed that with prospective high oil prices the country's debt could be sustainable, it was quick to add in its sensitivity analysis that a "2 – standard – deviation oil price shock would render Nigeria's external debt unsustainable". The IMF is currently cooperating with the World Bank to prepare a Debt Sustainability Analysis (DSA) that will incorporate the costs of additional measures needed for Nigeria to achieve the Millennium Development Goals. (MDGs)

(iii) **Moral, Geo-Political and Other Economic Reasons for Debt Relief for Nigeria:**

The struggle for debt relief for Nigeria that would translate to meaningful reduction in debt stock and debt service payment started in the late 1990s when the country sought to benefit under the HIPC initiative. The initiative provided a minimum of 67 per cent reduction in debt stock of countries considered qualified. Nigeria was not considered, as it was classified as a blend country which qualified for non-concessionary loans (commercial rate) from IBRD as well as, concessionary loans from IDA.

Apart from the debt indicators which provide strong basis for debt relief, a number of other issues, both domestic and international in outlook, demand that a reconsideration of debt relief to reduce debt stock and its burden as well as free resources for economic development should be granted to Nigeria. These include:

- (a) **Nigeria's Rating on Human Development Report:** Country rating based on level of life expectancy, education, GDP per capita and other parameters of measuring poverty, aptly consider Nigeria as poor. The Human Development Index placed Nigeria as 151st among 177 countries but rated her 62nd on Human Poverty Index (WDR 2002). This situation has not improved. GDP per capita remains low at about \$478.0 per annum in 2004 or barely \$1.30 per day and close to 57 per cent of the population is living below poverty line. Life

expectancy stands at 51 years while adult literacy rate is barely 65 per cent making Nigeria to stand among the lowest in the world. Similarly, with infant mortality at 110 per 1000 births and maternal mortality of 1000 per 100,000 live births, Nigeria ranks among the highest in the world.

(b) **The Millennium Development Goals (MDGs):**

Indeed, if the global community including our creditors is really committed to addressing the issue of poverty reduction as targeted under the Millennium Development Goals (MDGs), granting Nigeria total debt cancellation will not even be sufficient, additional resources will have to be provided. There is extreme poverty in the country, the level of literacy is low, while the spread of HIV/AIDS, malaria and other diseases needs to be put under control. Nigeria lacks the resources to do all these and needs support from all sources to make the MDGs achievable.

(c) **Support for the National Economic Empowerment Development Strategy (NEEDS).**

For almost two years, the Government has introduced and implemented an economic programme (NEEDS) designed to address poverty, empower the private sector and make it the engine of growth, restructure the government sector to make it more effective and efficient as well as address social issues. The program has been quite successful and has been so rated by the IMF. Aside from the current level of resource allocation to prosecute the programme, an additional \$4.5 billion is required annually for the next three years to meet resource requirements including for the provision of infrastructure that are in dilapidated state. Total debt forgiveness will go a long way in making resources available for funding the programme.

(d) **Nigeria's Huge Investment in Supporting Regional Stability:** Nigeria has in the last decade or so spent several billion dollars to maintain peace in Liberia, Cote d'Ivoire, Sierra Leone and other countries in the West African sub-region. This is aside from the contribution and financing of various United Nation's Missions in other regions of the World to secure global peace. These activities were undertaken in the global interest and therefore, demand that some compensation should come by way of debt relief to support and encourage Nigeria to continue this effort.

(e) **Equal Treatment To Nigeria as Extended to Other Countries:**

There is a strong perception that Nigeria has been accorded unequal treatment as other countries. At the time Nigeria sought HIPC classification and could not secure it, other comparable oil exporting African countries like Gabon, Angola and Cameroon were considered. For instance Nigeria is poorer than Iraq considering the per capita income, substantial debt cancellation was granted the country within a short time.

- (f) **Low Foreign Aid and Large Resource Outflow:** Nigeria receives aid of less than \$2.0 per capita per annum which is one of the lowest in the world. This is based on the wrong perception that the country is not poor inspite of the low income per capita. In addition, aside from payment for debt service, net resource transfer out of Nigeria stands at about \$12 per capita annually. On drawings and repayment on loans, a large net outflow is also recorded. In effect, for the country to achieve meaningful economic development a reversal in trend of resource flows is required. Indeed as Prof. Jeffrey Sachs correctly observed Nigeria needs \$40 per capita of aid annually to achieve the MDGs by 2015.
- (g) **Need to Support the Nascent Democracy:** Nigeria was seriously misgoverned by the military for a long period. The civilian democratic government which came to power since 1999 has demonstrated commitment to good governance. Viable economic programme has been put in place and the results so far, are encouraging. The failure of democratic governance in Nigeria can be contagious within Africa and this is not desirable. The sustenance of the process therefore, demands some quick wins in the form of democratic dividends. This will only come with economic prosperity. Nigeria therefore, requires support of all, including the creditors, to boost economic growth and development.

Part V

Summary and Conclusion

An attempt has been made in this paper to justify Nigeria's demand for debt relief that would reduce the stock and burden of external debt of Nigeria, the servicing of which has reached an unbearable dimension. The paper traced the genesis, trend, and structure of the country's external debt as well as the factors that prompted the accumulation of the debt.

To justify the request for debt reduction and indeed total debt cancellation, the major economic and external debt indicators were analysed, all pointing to the seriousness of the debt burden given the level of economic development of the country as also presented in the World Development Report on HDI. Indeed, it was argued that to support the NEEDS, the economic programme of the government, the implementation of which has signaled a clear break from the imprudent macroeconomic policy of the past, Nigeria needs support of every well-wisher.

Furthermore, to achieve the MDGs and support the country's effort at ensuring political and economic stability of the West African Sub-Region, which is of global interest, Nigeria deserves debt relief. Finally, to support Nigeria's nascent democracy, the failure of which could affect the entire African region, the necessary encouragement that can enhance the dividend of democracy should be given.

It is important to add that, much as the current effort of the Paris Club is highly commended, the Club should indeed do more than it has promised by ensuring total write-off of Nigeria's debt. Nigeria has paid for more than it has borrowed from the Club

over the years. The bulk of the outstanding debt arose from capitalization of interest and penalty charges that fell due on the initial debt.

Moreover, if this is done, the members would be demonstrating in undoubted terms, their commitment to attaining the MDGs in Africa. Nigerians and indeed the black race, will certainly appreciate this.

Finally, it is important to stress the need for the Government to sustain existing macroeconomic policies including prudent debt management policy, if the ugly experience of the past would not be repeated. Growth- friendly structural policies including infrastructure, trade, tax and social policies and regulatory frameworks that affect economic incentives for private investments and production should be adopted and sustained while the fight against corruption should also be sustained. These policy measures are currently being implemented and there is no doubt about Government's commitment. The Government of Nigeria needs all the support to achieve these goals.

References

Abrego L and D. C Ross (2001). Debt Relief under HIPC Initiative: Context and Outlook for Debt Sustainability and Resource Flows, United Nations University/ WIDER Discussion Paper, September.

Ajayi, S. I. (1991). "Macroeconomic Approach to External Debt: The Case of Nigeria" Research Paper No. 8 (Kenya: Africa Economic Research Consortium)

Ademola A. (1977). Sustainability of Nigeria's Debt Paper presented at a Seminar on the Debt Problem and the Nigerian Economy: Resolution Options, Organised by the CBN at Abuja, Nigeria, Oct. 28-29

Ariyo, A. (1997). Paper Presented at a Seminar on the Debt Problem and the Nigeria Economy: Resolution Options, Organised by CBN. Abuja, Nigeria Oct. 28-29

Central Bank of Nigeria, Statistical Bulletin, CBN Nigeria, Various Issues

Central Bank of Nigeria, Annual Report and Statement of Accounts, CBN, Nigeria Various Issues

Hernandez, E. C (1974), Issues in design of Growth Exercises. IMF Working Paper WP/88/65, IMF, Washington D.C

Hutcheson, T. L. (1996). "External Debt and Debt Relief", Paper presented at CBN Seminar on Understanding Nigeria's Economic Policy for Finance Correspondents, November

IMF/World Staffs (2004). Debt Sustainability in Low Income Countries- Proposal for an Operational Framework and Policy implications, Feb. 3

King, B. B (1968). Notes on Mechanics of Growth and Debt. World Bank Staff Occasional Papers 6, World Bank, Washington D. C

Klein T.M. (1994). "External Debt Management, an Introduction". World Bank Technical Papers, No. 245, the World Bank, Washington, D.C June

Mc Donald, D. C (1982). Debt Capacity and Developing Country Borrowing: A Survey of the literature, IMF Staff Paper, 29 (4)

Nwankwo, A. (2004). "Diagnostic of Nigeria's Debt Problem". Paper presented at the Stakeholders' Forum on Debt Management for the 36 States of the Federation, Organized by Debt Management Office, Aug. 30-31.

Omoruyi Sam (2005). Debt Burden (Sustainability) Indicators. Paper Presented at Regional Course on Debt Recording and Statistical Analysis, Organized by WAIFEM, July 18-29, Lagos

Rostow, W.W. (1971). Stages of Economic Development (New York, Cambridge)

Sachs, J. (2000). The Charade of Debt Sustainability, Financial Times, September 26

Solomon, R. (1977). A Perspective on the Debt of Developing Countries. Brookings Paper on Economic Activity

World Bank (1989). Dealing with the Debt crisis; "The External Debt Difficulties of Low-Income Africa

World Bank (2000/2001) (1999) (1985) Development Report