Conference on The Nigerian Economy & The Relationship of the United States
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INCENTIVES/DISINCENTIVES FOR FOREIGN INVESTMENT IN NIGERIA

Our topic specifically deals with the key question repeatedly posed yesterday - "Why, given Nigeria's admitted great ~~L~~.T. long term potential", has so little U.S. foreign investment found its way to Nigeria?"

Yesterday's speakers and Mr. Onosode indeed set the stage for

1) looking at the "rules of the game" faced by the foreign investor in Nigeria,
2) evaluating which rules are seen as incentives or disincentives by both existing and prospective investors, and
3) providing" food for thought" to help stimulate the dialogue and analytical process which this Seminar has helped foster.

Hopefully, as a by product, my comments should also shed some light on our key question - as stated positively and simply by Chief A.O. Lawson last night - "How can Nigeria attract U.S. investment?".

In approaching this topic, I believe there is little to be gained from "pulling our punches". I rather suspect that we will have to kill some "sacred cows" on both sides of the ocean in order to get at the realities and "truths" on which policy decisions and/or ~~for~~ future research should be based. Certainly, I was impressed with Mr. Onosode's presentation of the role the foreign investor should play, and perhaps was somewhat comforted by knowing that U.S. presence is "nil" outside banking and oil. Perhaps, U.S. investment can provide some ~~be a~~ "fresh air" in the future.

While certain general comments on the overall political and economic situation are necessary to put our topic in context, I then want to get down on the practical level to deal with specific laws,, regulations, practices, etc - including indigenization, foreign exchange controls, taxation, and other incentives. My input is derived from working with some 75 - 100 existing companies or prospective investors over the past five years. I am sure today's ~~this~~ audience alone can multiply this sample size by a factor of 5 or 10. I ~~It~~ also draw ~~s~~ on 12 previous years of experience in Latin America, Middle East and Europe, and as a result ~~hence~~, the main utility of my comments may well be simply to stimulate questions or further comments from the audience.

First, let me start with a few general observations on the overall political/economic situation. Second, I will make a few observations about the existing "rules of the game". Then, lastly I will comment on specific "rules", giving my own views as to the degree of incentive or disincentive involved.

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On the overall political/economic situation, I would endorse Chief Lawson's view that "Nigeria is at a turning point in its economic history." This is true not only because Nigeria faces a new and different outlook for both oil revenue and debt management, but also because every OECD country has gone through a similar turning point at one time or another in the past ten years. In fact, the United Kingdom and U.S. are the laggards in this regard. In my view, the world economy of the 1980's will be fundamentally different than what Nigeria experienced during the 1970's. The 1970's incidentally was the period of time when Nigeria's "rules of the game" for the foreign investor were developed. The reality of this worldwide "turning point" must inevitably force Nigeria to reorder its economic strategy, including (reaching) a decision as to (the degree to which) the extent foreign investment is to be attracted and ~~any~~ significant changes in the "rules of the game" (will be made so as to attract) for the foreign investor.

The U.S. investor will watch any positive rework of the "rules" with interest but the overriding concerns will remain two-fold:

1) <u>Political stability</u>

Nigeria is a young democracy and a continued good track record will be seen very positively by U.S. investor. The 1983 elections provide an excellent opportunity to prove how viable and healthy the Nigerian democratic process is.

2) <u>Management of the economy</u>

Specifically how does Nigeria maneuver to maximise its oil revenues, how does it cut its spending to fit its revenues (Micawber <---> Sonekan ~~example~~ (example raised by Chief)), and how do we order our priorities and resources to develop viable non-oil sectors - particularly agriculture and manufacturing? To be candid, most U.S. businessmen are still waiting to see how well Nigeria gets its economics act together before considering any major ~~L.T.~~ long term investments.

This pragmatic concentration on political stability and economic management is particularly emphasized by those U.S. investors who are long term oriented - particularly those interested in the priority sectors of agriculture and manufacturing - where they must invest in "bricks and mortar".

In fact, one of the clues as to "Why U.S. investors have not beat a path to Nigeria's door "lies in the fact that U.S. companies are not generally strong traders, nor particularly export oriented, and it is only recently that Nigeria is getting around to treating agriculture and manufacturing as a major priority. In other words, Nigeria is just now playing to the strength of the U.S. economy.

Let me now make a couple of general observations about the "rules of the game" before turning to specifics.

In the first place, everyone in this audience is familiar with the fact in Nigeria that there are <u>laws</u> and there is <u>practice</u>. The <u>laws</u> are rather clearcut, unambiguous, and remarkably stable - particularly over the past few years. The only problem is that the <u>practice</u> changes constantly and it is the practice - not the laws - which is the controlling factor in Nigeria. To those of us knowledgeable about Nigeria, this presents no problem. We accept it, we monitor the practice constantly, and in fact we find the system has a certain coherence and predictability about it which we learn to cope with successfully.

So what is the problem? At least for the U.S. investor, the problem is that this drives most U.S. managements "up the wall" - particularly the new investor you wish to attract to Nigeria. Please do not take offence at this - I have seen exactly this same phenomenon in Latin America and the Middle East. Rightly or wrongly, U.S. businessmen spend an enormous amount of time to dot every "i" and cross every "t". It is enormously disconcerting to the U.S. investor to run into a constantly ~~morning~~ moving target - this thing we call "practice" - and to not be able to get written rulings, interpretations, opinions, etc on which a clearcut decision can be based.

Compounding the problem is the well known difficulty to deal with the bureaucracy in Nigeria. Again there is a clash of culture - with the typical civil servant approaching his job as if he is doing the private sector a favour, while the typical U.S. investor ~~taking~~ takes the approach that government should be jumping at the chance to get his business. Perhaps I have painted the attitudes too extremely, because certainly Europeans and Japanese experience the same difficulty, but it seems every "U.S." newcomer goes through a period of "shock" before adapting to the "Nigerian way of doing business". War stories abound and this creates a bad image for Nigeria that turns off the faint hearted U.S. investor.

Lastly, as a general comment on the "rules of the game, let me touch on the problem of "payments" and obeying the laws. There is no question in dealing with managements from many nationalities that U.S. companies make a more rigorous effort to obey the laws - either in Nigeria or their home country. It goes against their grain to knowingly break laws or to expose themselves to the consequencies of say the ~~F.C.P.A.~~ (Foreign Corrupt Practices Act.) I do not attribute this to a greater morality in the U.S. - but more probably to a higher risk of getting caught and facing the consequencies. There is no question in my mind that this is a fact of life in comparing U.S. businessmen to their European and Japanese counterparts, and that today in Nigeria this is one of the factors contributing to lack of U.S. penetration and presence in the Nigerian market. Hopefully, this is one factor that will gradually fade away. I for one am very pleased with Chief Sonekan's treatment of this problem and personally share his views on the matter.

Now let us deal with some specifics - particularly

- indigenization
- foreign exchange controls
- taxation
- other incentives

<u>Indigenization</u>

- I must ~~have got to~~ be careful now as my Chairman - Chief ~~Wole~~ Adeosun - was the author of the Indigenization rules ~~we~~ and the two of us frequently debate what we think the outcome has been to date.

- I personally am of the view that the jury is still out and that we may need a new Adeosun Commission to take a fresh look and to decide whether modifications are needed in view of the changed economic situation Nigeria ~~we face during the 1980's.~~ now faces for the remainder of the 1980's.

- To date, the exercise has been a clearcut success from the Nigerian viewpoint and the foreign investor (even Americans after a few initial hiccups) have learned to live with the system. With a few exceptions noted below, I agree with Jay Fetner that most new investors today do not give indigenization a second thought. They simply accept it as a fact of life for doing business in Nigeria.

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- Indigenization was done at a fortiutous time ~~,~~ as the 1976 to 1980 period was generally one of strong economic growth and, although some foreign companies kick about the price they received and their inability to remit ~~FX~~ (the sale proceeds in foreign exchange), generally the foreign investor does not feel he was badly mistreated. In fact, more than one client has indicated they knew something was coming, and much preferred to have widespread private shareholders rather than government as their partners.

- The main objections I continue to hear from clients are limited to three situations -

  (a) the construction or project oriented company, (who does not intend to operate ~~LT~~ long term in Nigeria) and does not see the point in sharing 12 - 24 months of "onshore" profits with shareholders who "contribute nothing to the deal".

  (b) those foreign investors who have selected Nigerians who do not pay up their capital.

  (c) major agricultural or manufacturing investments who have no choice (because of project size) but to have government as a partner.

- On balance, therefore, I accept that Indigenization was a successful event - judged in terms of the 1970's in Nigeria. Above all, it resulted in a substantial degree of transfer of sovereignity over the economy into Nigerian hands. Perhaps, it did not go as far as some Nigrians would like, but on balance it accomplished ~~obtaining~~ the main objective~~s~~ of getting Nigerian control over the economy.

- My concern, however, and where I would like to stimulate debate, is that I am not sure that Indigenization has been fully tested and I suspect that significant modifications might be needed to cope with the (remainder of the) 1980's. There are two specific concerns -

  (1) Existing companies had little or no choice, particularly if they had major assets, they would have had to walk away from. They have re-invested earnings but very few have brought new capital to ~~Naira.~~ Nigeria. They are merely reinvesting retained earnings thus far.

Newcomers since 1977 have primarily been service, construction, finance, or low investment type companies. My concern is that these type of companies do not really provide a test. I am not aware of major agriculture or manufacturing newcomers who have entered the market since 1977, and have personally seen 1 or 2 large deals where the economics did not work out for a 60% owner on major investments because of cash flow and financing considerations. My concern, I guess, is fundamentally that Nigeria is still attracting foreign investment primarily to those sector where there is synergy which produces an "offshore" profit that makes the deal viable. The real test of Indigenization will come when major manufacturing and agriculture investments are made and the ~~only~~ main profits are generated "onshore".

2) A further concern is whether Indigenization is either still necessary or the best way to deal with foreign investment. Most developing countries have avoided ownership rules and developed other controls. The major exception is Mexico and Mexico has recently demonstrated it will greatly liberalise ~~the~~ its ownership rules.

My two questions for the "new" Adeosun Commission are -

a) isn't there a danger of foreign investment going elsewhere at exactly the time ~~its~~ it is needed due to scarcity of both private and government funds?

b) aren't we limiting the development of Nigerian capital when we encourage them to turn their savings over to foreigners to manage?

Foreign Exchange ~~FX~~ CONTROLS

- I can only underline yesterday's conclusion that the ~~FX~~ Foreign Exchange area is the biggest simple disincentive for the foreign investor - particularly for the U.S investor and particularly in view of the periodic balance of payments B.O.P. problems Nigeria has experienced, I believe Nigerians only partially appreciate the depth of the U.S. investors reaction, which is perhaps a little strange given the general consensus that the Naira

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is overvalued today and the very active parallel ~~FX~~ foreign exchange market all up and down the West African Coast.

- The 60% dividend limitation also goes against the grain. It results in blocked funds when adequate local investment opportunities are not available. It also frequently results in higher prices charged to ~~Naira~~ Nigeria - so that the 60% remitted abroad meets the necessary worldwide profit or R.O.I. objectives.

- One final ~~FX~~ foreign exchange area where ~~Naira~~ is not competitive ~~is~~ vs. the little Japans (Taiwan, Hong Kong, South Korea, Singapore, Malaysia) or even Brazil or Mexico - is the technical assistance fee. Perhaps not a big factor today - it will be increasingly important if ~~Naira~~ Nigeria wants to put its labour force to work by attracting high labour content, export oriented products where comparative advantage is absolutely essential.

  The present 2% rule on technical assistance is applied so automatically that it is both an incentive and disincentive:

  a) it is an incentive to low technology companies where it is an outright gift.
  (b) it turns off high technology companies who either do not come or build the technology value somewhere else in their deal.

Tax Incentives

- Corporate rates at 45% are rather neutral vis a vis other ~~LDC's.~~ developing countries.

- Individual rates - reaching 70% at ₦50,000 income - are a definite disincentive and, in practice, cause marginal tax avoidance schemes to be undertaken. Federal Government recognised this in the 1982 Finance ~~Act~~ Bill -- but unfortunately this is not yet law.

- Depreciation and capital allowances are neutral or perhaps ~~to~~ a small disincentive versus ~~LDC's~~ developing and OECD countries. There is a plus in the unlimited loss carryforward available on unused capital allowances.

- Pioneer status (3 to 5 years tax holiday~~s~~) is a good idea but does not seem to work in practice. There are only a handful of projects approved -- even major projects like ~~BLNG~~ Bonny LNG do not qualify. It is also difficult in practice to get a commitment or "advance ruling" even though this may be critical to the investor from a cash flow/bank financing standpoint.

Other Incentives

- Approved User (ability to import raw materials at nil or reduced customs rates) is absolutely essential to protect local manufacturers. It worked reasonably well until the ~~FX~~ foreign exchange crunch (at which considerable abuse arose) -- now we will have to see how it works out in the future.

- Low interest rates - when combined with overvalued Naira - has worked to encourage foreign companies to invest minimum capital and to borrow the maximum locally. While the system works as an incentive for the foreign investor, I dare say this is a disincentive from ~~Naira's~~ Nigeria's standpoint.

Conclusion

- There are perhaps ~~few~~ four points worth repeating by way of "food for thought" for this audience.

  (1) Political stability and sound management of the economy ~~as~~ are the overriding factors that the U.S. ~~L.T.~~ investor will give most attention to before making long term commitments in Nigeria.

  (2) The ~~Naira~~ Nigerian rules of the game - have a few weak spots vis a vis other ~~LDC's~~ developing countries - but they are on balance acceptable to the foreign investor. They may merit further study and liberalisation if Nigeria really wants to aggressively attract U.S. investment. This latter conclusion may particularly be true in the late 80's economic environment.

  (3) The U.S. investor is initially " shocked" by the Nigerian way of doing business and, as a result, there needs to be both a two way education process plus a great deal of perseverance on both the ~~Naira~~ Nigeria and U.S. side. In my view, we are both early on in the "learning curve" in finding out how to work effectively together.

  (4) Lastly, a final point as to "Why U.S. investors do not flock to Nigeria" might be to suggest ~~the~~ that Nigerians really study the U.S. economy in some depth, and ~~vice versa.~~ that American really take the time to know the Nigerian economic and political system. We may both better appreciate that our respective nations are at critical "turning points in our economic histories" and this appreciation and understanding of each other may well lead to the patience

and perseverance that will undoubtedly be needed for us to work and invest together successfully in the long term.

This seminar is a big step toward this understanding of each other and it is my hope it will launch us toward ~~on~~ a dialogue and action plan that results in more U.S. investment in Nigeria.

Richard L. Kramer