Book 2 - chapter 3

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1995 BUDGET IN RETROSPECT AND PROPOSALS FOR THE 1996 BUDGET

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1995 and 1996 should be the turning point leading to Nigeria's economic recovery. I use the word "should" because we are at a crossroads, both economically and politically. Fortunately, the 1995 Budget has created the foundation for 1996 to launch our economic recovery. A great deal therefore depends on the 1996 Budget and the critical economic policy choices we must make.

My task today is to help us chart the way forward. I have been asked to review the 1995 Budget in retrospect, particularly against the backdrop of the 1994 Budget and accumulated problems of past economic mismanagement. This past analysis will help us define the priorities for the 1996 Budget. Our Budget 1996 discussion will also focus on Nigeria's economic potential due to my strong belief that we must measure our plans and performance against international standards of economic development.

THE WAY FORWARD

We must first define the end result we seek to achieve. Our vision for Nigeria should place us among the leaders of developing countries. We should set our sights on global leadership and measure our progress in terms of such economic targets as -

- continuous per capita GDP growth per annum in the range of 5-10% in real (disinflated) terms,
- single digit inflation and savings rates well in excess of 20% of GDP,
- government budgets which, after payment of all debt service currently, will be roughly in balance (showing either modest surpluses or deficits) with spending clearly under control, and
- significant investment flows, both Nigerian and foreign, again well in excess of 20% of GDP.

The way forward must therefore focus on the long term aim of realizing Nigeria's great potential. Budgets and economic development plans must work to raise the quality of life of all Nigerians. We must measure our progress in terms of a steady increase in Human Development Indicators, which gauge the well being of our people in terms of health, education, living standards, etc. We must also protect our environment and use our abundant natural resources wisely.

The above "vision" of achieving our economic potential is surely acceptable to most, if not all, Nigerians. Furthermore, it is achievable if the right economic policies are rigorously implemented over the next several decades. Since it is within our grasp to start economic recovery in 1996, I believe the above targets for growth, inflation, savings, budget outcome and investment flows are the main indicators against which 1995 and 1996 Budgets should be evaluated.

THE 1995 BUDGET IN RETROSPECT

The 1995 Budget marked a bold turnaround in Nigerian economic policies and is to be strongly supported. Above all, we must build on the 1995 Budget foundation and strongly resist all pressures to make yet another U-Turn. Let us therefore look back at the legacy of the 1994 Budget which has so influenced the downward course of the economy during most of 1995. The 1994 Budget is the cause of major economic problems still with us in 1995.

THE 1994 BUDGET

At last year's Senior Treasurer's Retreat, Dr. 'Biodun Adedipe of FCMB did a very good job of putting the 1994 Budget in perspective. His words are worthy of repeating, and even expanding upon, because most of the economic ills of 1995 are directly traceable to the 1994 Budget and to earlier years of economic mismanagement.

First, let us recall that the 1994 Budget was largely a political document. It addressed symptoms rather than underlying causes of our economic backwardness. It sought to establish political legitimacy by populist economic measures. As Dr. Adedipe quoted last year - "the thrust of the budget was: 'to arrest or correct the steady deterioration in production, unemployment, adverse trade balance, enormous budget deficit, mounting domestic and external debt, high rate of inflation, reckless spending of Natural

Resources, uncontrolled devaluation of the Naira, unprecedentedly high bank rates (and) gross indiscipline in the system.' "

While most of us can agree with this diagnosis of Nigeria's economic symptoms and ailments, the prescription of re-regulation of the economy was a shock - since it was a prescription doomed to fail from the start. To again quote Dr. Adedipe, "the (1994) budget aimed to :

i. stabilize the Naira exchange rate, which was pegged at N22/$;
ii. reduce interest rates to reasonable levels, which were fixed at 12% to 15% for savings/deposits while lending rates (all inclusive) were at a maximum of 21%; and
iii. stabilize the general price level under an expectation of an inflation rate of 15% p.a. by the end of the year."

Dr. Adedipe rendered four verdicts on the 1994 Budget which are worth repeating -

- Verdict #1 - " The fixed exchange-rate system adopted in budget 1994 did not work simply because the supply of foreign exchange available to government (the seller) was inadequate. Several other stringent measures that were contained in the budget further discouraged the inflow of private and non-oil foreign exchange."

- Verdict #2 - "The peg on lending and deposit rates (has) not worked ..."

- Verdict #3 - "The official statistics released by CBN estimated the rate of inflation as 61.6% p.a. by the end of June, 1994." His own surveys "have indicated an average inflation rate of between 120% and 140% p.a. since August 1994."

- Verdict #4 - "Budget 1994, which was initially hailed as the manufacturers budget, has worsened the state of the manufacturing sector."

Why do I quote so extensively about 1994? There are three reasons -

(1) the 1994 Budget was a blunder. It was an economic prescription aimed at symptoms rather than causes of economic malaise. Nowhere did the 1994 Budget seek to address the causes of ill health, which would attack and contain government spending, stimulate savings and investment, encourage competition and productivity, and rely on free markets rather than government controls. The 1994 Budget was a blunder that laid the groundwork for a difficult 1995 because it unleashed negative economic forces which are still with us today.

(2) the 1994 Budget was widely hailed as a good budget at the time. In fact, it put the economy, which was already in free fall, into a tail spin. It demonstrates how many observers fall prey to wishful thinking rather than facing reality. It also revealed how many economic players were willing to put short term self interest ahead of long term national interest, when the inevitable result was to "shoot ourselves in the foot."

(3) many observers still do not want to believe the evidence. They attribute the negative results flowing from the 1994 Budget to problems of human behaviour. Government did not muster the political will. Private sector (particularly bankers) maneuvered around the rules thereby undermining the 1994 Budget. External creditors and foreign investors were also blamed for being unduly critical of well-intentioned policies, etc. etc. In effect, we blamed the players when the rules of the game were wrong.

What I wish to strongly assert is that the 1994 economic policies were deeply flawed. They failed in practice because they worked against the interests of the private sector and against the interests of the Nigerian people. They did not gain external support because both creditors and investors believed them to be wrongheaded and unsustainable. The 1994 Budget was a blunder that must not be repeated.

Fortunately, the 1994 Budget should have taught us a great lesson. No matter how nice the words seem, regulation, government led development and turning our back on the outside world simply do not work in practice. We must find a better way - and the 1995 Budget was a good start in the right direction.

THE 1995 BUDGET

It is to the great credit of the Head of State that the 1995 Budget marked such a bold, fresh start. The 1995 Budget introduced several new measures and implemented fiscal and monetary disciplines which, if continued consistently in the future and supported with fortifying reforms, can launch economic recovery from 1996 onwards.

There were four bold and future oriented changes in 1995 which must be singled out for praise -

(1) the implementation of tight and coordinated fiscal and monetary controls. These controls may result in a modest cash surplus once Petroleum Trust Fund (PTF) and Foreign Exchange (FX) windfall funds are included, albeit with considerable debt service obligations deferred to the future. These measures have started to break the back of inflation which must be seen as Public Enemy #1 for the Nigerian economy.

(2) the resolution of the cash call crisis with our joint venture partners has stopped an inevitable fall in our crude oil production capacity and reserves. If the upcoming negotiations on Memorandum of Understanding (MOU) are realistically concluded, we will be positioned to rebuild our competitive position provided government can muster its share of future increased spending levels.

(3) the opening up of foreign exchange markets through the abrogation of Exchange Control legislation and the establishment of the Autonomous Foreign Exchange Market. These measures set the stage for us to improve our export performance, to attract inflows of foreign and Nigerian capital, and to reduce our import dependence.

(4) the opening up of foreign investment through the elimination of IDCC (Industrial Development Coordinating Committee) and permitting up to 100% foreign ownership in all sectors except upstream petroleum. These measures provide the framework for Nigeria to start competing to attract foreign capital, technology and management.

Taken together, these four changes have major long term development implications provided they are permanently sustained and enhanced by supporting reforms. They go to the ***cause*** of Nigeria's economic sickness because -

(1) tight fiscal and monetary management are the key to reducing inflation to single digit level thereby creating an enabling environment attractive to private savings and investment and helping to address our excessive debt burden,

(2) a healthy oil production sector is critical to funding both government and future non-oil development,

(3) free foreign exchange markets are imperative if we are to attract hard currency funding necessary to build our economy, and

(4) unrestricted ownership is the only way we can compete for foreign investment - and it also enables us to attract Nigerian capital back home.

Unfortunately, it is clear that many people inside and outside government have not supported these four major changes. There are many self interests which want spending opened up even though inflation would go through the roof again. The cash call issue was never really resolved until August, when the Head of State personally intervened. Decrees on foreign exchange and ownership were not released until, after considerable debate, seven months after the 1995 Budget Message. Perhaps worst of all, government has threatened to reverse the privatization of at least four major banks, which gives a very negative signal to the outside world. Lastly, logical steps toward privatization, which enhances each of these four major changes, are still strongly resisted. There is simply not the critical mass of support behind the 1995 Budget which convinces Nigerian and external observers that we have our economic act together coherently and that we are on our way to recovery.

Nonetheless, there is increasing recognition that the 1995 Budget represents a bold step forward. Similarly, more and more far sighted leaders recognize that its basic thrust deserves our full support as we look forward to 1996. Lets now analyze the 1995 Budget further in terms of shortfalls and unfinished business before we turn our attention to 1996.

1995 BUDGET SHORTFALLS AND UNFINISHED BUSINESS

As we end 1995, the Nigerian economy is still in deep recession. Our image externally remains weak and, in many respects, distorted. It is clear that significant investment is not yet ready to come to Nigeria. Our external creditors are quite demanding in crucial negotiations leading to debt reduction. Clearly, there is a long list of "unfinished business" which will help us set priorities for 1996. Just as importantly, there are several shortfalls in the 1995 Budget itself which need urgent attention.

Let me start with the 1995 Budget shortfalls and select only six items for specific comment.

(1) First and foremost, the 1995 Budget continued the freeze on interest rates at 21% for lending. This continued the 1994 errors despite clear evidence that the freeze works to reduce savings, to discourage foreign exchange inflows, to encourage speculation against the Naira, and to turn off foreign support. The inevitable result is reduced liquidity in the banking sector and crowding out of all but the largest companies as borrowers. The freeze does not work effectively in practise and is a clear signal to investors and external creditors that we are ***not yet*** committed to a free market economic system.

(2) CBN intervention on AFEM (Autonomous Foreign Exchange Market) has had a similar impact. The requirement of upstream petroleum companies to sell ***their*** foreign exchange to the CBN is counterproductive. These funds are generated by the private sector and, in effect, confiscated by government despite the abrogation of Exchange Controls. This approach neither encourages private investment by petroleum companies nor efficiently provides these funds to other private sector users. CBN interventions are infrequent, unpredictable and suffer much delay, thereby causing the FX rate to be higher than it would otherwise be. Moreover, private sources of FX sell at higher rates between interventions than would be true if petroleum companies sold through AFEM direct to banks in smaller amounts but frequently based on their own timing requirements. There is, of course, nothing wrong with CBN intervention in AFEM but it should be done openly, frequently, and with government owned FX.

(3) AFEM works to tighten liquidity more than is necessary. This has choked off private sector activity unduly. Every AFEM intervention takes liquidity out of the system, by roughly the difference between N22 (official budget rate) and N80+ (AFEM rates). The sale of $1.5 bn through AFEM has taken roughly N85 bn out of the banking system, which should have created an equivalent budget surplus for government. This "FX windfall" was to be neutralized, according to the Minister of Finance, which would have contributed mightily to the reduction of inflation and the building of credibility with external creditors.

A parallel reduction in liquidity is being achieved by PTF (Petroleum Trust Fund). PTF was to accumulate over N60 bn in funds during 1995. Only a nominal amount apparently has been spent thus far and there is yet to be accurate disclosure of actual balances and transactions.

Despite these massive amounts of liquidity removal from the banks and petrol consumers, CBN has increased stabilization securities - by about N10 bn this year thereby bringing the current outstanding to about N30 bn.

While these moves have helped reduce inflation significantly, they have also made it impossible for the private sector to expand and to help the economy recover. The policy shortfall is ***not*** on the side of strong fiscal controls, which should be continued, but on the side of overly strong monetary controls, which if relaxed in moderation and systematically, could help start private sector recovery.

(4) Government has ***not*** been as transparent as promised. This is illustrated by my necessary use of rough numbers in the previous point. Reliable data is sorely lacking. The Minister of Finance's First Quarter Report was excellent. It promised full disclosure as befits his professional calling. The Second Quarter report was a non-event and we have no meaningful information at the third quarter mark. Several questions arise. What is the current rate of inflation and why isn't it falling faster? How much debt has been paid? What is the status of contractor payments and payment of recurrent expenses? How much has been earned and spent from PTF and FX windfall funds? Finally, what is the budget surplus (deficit) today and why?

(5) The retention of the N22 FX rate for official business is also retrogressive. It leads to the wrong pricing of government spending as well as the temptation to favour the few at the expense of the many. Now that the private economy has adapted to the N80 level, government should do likewise. If government has to pay AFEM rates, it will get its house in order by setting its priorities correctly.

(6) Lastly, there is an enormous shortfall on the privatization front. Government has chosen a limited and largely unworkable approach in the use of contract leasing. Contract leasing may work to lease hotels, real estate, airplanes, etc. but it has not been proven effective for privatizing businesses and complex

operations such as refineries, petrochemical plants, manufacturing plants, sugar companies, steel mills, etc. This shortfall simply signals government's lack of total commitment to privatization, which was further illustrated by possibly reversing course regarding privatization of the four largest commercial banks.

Having listed the above six shortfalls, which are ***errors of commission*** in the budget, let me now turn to ***unfinished business***. To a large extent, these are ***errors of omission*** (eg, areas totally ignored in the 1995 Budget Message) which are critical for economic recovery. Moreover, these items remain high priorities for 1996. Let me look at only three such items briefly:

(1) First is the emotional area of subsidy removal. We have not removed the fertilizer subsidy (despite its well known abuse) and, despite devaluation, there have been no further steps to free up petrol prices. Private sector investments in agriculture and downstream petroleum therefore continued to be blocked. Moreover, NNPC receives insufficient margins thereby further undermining refined products supply and further accelerating purchase of imported products which are sold at a loss in the domestic market or even smuggled to neighbouring countries. This omission is unfortunate since delay does ***not*** resolve the subsidy issue and simply perpetuates misallocation of resources.

(2) There are insufficient incentives for savings and investment. Tax reform is urgently needed. While it is a worthy objective to collect all taxes that are legally due, current tax rates remain oppressive in the light of high rates of inflation and unattractive to any investor who can choose to invest elsewhere. Conspicuously omitted in 1995 were any initiatives to reduce tax burdens for savers and to attract corporate investment through accelerated capital allowances or other tax preferences.

(3) There has been no relief for labour and salary workers despite the obvious deflationary thrust of the 1995 Budget. At a minimum, we should have seen a significant increase in civil service compensation levels and substantial personal income tax relief. Tax relief should include tax rate decreases, increased allowances and sharply higher threshold for taxation. Individual tax burdens have been greatly increased by past inflation over the years. Steps to get much needed purchasing power into the hands of labour and salaried workers are greatly overdue.

PROPOSALS FOR THE 1996 BUDGET

In defining 1996 Budget proposals, we must recognize that government has two challenges. First is to not backslide and return to hyper inflation, regulation and disinvestment. Second is to position the 1996 Budget within a 3 to 5 year strategy which will earn debt relief, attract major investments and launch sustainable economic growth. Let us look at both challenges before discussing specific proposals.

First of all, there must be no U-Turn and the 1996 Budget must be seen to build on the 1995 foundation. 1995 is a year of necessary deflation. 1995 policies produced ***pain*** and we are yet to see the ***gain***. But they are in the right direction to sanitize the economy and to build confidence in the Nigerian economy. The one battle we must not lose in 1996 is the War Against Inflation.

Therefore, first and foremost, the 1996 Budget must be a balanced, or surplus, budget. Government must reorient fiscal policies to foster recovery while still bringing inflation down towards single digit levels. Government does not have the means to fund all its priorities and simultaneously to launch economic recovery. It must therefore live within its means while providing the enabling environment for private sector led growth.

In short, the first challenge is to avoid U-Turns and to put the ball in the private sector court.

The second challenge is to launch a 3 to 5 year growth process by introducing the right economic reforms and policies in the 1996 Budget. These reforms and policies have been articulated during the two Nigerian Economic Summits. The Summit recommendations focus on fostering the private investment levels which will support real GDP growth per capita in the 5-10% level per annum. These recommendations have only to be fine tuned and implemented in close partnership with the private sector and creditors. They also need to be widely debated and supported by Nigerian leaders, opinion shapers, media, academics, labour, and the public.

Lets now turn to specific proposals bearing in mind the two overriding challenges to continue forward progress and to turn the private sector on.

GETTING GOVERNMENT'S HOUSE IN ORDER

Let us start with keeping, and further getting, government's house in order. There are five major areas where the 1996 Budget must demonstrate our commitment to live within our means and to win the war against inflation. They are -

(1) ***Surplus budget.*** Living within our means is best demonstrated by a surplus budget. To be credible, surplus must be tightly defined in accounting terms. It must include timely payment of all commitments, including debt service. To be credible, the 1996 Budget must be transparent. It must therefore include ***all*** revenue and expenditures, including PTF. To be credible, the 1996 Budget must also encourage similar "living within our means" at all levels of government and for all parastatals. No single step can better assure the victory over inflation and the building of external confidence than a realistic surplus budget.

(2) ***Refocus spending.*** The surplus budget objective will cause government to refocus spending because they do not have sufficient revenue to address all spending needs and to service debts. First priority must be given to cash calls and protecting our vital petroleum revenue stream. Refocusing should then be designed to move spending towards the needs common to all Nigerians - roads, transport, education, health, security, law and order, and infrastructure generally. Maintenance of existing facilities and institutions should receive priority over new projects and capital spending. Refocusing will help channel government spending to where it is most needed and will start to scale back unproductive spending. Similarly, refocusing should cause government to get out of business.

(3) ***Launch PTF prudently.*** While 1995 has been a year of accumulating PTF funds, 1996 should start their regular and prudent spending. Several criteria need to be met. Prioritization needs to be from an overall government perspective. Commitments need to be made only from funds already on hand. Steady release of funds is necessary to avoid fueling inflation. Transparency is necessary to build credibility. If these criteria cannot be met, and planning effectively coordinated with all relevant government agencies, then the next step will be to eliminate PTF and let the funds flow directly to Finance.

(4) ***Rightsize government.*** A commitment to rightsizing of government needs to

be made in 1996. Some areas - education, health, infrastructure, etc - need more attention and funding. Others need to be reduced. Government needs to get out of areas private sector does best and to sell surplus assets at open tender. Monopolies should be eliminated, either by carefully planned privatization or by fostering open competition between private sector and state owned enterprises. Privatization and asset sales will significantly cut future spending while also providing funds to reduce debt burdens. Efforts to rightsize government will build considerable credibility and contribute significantly to investor confidence.

(5) ***Civil Service Reform.*** In implementing the Ayida Committee Report, it is critical to increase civil service pay and benefits, including pensions. The large compensation gap vs. private sector is not tenable and must be reduced to a reasonable difference that does not distort motivation to perform professional work honestly. The civil service is the backbone of government and must be strengthened if government is to play its vital role successfully.

The above five areas should accelerate the unavoidable task of government getting its house in order. Equally important, government should move aggressively to provide an enabling environment, thereby putting the ball in the private sector court.

TURNING ON THE PRIVATE SECTOR

Budget 1996 should focus on those reforms and incentives which will stimulate savings and investment while continuing to moderate consumption and to sharply reduce inflation.

There are five priority areas -

(1) stimulating savings,
(2) attracting investment,
(3) increasing competition among banks,
(4) creating non-inflationary consumer demand, and
(5) stimulating non-oil productivity and exports.

There is inevitable overlap between these areas because synergy results in the process. Lets, however, look at each separately.

(1) ***Stimulating savings.*** The long term target of over 20% savings to GDP is critical to achieve. Savings provide the funds for investment and, by replacing consumption, help reduce inflation. Measures to increase savings would also help attract portfolio investors and return of Nigerian flight capital. Recommended reforms are to remove all constraints on interest rates and NSE transactions. Capital gains and capital transfer taxes should be eliminated while interest and dividends should be taxed at 10%, with the 10% withholding tax being a final tax for both residents and non-residents. Investment trusts should be tax free with distributions to investors taxed by withholding taxes only.

(2) ***Attracting investment.*** Again, our long term target is for investment to be well in excess of 20% of GDP. Two incentives should be introduced. Corporate tax rates should be reduced to 25% and made inclusive of all income taxes (education, etc). Secondly, accelerated depreciation should be introduced by increasing capital allowances. This could best be accomplished by reducing useful lives on assets, which should be cut to half of current lives, so roughly doubling the rate of depreciation.

(3) ***Increasing bank competition.*** Now that CBN/NDIC are addressing the distressed bank situation, it is time to increase competition among surviving banks which will work to the benefit of both consumer and borrower. Bankers Tariffs should be abolished thereby letting banks compete on price. CBN should allow banks to open or close branches without CBN approval. Sectoral lending limits should be eliminated. Merchant Banks should be allowed to become Commercial Banks, and vice versa. New licences, particularly for foreign banks, should be granted promptly provided requirements are met. Interest rates should be totally freed up and CBN should move to indirect market intervention.

(4) ***Creating non-inflationary consumer demand.*** The 1995 deflationary measures have set the stage for the economy to recover during 1996 in a non-inflationary way. Large bursts of spending or increases in money supply must be avoided at all costs. Instead, steady and systematic increases in private sector purchasing power are suggested, including -

- civil service salary increases (as suggested above),
- elimination of excise taxes (since VAT is the preferable taxation system),
- reduction of tariffs to maximum of 25% (with rates graduated from NIL to 25% in 5% increments) and
- individual income tax reduction, particularly to impact PAYE individuals. My view is that all compensation should be monetized and a simple two tier system be introduced. All current allowances should be maintained and adjusted for recent inflation. There should be two rates - 10% over N100,000 and 20% over N1,000,000. These brackets should be indexed for inflation to avoid future "bracket creep",

The above moves will stimulate consumer demand in a non-inflationary way. It is doubtful that nationwide revenue losses would be large - perhaps up to N5bn out of 1995 budgeted revenue of N288 bn (at N22 rates). Such amount could easily be offset by better collection efforts and/or increased VAT rates. In addition, revenue reduction that goes to taxpayers is highly likely to be spent more wisely than if left in government hands. In the future, an even stronger case for major tax reduction can be built; but since the 1996 objective should be only to get the recovery started, a modest initial tax reduction is suggested.

(5) ***Stimulating non-oil productivity and exports.*** The real sectors of the economy - agriculture, manufacturing, distribution and trade - are the key to unlocking Nigeria's great potential. These are the sectors where employment and added value must be generated. Both large and small enterprises must be fostered.. Incentives for both are needed, but there must be care not to set up artificial protection of businesses that can never be viable in today's global market.

We therefore need to be tough minded to make sure subsidies are not involved. Emphasis should therefore be on businesses where Nigeria has a competitive advantage and which supply or serve already viable businesses. In the process of developing globally competitive real sectors of the economy, we must not try to keep unproductive and non-competitive industries afloat.

The 1996 Budget should provide incentives for exports, including simplified export procedures. It should focus on getting past projects off the ground - such as petrochemicals, the EPZ (Export Processing Zone), solid minerals development, etc. It should clearly state that once these government projects are launched, the private sector is to lead the way on all future business related investments without government involvement.

This will help clear the way for major investments in rubber, sugar and other agriculture based industries as well as for users of petrochemicals. It will also link to government privatization programmes which should be given rebirth in 1996.

My view is that a comprehensive industrial policy, worked out in collaboration with experts knowledgeable of several Asian and even Latin American miracles, should be undertaken during 1996. We need a fresh approach and our future cannot be built on the weak foundation constructed when our economic policies were inward rather than outward looking.

SECURING DEBT REDUCTION

The last imperative for the 1996 Budget is to support the Medium Term Economic Plan (MTP), which is being negotiated with IMF/World Bank preparatory to debt reduction agreements with the Paris Club.

Our debt burden is now about $40 billion, consisting of about $32 billion principal and about $8 billion arrears. There is no way we can service this debt burden and the alternative of continued default is not a viable solution.

Fortunately, the MTP negotiations are well advanced and the role of the 1996 Budget is largely to demonstrate commitment and results which lead to satisfactory agreements with our external creditors. The end result should be a debt burden we can bear - hopefully within 30% of our export earnings per annum of debt service. The price to pay is commitment to sound economic programmes and reforms that are in our best interest and acceptable to our external creditors.

Our only legitimate objection to IMF/World Bank conditions should be if they insist on terms and economic policies which are not in our best interest or not feasible to implement within their suggested timetable. Fortunately, this does not seem to be the case.

There are apparently five sticking points in the discussions to date, as follows -

(1) freeing up interest rates,
(2) merging the official rate (N22) with AFEM at free market rates,
(3) renewal of the suspended privatization programme,
(4) removal of subsidies (particularly fertilizer and petrol), and
(5) monitoring of transparency and commitments, since results are what trigger debt relief.

Lets look at each one briefly since it appears both Nigeria and the Bretton Woods institutions are really not that far apart.

The first two reforms - free interest rates and unified FX market - have already been recommended earlier. One could debate ***how*** these reforms are to be implemented but their time has come.

The third and fourth items are not so easy to resolve. ***Privatization*** is a multi year process. 1996 can only witness the sale of assets that require little or no pre-preparation, such as quoted shares held by government (or parastatals) or under-employed assets. The 1996 Budget can announce a renewed privatization programme with a step by step time schedule. This may logically require a study phase to develop an action plan to be implemented from 1997 onwards. Perhaps equally important, government should announce it will not reverse privatization of the four major banks. It should also look for ways to increase competition for present parastatal monopolies. Lastly, privatization of NNPC, NITEL, NEPA, etc. should include international tenders so that optimum value is attained. Since privatization cannot be done all at once, the key is to launch (or relaunch) a credible process in 1996.

Subsidy removal is an emotive issue and not well understood. The major rationale is that both fertilizer and petrol involve major abuse where, through smuggling and diverting product, large gains are made by the few at the expense of the many. Free markets would eliminate these abuses. Secondly, subsidy removal is wrongly thought to be inflationary. In reality, higher prices operate, as a tax does, to reduce government deficits which in turn reduce inflation rates. Most importantly, subsidy removal works to stimulate investment and to improve resource allocation.

Perhaps the key to subsidy removal is how to do it. My view has been to do it gradually and in stages so that the impact is minimized and the emotive issue eventually disappears. An example is in order.

Petrol pricing can be freed up in three stages - first at retail, then at wholesale and finally at crude oil pricing level. Retail is at the service station, wholesale is at the NNPC level, and crude oil pricing is at the Federation Account level.

I would start at retail by increasing prices 50k per litre per month until marketer margins are high enough marketers start to compete on price. At that point, retail prices would be totally deregulated. During this stage, depot (wholesale) prices would remain fixed and uniform across the country.

In the second stage, government would continue fixed crude prices but allow NNPC to sell at free market prices. At this point, privatization of refineries, pipelines, depots, etc. would become feasible at realistic values.

In the third stage, government would raise crude oil prices systematically until reaching international market levels.

In my view, this approach to petrol subsidy removal should be acceptable to both IMF/World Bank and government. It may take two or three years to achieve - but it would be far easier for the public to understand. Both the marketers and NNPC would progressively be saddled with explanations to the public. Most importantly, the emotive nature of the issue will gradually become a thing of the past.

Lastly, the fifth requirement of monitoring of transparency and commitments is hard to deny. Keeping the public and the business community in the dark is self defeating. Government credibility and investor confidence are both undermined.

In summary, debt reduction looks finally to be in sight. IMF/World Bank need to be realistic in what we can achieve and at what pace. Yet, the gains are so large that every effort on both sides should be made. For Budget 1996, the challenge is to be consistent with the MTP requirements and to build credibility that finally pays off in Paris Club agreements for debt reduction.

CONCLUSION

Let me wrap up in bullet-point fashion -

- the 1994 Budget and past mismanagement have generated ailments we are still feeling at the end of 1995.

- the 1995 Budget introduced bold and forward looking economic policies which have laid the foundation for economic recovery starting in 1996, but which have left the economy in deep recession at year end.

- the challenges of the 1996 Budget are to avoid U-Turns which destroy confidence and to introduce reforms which foster major private sector savings and investment.

- the 1996 Budget must therefore maintain the momentum of the 1995 Budget by continuing prudent fiscal/monetary disciplines which reduce inflation rapidly towards single digit levels.

- further new reforms are urgently needed on three fronts -
  - steps to rightsize government to live within its available means while refocusing on what government can, and must, do best,
  - steps to turn on the private sector by fostering major increases in savings, investment, and business activity, and
  - steps to earn debt reduction so that we can get the debt trap behind us and position ourselves to outgrow our remaining debt.

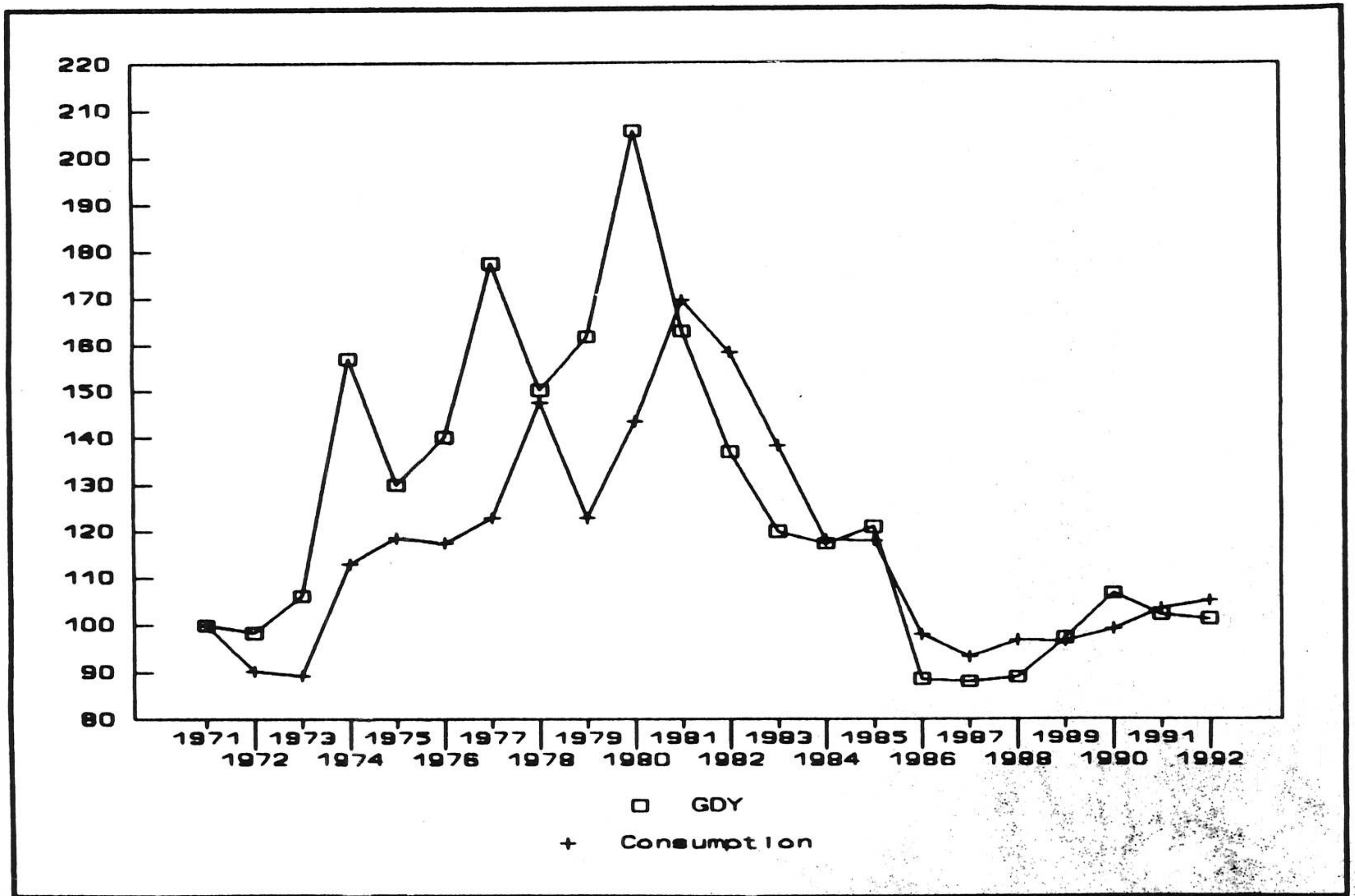
- Lastly, in the process of finally adjusting to the aftermath of the oil boom and glut which characterized Nigeria in the 1970's and 1980's, it is hoped that we now have learned valuable economic lessons in the 1990's which will hold us in good stead for the 21st century. We should have learned some basic truths including -
  - the old economic prescription that the sooner the medicine is taken, the less painful the outcome,
  - the lessons from SAP that taking the pain without finishing the prescription leads only to pain, but no gain,
  - the lesson of the 1994 U-Turn that we cannot equitably divide a smaller and smaller cake by populist economic policies, and

- the lessons of the Asian Miracle (now being duplicated in Latin America) that there is a formula for economic success which must be tailored to fit each country and which works only after steady, continuous implementation over decades and generations.

The way forward is to take the long road to economic success as set out earlier in terms of 5-10% per capita real growth, over 20% savings and investment to GDP, government living within its means, and single digit inflation.

The 1996 Budget must start us towards that vision. It must build squarely on the 1995 Budget foundation. It must support a future strategy of sustainable economic development which is consistent with the Medium Term Programme we are negotiating with creditors to obtain debt reduction. Since the 1996 Budget offers an opportunity that must not be lost, we must neither turn back nor fail to think big. The 1996 Budget must therefore follow the bold and farseeing pattern set down in 1995 by introducing reforms which launch non-inflationary economic recovery. By launching economic recovery, we can unleash the power of the private sector and attract all the resources needed to realize our potential. It is not time to think small and talk of fine tuning. We need a quantum leap forward. Nigeria has great potential and must have large dreams and supporting economic plans. The Nigerian people will pay the price for a Nigerian economic miracle. The 1996 Budget is the best opportunity to launch their long march towards this vision of a steadily improving economic quality of life.

Figure 1.1: Indices of Per Capita Income (GDY) and Consumption, 1971 to 1992



Source - Nigeria: Structural Adjustment Program - Policy, Implementation, and Impact
By: The World Bank

No Data to draw this accurately.

Nigeria: The journey so far and the road ahead