Book 2, Chapter 1

NIGERIA AT THE ECONOMIC CROSSROADS:
General Overview and Macro-Economic Implications of the 1999 Budget

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Nigeria is at an economic crossroads. The outcome depends on how the economy is managed during the next year — by both the Abubakar administration and the incoming civilian government. Good management, which implies policy continuity and introduction of growth oriented reforms, can lead to strong economic recovery and open the door to sustainable economic development. Bad management, which implies U-turns, populist spending policies and return to outdated economic concepts, can set Nigeria back many years and derail the difficult, but solid, progress made in recent years.

The 1999 Budget is good news in this regard. It maintains continuity of policy with the past. It squarely faces a looming deficit thereby keeping inflation down to low double digit levels. It makes several bold moves necessary to restore external credibility and to open the path to debt relief and both debt and equity funding. It clearly promises that an economy with healthy fundamentals will be handed over to the next government.

The 1999 Budget appears the best possible under the circumstances. If the words are implemented to the letter, it can even be a remarkable budget. But, since it did not address growth initiatives, the 1999 Budget does not put in place the incentives and funding necessary to stimulate investment and to lift the economy out of recession. Hence, most of the problems of growth will be left to future leaders to sort out. It is the uncertainty about how our future leaders will manage on the economic front that causes the economic crossroads we are facing today.

My task today is made easier by the excellent 1999 Budget Newsletter which Arthur Andersen will hand out at the end of today's session. I therefore intend to stay at a rather high level – dealing with the context in which we find ourselves today, with the key highlights of the 1999 Budget and with the outlook and implications for management.

My remarks will therefore break down under three headings –

(1) Overall Context

(2) 1999 Budget Highlights

(3) Economic Outlook and Implications

OVERALL CONTEXT

Global Outlook

- Globally, 1999 will be a year of slow economic growth punctuated with still further crises such as in Brazil today. You can expect pessimism to prevail but ***not*** global recession despite increased joblessness, lower corporate earnings, further cost cutting, increased savings and lower consumer spending.

- 1999 will also be a year of worldwide surpluses. Too much oil. Too much food. Too much production capacity. While the world's population will pass 6.0 billion during 1999, lower consumption levels will maintain steady downward pressure on commodity prices. In fact, we are probably in the early stages of a multi-year period of global commodity based deflation. Deflation will bite particularly hard on commodity based countries such as Nigeria.

- Global news is not all somber, however, as the successful introduction of the Euro, the restructuring of many economies (particularly in Asia) and the continuous strengthening of private sector companies (driven by technology and competition) all combine to position the world for renewed growth early in the next millenium.

- Against this deflationary and intensely competitive backdrop globally, Nigeria is relatively well placed to start its economic recovery – provided the economy is soundly managed. Historically, the Nigerian economy has been so badly managed and resources so badly squandered that we have the short term opportunity to significantly improve our economic lot simply by better management. In particular, privatization of virtually all government owned enterprises can significantly spark economic growth. Moreover, the low cost of Nigerian petroleum continues to encourage the major oil companies to invest. Also, the opportunity to earn debt relief can significantly reduce our external debt burden. Most importantly, the taming of inflation and the disciplined fiscal/monetary policies put in place from 1995 onwards have set the stage for economic recovery.

The Abacha Legacy

The reason for my optimism that Nigeria can buck global trends is linked strongly to the Abacha years. After a disastrous U-turn towards populist policies in 1994, the Abacha administration settled in to a pattern of balanced budgets, relatively tight money, reduced spending and managing inflation downwards to single digit levels. While the Abubakar administration is harvesting the benefits of this legacy, sadly the Abacha administration never made a sound attempt to go for economy growth and virtually every external stakeholder was alienated by corruption, misguided political policies and belligerent behaviour.

Progress Under Abubakar

The almost flawless performance of the Abubakar administration on political, human rights and social fronts have raised considerable hopes for the right economic reforms to be implemented, irreversibly, before handing over to civilians. However, the record is likely to be one of "too little, too late" and the end result will be to hand over to an incoming civilian government an economy still in recession with limited FX reserves and minimal investor interest.

Yet, Abubakar's economic team has done many things right, particularly as far as ***words*** are concerned since they have committed to implementing VISION 2010, particularly its economic reforms. As far as ***actions***, they have taken several significant steps to deregulate downstream petroleum, to eliminate several laws which inhibited competition, and generally to maintain fiscal/monetary discipline. Moreover, the 1999 Budget, which we will examine further, does in fact face reality and introduce many positive reforms. Though deficient in many areas, it is probably the very best possible given the circumstances.

Based on the economic record thus far, Abubakar will probably be remembered for implementing many programs conceived under Abacha, for focusing on VISION 2010 for the long term economic development of Nigeria, and for re-establishing dialogue with multilateral agencies and foreign investors. Most importantly, while there is nothing new in his actions thus far and there are too many half measures and missed opportunities for us to expect economic recovery to start before he leaves office, he will turn over an economy with sound underlying economic fundamentals to the civilians.

Political Uncertainty

Thus far, we have witnessed a positive but very curious political transition process. There is an almost complete lack of discussing the issues, preparing and debating manifestos, and campaigning based on economic platforms. The process so far is full of horse trading and personalities. Who you can trust appears more important that what they stand for and/or who is the best candidate based on merit. Uncertainty is therefore introduced because it appears that many political leaders may neither understand the economic realities facing Nigeria nor have the experience or background necessary to manage the economy towards economic recovery and sustained growth.

While multiple efforts will be made to address this situation, the major risk staring us in the face is that new leadership, eager to please the public, could reverse economic policies which have laid a foundation for growth and will open the floodgates of spending as happened under Shagari. Perhaps the major blessing is that funds will be short and external stakeholders will lay down stringent conditions before coming to Nigeria's aid. What is also probable is that much of the good work of VISION 2010 and past Economic Summits can be salvaged by opening up dialogue between politicians and economic stakeholders – both Nigerian and foreign.

The reality we face is clear. We are deep in recession but can lift ourselves up with good economic management, which in turn will spark support from external creditors and investors. We can start economic recovery by this time next year if we do the right things and do them right. Conversely, we can also blunder into an "own goal" setback if we reverse key policies and fail to implement growth oriented reforms. Despite the global uncertainty, Nigeria's future is in our own hands.

1999 BUDGET HIGHLIGHTS

With the above context in mind, lets now focus on the 1999 Budget, including the recent petrol deregulation.

My overall conclusion is that this is the best budget we could have expected under the circumstances. It faces many problem areas squarely, maintains consistency with the past and manages the problem of limited resources relatively well. While it also perpetuates recession for another year, it turns over a sound economy to civilians at mid year.

Lets now look at the ***key highlights*** since there is no sense to look at details or go item by item – since Arthur Andersen has done such an excellent job in its 1999 Budget Newsletter.

First of all, lets look at what the 1999 Budget did ***not*** do before assessing what it did. Specifically, it did ***not :***

- Introduce the economic growth reforms articulated in the VISION 2010 Report as further amplified during the Fifth Nigerian Economic Summit in November 1998. Specifically, it did not introduce tax reforms, or reduce significantly the cost of doing business, or shift resources from public to private sector hands, thereby stimulating economic recovery.
- Set out a clear timetable and process for privatization – a key policy reform where significant progress is a prerequisite for heightened private investor interest in Nigeria.
- Free up foreign exchange and petrol pricing in such a way that competition would be intensified and policy reversal virtually precluded; hence leaving considerable room for speculative excesses and foot-dragging as to future private sector involvement, and
- Start the process of pruning back government to sustainable size and activities by reducing manning levels, shutting down uneconomic projects, and clearly shifting responsibility for the economy to a private sector operating under free markets and intensifying competition.

As a result, the 1999 Budget will ***not*** produce an economic recovery and will leave the nation in recession when the baton passes to the civilians.

I repeat my earlier comment that the 1999 Budget was the best that could be expected under the circumstances and made some very tough and courageous decisions, many of which we will now proceed to examine.

There are seven such major decisions that I wish to highlight today –

(1) Petrol deregulation
(2) Elimination of official FX rate
(3) Rollback of civil service compensation
(4) CBN autonomy and banking reforms
(5) Trade reforms
(6) Economic liberalization
(7) Funding of upstream petroleum

Each of these seven areas represent a move in the right direction albeit with some tendency towards half measures which will undermine the end result. Therefore, for each of the seven areas, I'll need to highlight what was done, assess the probable end result, and identify, if necessary, the gaps to be filled and/or the signs private sector should monitor in managing their own businesses.

1. Petrol Deregulation

The late December reforms were bold moves which promise permanent solutions to Nigeria's chronic supply and distribution problems. The reforms did three things –

(1) Freed up product imports by allowing oil marketers to freely import refined products in direct competition with NNPC. This is a major breakthrough although the present marketer import capability is small and limited to Lagos. If there is no policy reversal, this measure alone will ultimately assure adequate product supply in the long term.

(2) Raised petrol prices to N25 (subsequently reduced to N20) under a uniform pricing system, for which price equalization is to be managed by the oil marketers. This price provides adequate margins to the private sector and presumably NNPC – so as to permit the downstream to operate efficiently and maintain its facilities. In fact, once supply corrects itself, the margins probably permit price cutting and competitive pressure among marketers. The new system is excellent but the element to watch is whether government lets the oil marketers change prices as underlying conditions (crude price, costs, FX rates, etc) fluctuate.

(3) Significant funding for refining turnaround maintenance and refurbishment implies that the domestic supply will be able to satisfy local consumption at some point during 1999. Probably, the earliest this can happen is March 1999, hence there will be considerable black market activity and prices well above official levels during the months to come. Hopefully, the steady improvement in supply and the reduced incentives to smuggle will improve the situation rapidly enough that public pressure and status quo forces will ***not*** force policy reversal.

Government was ***not*** fully prepared to take this bold move as extra supplies were ***not*** available. Nonetheless, deregulation appears to be working and should demonstrate visible results to the public every month from now on. If allowed to fully work, this reform will be the most important economic legacy that this Administration will leave for the country.

2. Elimination of Official Foreign Exchange (FX) Rate

This "bold" reform was a "no-brainer" but required courage. The official rate benefited very few people at the expense of the entire nation. It was the biggest single deterrent to external financial support. It should have been done years ago and is to the immense credit of the Abubakar administration that they finally gained the courage to face the music. This single measure will greatly enhance Nigeria's ability to deal with the outside world, particularly the IMF, World Bank and Paris Club.

However, we will soon find that elimination of the official FX rate is insufficient as there is already intense speculation against the Naira. Let us therefore recall what was recommended to government.

The recommended reform was to simultaneously free up AFEM to be market determined and to permit oil companies to sell their FX on the free market. Neither measure was implemented. The immediate result, in the face of severely reduced FX earnings, has been to generate an unsustainable demand for FX ($200 m per auction at AFEM with rates fixed at N86:$1) and a N10 gap vis a vis autonomous and parallel markets (which are trading at +/-N96 level) thereby inviting arbitrage, or "roundtripping".

At about $11 crude oil price levels, Nigeria does ***not*** have the level of FX reserves to outduel currency speculators by trying to keep a strong Naira under an AFEM system managed by CBN. The sooner CBN is allowed to free up FX markets and oil companies to sell at market rates – the better. In the meantime, this bold move by the Abubakar Administration will receive widespread plaudits but fall short of the intended result. Quick additional action will be a very positive sign to the private sector, which otherwise will expect unnecessary devaluation of the Naira.

3. Rollback of Civil Service Compensation

The delay in implementation until January 1st followed by rollback of this ill advised, more than threefold, increment in civil service compensation structure also shows the strong will to keep the deficit down and to fight inflation. Again, this move took courage and is one of the best features of the 1999 Budget.

Here again, the underlying problem will not go away and will be bequeathed to the civilians. Public servants are relatively underpaid and governments, at all levels, are overstaffed. Future administrations will have to face the music by rationalizing staff so non-inflationary salary increments can be made. The other alternatives – further tax increases which will cripple the economy or deficit financed salary increases which fuel inflation – are simply not acceptable if Nigeria is to achieve sustainable growth.

4. CBN Autonomy and Banking Reforms

The restoration of CBN autonomy is a major achievement, particularly in view of the restated intent to get CBN out of retail banking and the welcome alternative for merchant banks to become commercial banks.

The test of willpower appears to be whether or not CBN will close down those banks ***not*** meeting the N500 million minimum paid-up capital within a reasonable time following the now expired yearend deadline. Similarly, continued implementation of the Failed Bank Decree and follow-through on restructuring and commercializing Development Finance Institutions should be watched closely. Success on these fronts could leave the banking system in very good shape by yearend 1999.

5. Trade Reforms

While timid and long overdue, several trade related reforms are very much in the right direction.

The shift from pre-shipment inspection to destination inspection for ***both*** imports and exports can be a major breakthrough if implemented properly. It can significantly reduce financial costs of imports and stimulate interest in exports.

Another good measure on balance is the abolition of 25% import duty rebate, which has been an anomaly since August 1995. It is proper for government to simplify the import duty structure. If relief to importers is justified, then direct reduction in import duty rates is a preferable approach. Since there is so much self interest in this area, let me keep the ***national*** interest in focus. Measures that stimulate exports and local production are needed just as measures which curtail imports are helpful. We should bear this is in mind when one argues for a strong Naira (which is counterproductive) or against what is in effect a Naira exchange rate rebate.

The freeing up of exports of beans, yams and rice is also positive. Not so clear are some measures to protect local industry, which can protect very inefficient and unviable industry, under the populist banner of "anti-dumping".

Longer term, what is needed is tax reform and cutting the costs of doing business. Such measures are critical if we want to stimulate viable and competitive local manufacturing and export oriented industry.

6. Economic Liberalization

If we start with the premise that Nigeria's economic development must be private sector led based on free market systems, open competition and privatization, the 1999 Budget stays on track with several positive measures. My concern is that the pace is so slow that significant investment is unlikely to be generated until the political transition is over and the future economic direction known.

Two measures deserve comment:

(1) Government has restated its commitment to privatization of some 19 major public enterprises and indicated, once again, that the privatization decree and the clarification of BPE (Bureau of Public Enterprises) roles and responsibilities will soon be made known.

(2) Government has again committed to review the statute books to eliminate the remaining laws and regulations inhibiting competition in all sectors of the economy. These measures would be in addition to the eleven decrees issued in late 1998.

While these measures indicate continued commitment to economic liberalization, the slow pace and the obvious internal resistance to government transfer of economic power to the private sector combine to make it prudent to wait until reforms are announced and implemented before counting on future liberalization. There is simply no clear vision and broad commitment to liberalize the economy, hence liberalization reforms must overcome strong status quo resistance and self interest before they become reality. Moreover, with natural tendencies to rollback reforms to maintain the status quo and uncertainty as to future civilian policies, most external observers expect half measures rather than thorough and meaningful reforms.

7. Funding of Upstream Petroleum

Due to the looming deficit, this administration has chosen to cripple the golden goose (upstream petroleum) rather than face controversial funding alternatives upfront. The cutback of Joint Venture cash calls from $2.8 bn to $2.0 bn level will bring upstream petroleum to a virtual standstill – with the industry simply marking time and barely maintaining productive capacity.

There is, however, good news on two fronts –

- additional capital investment incentives will help stimulate both associated and non-associated *gas* development, and
- agreement to honour PSC agreements will increase the chances for these agreements to be extended beyond their expiry dates in 1999.

The many positive incentives and spending plans for upstream, however, can all be nullified *if* Government fails to address the disruption of oil activities caused by community problems in the Niger Delta. Although mentioned, Budget 1999 was short on solutions in this critical area.

GAPS AND UNFINISHED BUSINESS

While the above seven reforms areas are, on balance, quite positive, 1999 will be a year of economic recession and low investment activity. The reasons for this stagnation lie in several gaps, or unfinished business, which Budget 1999 did ***not*** address.

We can use VISION 2010 as a benchmark and focus on such strategic goals as 10% per annum growth in real GDP; single digit inflation; diversification of the economy away from oil; stimulation of investment and competition; growth in manufacturing, value added and exports; etc. If we do so, we clearly see that Budget 1999 falls way short of meeting Nigeria's needs for sustainable economic development.

What went wrong? In my view, there are three factors –

(1) Budget 1999 focused on limiting the deficit caused by low oil prices and the past failure to rationalize and privatize government. For example, one can see a drive to increase government revenue when it is tax cuts and tax reforms that are needed to stimulate savings, investment, consumer demand and business expansion. The current focus is on tightening our belt when the belt has actually become a noose around out neck.

(2) There is substantial opposition to liberalization of the economy. There are outmoded thinkers who do not understand or want to face today's global realities. There are status quo forces who fight hard to protect self-interest. There are civil servants and beneficiaries of the current system who resist implementation even after reforms are announced. In fact, there is only a small core of people speaking out for liberal reforms. Fortunately, their voices are supported by Nigeria's external stakeholders who are not about to move until they see meaningful change and sincere implementation of liberal reforms.

(3) Lastly, there is also the natural tendency for a transition government to make the minimum, necessary changes and the not-yet-elected political class to encourage delays so that they can act and get the benefits. Unfortunately, the needed reforms are not easy to do quickly and thoroughly under a democratic system and the future civilian leadership will be saddled with the task of taking and implementing tough economic decisions. This is not an encouraging scenario from the investor's standpoint.

One need only look at VISION 2010 and the November 1998 Nigerian Economic Summit to spot the gaps and define the unfinished business agenda for the next administration. Since the list is long, let me enumerate only five major reforms –

(1) Tax reforms aimed at non-inflationary growth through reducing both corporate and individual tax rates. The purpose would be to lower costs of doing business, stimulate savings and investment, and shift resources to the private sector where they will be utilized more effectively.

(2) Complete negotiations for significant debt relief thereby substantially reducing the debt burden. Current negotiations with IMF should result in agreement on a medium term economic strategy, finalization of a letter of intent and implementation of a staff monitoring programme. If done timely, this could permit the next government to ***start*** Paris Club negotiations, leading to debt relief, before September of this year.

(3) Jump start the privatization process. Promised privatization of NITEL, NEPA and 17 other major public enterprises should proceed with deliberate speed. An even broader effort should then exhaustively address all other state owned enterprises, with particular emphasis on NNPC and its holdings in oil service companies and oil marketing companies.

(4) Focus government spending on infrastructure, education and health, including incentives for private sector participation in these priority sectors.

(5) Complete the move to free markets including FX rates, gas prices, airline tariffs and petrol prices.

These five reforms should be the priority for this and the next administration, so that the turn of the century can witness economic recovery and the start of sustained economic development.

ECONOMIC OUTLOOK AND IMPLICATIONS FOR MANAGEMENT

In my opening comments, I stated that 1999 could mark the start of economic recovery or a retreat to old habits, depending on how the economy is managed. Lets now assess the outlook and implications.

Despite the relatively robust underlying fundamentals and the best budget we could expect from an administration focused on successful political transition, the macro outlook for Nigeria is continued recession and no per capita GDP growth during 1999.

The economy handed over to the civilians at mid year will be fundamentally sound and ready for growth inducing policies that can quickly stimulate rapid economic growth, particularly with all external constraints removed due to a successful political transition. Both types of external funding sources – debt and equity capital – will be available in significant quantities ***if*** Nigeria continues with past policy successes and adds those reforms which will complete the picture of a positive investment climate.

For our purpose, two questions arise. First, will the civilian government take advantage of this opportunity, or mess up this historic moment? Second, how should private sector managers and investors take actions as we near the crossroads?

Neither question has a clear-cut answer but it would not be fair to say – "it all depends." Of course, it does depend on who is elected and what their economic policy is, who their advisors are and how committed they are to Nigeria's long term economic development. It also depends on which policy reforms are introduced and how well they are implemented. Finally, it also depends on private sector confidence, appreciation of opportunities opening up, resources and capabilities, and willingness to invest long term rather than speculate or go for trading gains. So despite the many ifs in my crystal ball, lets at least look at the forces at play thereby helping to focus on how the nation and private sector should approach the near term.

In my view, there are six forces at play which merit our close and continuous monitoring:

(1) The degree of shared commitment to implement VISION 2010 (as further defined by the November 1998 Economic Summit and by serious efforts behind party manifestoes) to put Nigeria on a rapid growth trajectory.

(2) The continuity for most economic policies recently implemented by military administrations without civilians succumbing to populist programmes, thus making a U-turn to return to past, dead-end economic thinking.

(3) The successful achievement of debt relief negotiations followed by disciplined implementation that earns Nigeria significant debt reduction.

(4) The successful calming down of violence in oil producing communities so that both production and future investment continue at high levels, thereby preparing for the good times that can come as oil prices recover.

(5) The commitment to free market prices so that petrol smuggling, speculation against the Naira and capital flight are not allowed to undermine basically sound economic policies.

(6) The commitment to privatization and to allowing free competition to regulate markets for the benefit of consumers.

Good managements will monitor these six areas closely and continuously, then take action accordingly. With the past history in mind, including the grudging and half hearted implementation of progressive reforms, one can not honestly expect a perfect record or even high marks for those managing the economy. But I want to close with a caveat that perhaps focuses on a silver lining.

Nigeria is an under-managed economy whose principal need is to overcome wastage of resources, improve the performance of investments already in place, and free up the private sector to exploit numerous high potential opportunities. Regardless of global outcomes, progress on these fronts is almost totally in our own hands.

Nigeria has surprised the world with its recent economic reforms, with VISION 2010 and with the political and social gains of the past seven months. Nigeria is learning from its past and, with fewer resources available to squander, can make the transition to civilian rule without losing its way. In fact, in my view, the hard part has been done. Now we must stay the course and continue to make progressive reforms until an economic success formula results.

It is entirely possible that we are seeing the absolute bottom of Nigeria's economic decline and ***now*** is the time to plan for expansion and new investments. This is a far freer economy than either 5 or 15 years ago. The running room provided to the private sector is relatively attractive now and the major uncertainty focuses on future policy consistency.

All private sector eyes will be on this and the next administration as to how they implement the 1999 Budget and how they manage the economy. Good management can bring economic breakthrough from the year 2000 onwards while bad management can set us back an undefinable number of years and undermine the entire democratic transition. The jury is still out – and the verdict will be known by this time next year.