Segun
Book 3 -
Chapter 2

NIGERIA'S SEARCH FOR SUSTAINABLE DEVELOPMENT: DEFINING AN ECONOMIC GROWTH STRATEGY FOR THE 1990'S

CHAIRMAN
DISTINGUISHED LEADERS
LADIES AND GENTLEMEN

It is a pleasure to continue the tradition of honouring Nigeria's distinguished business leader - Henry Fajemirokun. Let me congratulate the Chamber for its continued sponsorship of these annual lectures and say thanks for the opportunity to speak out on major economic issues confronting Nigeria during the decade ahead. I see a need for urgency and boldness in addressing these issues if Nigeria is to make significant progress towards realizing its enormous potential.

My lengthy title was chosen purposefully. My paper deals with both what and how. What Nigeria must search for is sustainable development. How is to focus on key strategic ingredients which generate long term economic growth.

Why does Nigeria need to focus on sustainable development? Put simply, Nigeria is a petroleum based economy which has yet to utilize this enormous, wasting asset to effectively develop the rest of its economy. Today's Nigerian economy is therefore artificially based. It is only a matter of time before global competitive reality must be faced. Our economic priority must therefore be to use the time available to develop viable and self renewing agricultural, industrial and service sectors while managing our natural resources optimally to provide most of the initial funding. The task is easily defined but by no means easy to accomplish, particularly in a society which has gotten used to spending its oil revenues on consumption and low return investments.

It is possible we cannot avert major economic and political crisis given the existence of three major negative forces, plus the existing external debt burden and the human tendency to put off problem solving until a crisis develops. The three negative forces are long term in nature and require immediate fundamental policy changes to address their debilitating consequences. They are - widespread poverty, environmental deterioration, and excessive population growth. Since the external debt burden continues to grow steadily despite temporary rescheduling relief, these three negative forces threaten to overwhelm whatever progress may be expected from current economic programmes during the years ahead. These negatives should point Nigeria towards strategies capable of producing a quantum leap forward rather than merely tinkering with existing economic systems. I will therefore focus on a few rather far reaching concepts which can lead to breakthrough in Nigeria's economic development. What I hope to make clear is that Nigeria must set its mind to grow continuously at say the 5 to 10% level in order to outrun the negatives it faces. Hence, my major title deals with - "Nigeria's Search for Sustainable Development".

The sub-title deals with how. It recognizes that SAP (Structural Adjustment Programme) seeks to correct past economic policies and to lay the foundation upon which growth programmes can be built. There is strong recognition today that SAP represents an economic process which must be continued indefinitely. It is also obvious that inflation is economic enemy number one and that Nigeria must not stumble into Latin American style inflation cycles. There appears less clear understanding that economic policies must continuously evolve to cope with changing global economics if Nigeria is ever to produce sustainable growth. Analysis must therefore go beyond SAP to build on its strengths and search for economic strategies which create solid, long term growth. This is a competitive endeavour. Almost every other country out there is trying to do exactly the same thing. Hence, in an increasingly interdependent and competitive world, we must constantly seek new strategies which produce growth and competitiveness despite continuously shifting global markets. My sub title therefore deals with - "Defining an Economic Growth Strategy for the 1990's".

Given today's enormous changes in the global economic and political scene, it is obvious no one has the crystal ball to chart an ever changing path through the uncertain and demanding decade ahead. There is no way to forecast or prophesy accurately about the future. We should be humble about this fact of life. But we can deal with the fundamental underlying forces shaping Nigeria today and utilize this insight together with the limited wisdom available as to what seems to be working globally to produce sustainable growth. Our task is therefore to explore those major economic issues which Nigeria's leaders must face during the 1990's and seek to discern how those issues should be addressed in the context of the 5-10% annual growth rates required for stable economic, political and social progress.

My paper will therefore first address Nigeria's current economic setting, then turn to the global economic forces at work. Thirdly, we will explore five major economic issues which are crucial to address during the 1990's, then finally discuss the process of shaping the overall strategy which would lead to sustainable growth.

NIGERIAN'S CURRENT ECONOMIC SETTING

Forward progress since 1985 on the economic policy front has been little short of a miracle. Structural reform has put many of the necessary foundation blocks in place for Nigeria to begin to build upon for sustainable future growth. What is needed now, more than anything else, is time. Time for past sacrifices and policy changes to pay off. Time for an attractive investment climate to be put into place and marketed successfully. Time for employment generating investment to occur and thereby trigger Nigeria's economic recovery. Time as the crucial ingredient emphasizes the need for policy continuity - particularly the continuation of SAP and further liberalization towards market oriented economic systems.

But we all know that no leadership has an unlimited time to produce results. Today's leadership has the even more important challenge of finding the right transition to democratic governance as its overriding priority. The crucial question therefore is whether there will be enough time for economic reform to take root and to produce sustainable results. Put simply - is time running out?

Clearly, one of the most difficult leadership tasks of our time is to convert centrally run economies to private sector led, decentralized, and market oriented economies. Ours is an age of experiment, with the Eastern European countries and most of the entire Third World simultaneously attempting the same uphill task. The task is made particularly difficult - and even unpredictable - by the requirement for the public to sacrifice for up to a decade or more before seeing tangible, sustainable results. The development process - as demonstrated particularly in Asian countries - is very strong after it takes root but it takes a lengthy period to get the roots firmly established.

What is particularly risky in the process is the requirement for the establishment (the rich, the elite, the leadership, etc.) to make similar sacrifices - and be perceived by the public as making sufficient sacrifices -- in order for political/social systems to hold together. In simple words, the public must support its leadership over a sufficiently long time period and they must believe in its "light at the end of the tunnel".

We cannot predict whether Nigeria will have sufficient time to reach critical mass or not. But we can usefully review current economic status in the context of this overall question since this will help us define the issues to be addressed in the 1990's.

A sketch will be sufficient - since the excellent HBSAN budget reviews, CBN economic reviews and recent World Bank studies should satisfy those interested in deeper analysis. I would particularly commend the recent World Bank study - "Sub-Saharan Africa: From Crisis to Sustainable Growth", for its useful statistics and its comprehensive overall agenda for Africa to consider during the 1990's.

We can quickly characterize the 1990 Nigerian economy as follows -

- moving gradually with considerable slippage through a fundamental restructuring of both private and public sectors, driven by free market forces and public sector rationalization. These forces are significantly reorienting Nigeria's spending habits and resource allocation patterns in a positive direction.

- growing, after almost six years decline, at 3-4%. However, this represents only marginal per capita growth given population growth of 3+% and fails to meet employment generation requirements of at least one million jobs per year.

- continuing to run BOP deficits due primarily to external debt service and government capital spending.

- fighting inflation effectively but primarily with tight monetary policies which stifle private sector growth and, to a lesser degree than needed, with steps to reduce public sector deficit spending. On balance, Nigeria appears to be winning the inflation battle but again this battle is forever rather than ever being won once and for all.

- favouring agriculture, rural development and locally sourced industry through exchange rate policies which are managed to the point that such incentives are somewhat crippled and definitely not yet attracting any significant inflow of private investment.

- enjoying the benefits of relatively stable crude oil prices and high production volumes albeit in a fragile world oversupply situation which is increasingly dependent on Middle East OPEC members to maintain market discipline.

- rationalizing the public sector by privatizing selected government corporations, in whole or in part, and by systematically removing subsidies through increased tariffs for most public services.

- delaying the inevitable removal of other subsidies due to political constraints. Particularly significant are the enormous subsidy on refined products destined for Nigerian and neighbouring markets, the subsidy to new banks inherent in a foreign exchange allocation system,and the low cost funding provided to embattled banks which are increasingly unable to compete.

- underutilizing installed industrial capacity while not yet giving clear signals - particularly through exchange rate policy - that exports and locally sourced manufacturing are to be sufficiently favoured in the future.

- continuing to see more outflow of Nigerian capital and divestiture of foreign investment than positive inflows. (In reaching this conclusion, the oil sector which requires constant reinvestment was excluded.).

- continuing also to pursue rescheduling and foregiveness of external debt rather than reduced borrowing and repayment from windfall crude oil exports, which would more soundly attack the principal itself rather than simply buy time.

- improving savings and corporate working capital management dramatically by letting "real" interest rates emerge in a relatively free market for funding of financial institutions.

- leaving prices of goods, services, and labour relatively free to find their free market levels.

- taxing inflated incomes increasingly for both individuals and corporations in the formal sector through progressive rates, excess profit levies and absence of inflation relief, thereby encouraging increased drift towards the informal and untaxed sector of the economy and thereby causing a significant loss of Federal and state government revenues.

- suffering reduced demand for goods and services due to declining real incomes, thereby crippling profits and future investment incentives. Both conditions can be greatly helped, in a non-inflationary way, by individual and corporate tax relief.

This quick sketch obviously shows mixed strengths and weaknesses for today's Nigerian economy. We could hardly expect a different picture for an economy of $100 billion GDP in 1980 which had contracted to $24 billion in 1987. During this same period, per capita GNP declined from over $1,000 to the $370 level. Unreliable as statistics may be, these numbers do provide some appreciation for the sacrifice and cutback in living standards that the Nigerian public has endured. What they mask is the degree of sanitizing and housecleaning which the economy has undergone and how much sounder the foundation is than in 1985.

All in all, the picture is not an unfavourable situation particularly in view of the economy this administration inherited less than 5 years ago.

But - for a leader looking ahead at the year 2000 - there is a mammoth task ahead due to -

- the rather marginal growth rate of Nigeria's GNP,

- the 3.0 to 4.0 million new mouths to feed each year and the 1.0+ million jobs to create annually from now on,

- the $30+ billion external debt which is largely being rescheduled rather than repaid, and

- the relative disinterest shown by private sector investors in the light of their alternative global opportunities.

In my view, Nigeria has considerable room to manoeuvre, but its current economic policies show limited ability to move us onto the 5-10% growth per annum needed to outrun population, employment, debt service and public expectations for improved living standards. A breakthrough strategy is needed and it must cope with an increasingly competitive world.

GLOBAL FORCES AT WORK

We live in a fast changing and unpredictable world. A person with a crystal ball in May 1989 who predicted the past year's events would have been laughed at. Who could have believed such staggering events as but a few examples - the Chinese retreat from economic reform, the liberalization of the Russian political/economic systems, the threatened breakup of the Eastern bloc plus USSR itself, the Berlin Wall and reunification of Germany, debates over accelerated political unification of Europe and scaling down of NATO, events in Romania, etc, etc. Coming closer to home - Namibia, the transition next door in Benin, apparent trends in Gabon, Ivory Coast and Zaire, the release of Nelson Mandela, etc. are unexpectedly positive events which follow global trends. Clearly the winds of change are at work on both the political and economic fronts - particularly in Eastern Europe and increasingly throughout Africa.

What is behind these global forces at work ? What do they mean ? How are they likely to impact Africa generally and Nigeria specifically ? How must we reorient our economic strategies to cope ? These are all questions we must ask - and could wish for a crystal ball because the answers are not at all that clear.

The fundamental forces at work can, however, be discerned. The underlying economic forces stem from globalization of markets, accelerated technological development, and rapidly improving productivity capabilities. These forces have, on the one hand, created enormously intense and destabilizing competition between the major industrial countries/blocs and, on the other hand, demonstrated to the developing world that no nation has to be excluded from enjoying "the better life" since there are too many success stories around the world today for the public to believe otherwise. On the political front, increasingly knowledgeable publics are forcing their governments to either produce economic results or to give way to increasingly legitimate successors who will govern in the public interest. The public's patience increasingly wears thin when there is either sacrifice without visible results or the perception of uneven sacrifice/benefit sharing.

While one cannot predict the eventual outcome of these reform movements particularly since "status quo" forces will also be at work to reverse the reform, we can see the pressures on Africa (including Nigeria) being intensified due to the crying need for funding. Let us select only one of the global forces at work for further scrutiny - namely, funding. Funding will provide the primary pressure for reform due to our critical needs.

Virtually all funding sources today either directly reinforce the overall global trends or indirectly accomplish the same ends through conditions which are attached to the funding. We can see this at work for each funding source - exports, external debt, ODA and foreign investment, as follows:

. exports -- terms of trade can only continue to be unfavourable as more LDC's develop their commodity exports, as raw material content of finished goods continues to decline and/or be substituted for by alternatives, and as value added manufacturing and services become increasingly the source of a nation's competitive advantage.

. external debt -- regardless of debt rescheduling and debt relief (which I suspect will come grudgingly if at all), the more important trend is that less future lending from commercial sources will be available and that government or institutional finance will increasingly be on commercial terms or at least strongly conditional on economic policies such as structural adjustment programmes entail.

. ODA -- official development assistance promises to be increasingly available but most probably with increased attention to structural adjustment, to improved governance systems in the recipient country and to spending processes which ensure that benefits get to the intended beneficiaries.

. FDI -- foreign direct investment increasingly goes only where it is welcome and typically seeks ou particularly conducive investment climates among countries which are increasingly competing for this scarce resource. Moreover, it is less and less capital flows which count but access to global markets, technology and management practices which are the crucial ingredient being sought by host countries.

These forces at work on the funding side can be seen to move all in one direction - relentlessly towards forcing the recipient country towards economic, and even political, systems which increasingly follow patterns which have been successful, or to some degree proven, in either the developed world or in the successfully industrializing countries in Asia.

In the case of Africa, we can expect that Eastern Europe will provide the prime competition for scarce funds, particularly those coming from Western European sources. Africa will, in fact, need to be rather flexible and nimble to keep from being marginalized in the process of Eastern Europe's rebuilding. Africa will have to stand up and be counted if it is to avoid the inward looking force of Europe 1992 and the relatively more attractive markets and economic ties opening up throughout Eastern Europe.

There are some positive developments to be expected from disarmament (particularly "peace dividends"), continued technology advances, and heightened awareness of global environment problems. But - these positive developments will come gradually in the future whereas the current African economic crisis needs to be faced immediately. What is relevant for today's purpose is to realize that immediate funding help will come only on terms which foster continued structural reform, if it comes at all.

In my view, Nigeria cannot immediately escape these more stringent and reform oriented conditions for future funding, despite its petroleum resources and enormous potential. This is both because the source of funding wants to see genuine, long term economic development and because the investment climate in Nigeria remains relatively unattractive.

The only alternative scenario is for Nigeria to live entirely within its means and to repay external debt as it comes due. This may, in fact, be the best long term solution but hardly one that seems politically or culturally acceptable. Hence, the prognosis is for even stronger external pressures for economic reform to be exerted as a quid pro quo for future funding.

Perhaps there is a "silver lining". Internal pressures from the public and external pressures from funding sources are bound to cause future economic reform and innovation as to new economic strategies and policies. Since most countries tend to follow the line of least resistance, perhaps these pressures can lead Nigeria to significantly improved management of the economy.

We can do our part in this process by now turning to selected major issues which must be addressed if Nigeria is to attract sufficient funding to accelerate growth and demonstrate such improved economic results will increasingly serve the public interest. As Nigeria defines its Agenda for the 1990's, it should become abundantly clear that the problem is not funding, or resources generally, but how to allocate and utilize available resources effectively and efficiently.

AGENDA FOR THE 1990'S

Having established the need for accelerated growth and analyzed global trends which will reinforce pressures for continued economic reform, we can now conclude that the major issues to be addressed should go beyond "tinkering" with existing systems and should be oriented towards major breakthroughs capable of producing a quantum leap forward. The 1990's Agenda should therefore deal with the handful of key issues that can make a major difference.

My purpose is therefore to be selective as to key issues rather than comprehensive. May I therefore commend again to this audience as "must" reading, the World Bank's long term perspective study entitled "Sub-Saharan Africa: From Crisis to Sustainable Growth." This publication lays out the entire panorama of economic policy issues and options applicable to our region, then invites African leadership to design individual country programmes and specific action programmes for greater Africa cooperation. My own focus concentrates on Nigeria specifically and on issues which can make a breakthrough difference to Nigeria's growth in the 1990's.

In my view, there are five key issues around which breakthrough reform can be structured. They are -

(1) Shifting the growth burden to the private sector,
(2) Using tax reform to shift from consumption to savings,
(3) Moving from debt to equity finance,
(4) Creating an attractive investment climate, and
(5) Improving management and governance in the public interest.

Before addressing each issue, let me first aim at the sceptics who will raise the "Nigerian factor" as a way of saying "it can't be done here". My experience working with outstanding young Nigerian professionals and top managements is that it can and is being done today in Nigeria. As one of my senior Spanish partners said in explaining Spain's economic miracle, it only takes one committed generation to completely turnaround a nation in the right direction. The Babangida government has provided the start, the previously analyzed domestic and external pressures will help maintain the momentum, and now it is up to enlightened leaders willing to get behind a breakthrough agenda for the 1990's.

Shifting the growth burden

The major global lesson of the 1970's and 1980's is that centrally planned, public sector led growth represents a failed policy which, even in the best of times, barely keeps ahead of population growth. Only private sector led growth can move Nigeria into the desired 5-10% per annum growth level.

Government must cut back on its direct spending role but must not be a passive bystander. It must manage public resources more effectively and efficiently, particularly for new major capital spending projects. In Nigeria, it will also need to work aggressively to help create an enabling environment if the private sector is to take the lead in Nigeria's growth.

Since we will tackle the investment climate later, the first key issue for government to clearly address is the shift from government to private sector as Nigeria's engine of growth. This is fundamentally a matter of role and mind set, with the following policy changes signalling the new direction:

- shifting economic management to technocrats and to the private sector - as distinct from ownership, there is a clear need to shift management of economic enterprises to either technocrats or private hands. Thus far there has been little effort to do so and this area is one of the primary reasons for either divestiture or lack of new investment by foreign investors. Generally, management control rather than ownership is the key requirement for any major private investor. In addition, clear division of roles between ownership of public enterprises (exercised at the policy level) and management (exercised by technocrats at the operating level) is imperative for those economic enterprises maintained in the public sector. Moreover, such enterprises should be soundly capitalized and then required to be self funding without further recourse to government grants, subsidies or guarantees.

- shifting ownership to the private sector - this healthy process is already being implemented under the supervision of TCPC (Technical Committee on Privatization and Commercialization). The parallel quantum step forward would be to turn over new projects and new industrial areas to the private sector. Preferably this could get government out of the very large projects which create external debt service obligations and "mortgage" future oil revenues. Examples even could include exploration and production, petrochemicals, natural gas, fertilizer, etc. which would represent a major shift in policy and clearly signal private investors that government is serious about fostering private sector led growth.

- letting non-viable projects or enterprises go bankrupt - since this is the ultimate discipline in market driven systems, government must remove the situation of unlimited access to public funding which exists in most government corporations today. This would require prices regulated by either competition or regulatory processes, elimination of subsidies and tax breaks not enjoyed by the private sector, and elimination of soft loans or guarantees in excess of commercial terms. It would also require government to take a hard look at any new capital spending which does not meet commercial return on investment criteria. It is not even clear whether any public enterprise can be commercialized unless it is allowed the chance to go broke.

- <u>permitting private sector to compete with public enterprises on equal terms</u> - this policy would clearly tell investors that private capital is welcome anywhere in the Nigerian economy. One dramatic signal would be to liberalize or totally eliminate remaining ownership restrictions for oil exploration and production, mining, banking and insurance industries. These key sectors can all be controlled better through regulatory oversight combined with enhanced competition and the freed up capital would be enormous. Government could then take its time to review the proposals it would receive and decide when, and if, it wanted to divest in these industries. If it did so, again enormous capital resources could be freed up.

The above measures are needed to clearly signal the private sector that growth is in their hands. Such signal can be fortified by putting a cap on government spending of oil revenues. The first priority must be to replace this wasting asset by making exploration and development expenditures to replace/enhance crude oil reserves. Second should come external debt service, as further discussed below. There would be an enormous private sector response if all remaining foreign exchange were made available to the public and private sectors through completely competitive bidding at CBN auctions. Such an idea may seem radical or impractical, but it is exactly such major liberalization moves which are needed to foster breakthrough to higher growth rates in the 1990's.

<u>Using tax reform supportively</u>

The above measures would clearly signal the new private sector role. The second priority would be to stimulate the private sector by tax reform aimed at reducing consumption and at increasing savings/investment.

Present tax systems are focused on trade and income rather than consumption, are oppressive due to taxing inflationary profits and compensation (the latter at excessively progressive rates) and are subject to widespread abuse. The entire structure constitutes a disincentive to save and invest, tilts compensation packages towards benefits in kind which are inequitably taxed, and creates a penalty for the formal sector vs. the informal sector as well as a penalty for good corporate citizens vs. companies which openly evade taxes.

In my view, major reform to income tax systems should be pursued along the following general lines -

- individual income should be exempt from tax up to N25,000 with graduated tax brackets thereafter up to a maximum 40% rate over say N250,000. Benefits in kind should be taxed at market value and tax brackets plus allowances should thereafter be indexed for inflation. This approach will eliminate most taxpayers from filing requirements and will therefore clear the decks to implement strict tax compliance for those in taxable brackets.

This should be done aggressively and professionally. With tight collection, there should be no appreciable reduction in total collections and there could be a significant increase from tight enforcement.

- to the extent there are revenue shortfalls, direct consumption taxes should be applied on non-food goods and services. In particular, taxes on petrol could be levied at source and earmarked for education, health, transport and roads. (This would have the side benefit of reducing excessive energy consumption.) Due to the possible lower income tax receipts, care should be taken to allocate direct tax revenues appropriately to the States and LGA although collection should be at the Federation level.

- corporate taxes should be reduced to 20% on the first N1,000,000 profits and 30% thereafter with excess profits taxes totally eliminated. Withholding taxes on dividends should remain at current levels. Both measures encourage entrepreneurs and a more level playing field between formal and informal economic sectors.

- specific tax incentives (typically as tax credits) should be used to encourage investor behaviour along desired policy lines - such as exports, local raw materials utilization, specific industries, etc.

Tax reform should be targeted on three basic objectives - first, to penalize consumption in preference to stimulating savings and investment; second, to shift resources from the public sector to those private sector hands likely to spend or invest it more effectively; and, finally, to accomplish increased equity and strict compliance among all classes of taxpayers. The resulting resource availability and reallocation will have enormous breakthrough potential for the entire Nigerian economy.

Moving from Debt to Equity Financing

The third issue is to move Nigeria from debt to equity financed investments. Nigeria has certainly learned a lot about the oppressive burden of external debt. (One of my good friends expresses deep concern that it may be "eternal" debt.) Despite constructive economic programmes, external debt has increased by over $23 billion since 1980 and roughly $10 billion since 1985 (from $9 billion to low $20 billion to low $30 billion respectively). External debt now represents over 100% of Nigeria's annual GNP and it is a constant rescheduling struggle to keep debt service (principal and interest) below the targeted 30% of export earnings.

Judging from the inflationary excesses of 1988/89 and the current outcry about high interest rates which are just now becoming "real" when related to inflation rates, it appears that the private sector may still not appreciate the magnitude of the debt/equity problem in Nigeria. Unfortunately, there is not fully reliable data to quantify all variables involved at both the public and private sector levels. Hence, it is appropriate to raise key questions and issues with the aim of sparking further debate and research.

Key questions to be researched and debated would include -

- what level of external debt and annual debt service can Nigeria sustain without crippling its prospects for funding the achievement of 5-10% growth rates ?

- what debt/equity relationships should obtain in the private sector, particularly if inflation is to be kept under tight control ?

- what cleanup of public and private sector borrowings is needed to sanitize the banking system?

- what tradeoff policy should be followed by government as to rescheduling existing debt vs. repayment? and as to new borrowing?

- what government funding and guarantees, if any, should be made available to support capital spending by government corporations ?

- what policies should be followed to stimulate domestic savings, encourage capital inflows, and make equity investments attractive relative to debt financing ?

Such research and debate should particularly delve into the facts and figures behind external and domestic debt so that government and business can appreciate the true dimensions of Nigeria's debt problem. These answers lie outside the scope of today's paper but we can sketch out several concepts to be explored in searching for breakthrough solutions for the 1990's.

In the first place, it is well to understand that use of debt is intimately linked to its practical consequences. In Nigeria, borrowers typically take advantage of both inflation and the relatively weak legal systems for enforcing debt collection. These two factors, plus the deductibility of interest for tax purposes, combine to make an irresistible bias towards debt financing. With inflation creating devaluation prospects, the natural hedge of "dollars" offshore financed by local Naira borrowing makes "Latin America" style speculation against the Naira inevitable. Debt has, in fact, become an end in itself for both public and private sector managers. There has become an entrenched tendency to buy any asset provided it can be financed by debt -- a mind set that has proven in Latin America to be as hard as cancer to cure. This mind set, allowed to continue to excess, could singlehandedly undermine all attempts at getting Nigeria to higher levels of growth. Inflation control and further free market solutions are the indicated cure of Nigeria's early stage of debt sickness.

Nigeria has wisely taken strong steps to reduce inflation, to let interest rates find their market level, and, somewhat less convincingly, to "float" the Naira exchange rate. These are all measures which, continued without giving in to "status quo" pressures for relaxation, can be depended on to educate us all about the proper use, or mix, of debt and equity.

Debt, of course, is neither intrinsically good or bad. It depends on the deal, the capital structure and the economic circumstances. If used effectively for successful investments, debt can speed up Nigeria's development and would not represent an undue burden provided it grows at a lesser rate than revenues (or GNP) which can service the debt on a timely, reliable basis. However, as we know, debt can be extremely destructive if used to fund loss making investments, or if used excessively in relation to equity capital, or if it undermines Nigeria's economic policies.

In my view, reduced and wiser use of debt throughout the public and private sectors shows considerable promise to contribute to breakthrough economic solutions. It also may opportunely have wide public support politically. Lets therefore review the reasons and explore suggestions useful to future policy makers.

The Nigerian public has repeatedly "voted" against external debt. This was a key conclusion from the "IMF Debate" and even the recent World Bank loans for education demonstrate this natural aversion is still running strong. The fundamental reason appears to be lack of trust that such funds will be spent wisely and in the public interest. Since politically it is always easier to ride with the current, we could usefully question how government could use this strong feeling for a breakthrough strategy.

Let me ask rhetorically what public support could be engendered for an external debt policy that included the following features -

- debt service policy based on principal and interest not exceeding 30% limit of crude oil export earnings. Rescheduling to then be done, once and for all, to live within these limits.

- crude oil export earnings to be budgeted conservatively and any windfalls (from unexpectedly good prices or export volumes) applied systematically against debt service.

- no new borrowing to be undertaken in the future until debt service requirements decline below 25% of crude oil export earnings.

- no borrowing at all by government corporations based on government guarantees.

- saving in advance (PAYE system) for any new major projects to be funded by the public sector and which would threaten to exceed the 25% limitation.

The above example is simply conceptual but should illustrate how Nigeria could clearly decide to no longer mortgage its future oil revenues in search of elusive development.

You may already have formed conclusions as to the kind of Nigeria this would mean, but let me continue with two related questions -

- private funding (domestic and foreign) is routinely attracted to finance major capital projects in other countries. Could this be done in Nigeria? If so, on what terms and conditions? and how to be sure the public interest is served? If not, how much would the return on these investments exceed the debt service which would be saved by project deferral? In other words, could Nigeria either attract the right private sector investment to replace the public sector or at least minimize its losses by saving interest until major projects can be funded in advance?

- would a minimum 50% equity/structure on major public sector projects provide a sounder financing structure during the time period Nigeria is re-establishing its creditworthiness?

My aim with these questions is to explore what a fundamental shift towards equity financing and private sector investment would do to bring sanity and credibility to Nigeria's economic situation. Just as importantly, the political consequences may well be to strengthen public support for SAP with limited, or no, loss of economic growth.

If the shoe fits the public sector, it must apply with equal or more relevance to the private sector. Fortunately, the banking sector can sort this out in short order provided banks are permitted to operate competitively and the supporting legal/regulatory structure is put in place.

Since banking is now an increasingly competitive industry, we can usefully focus on a few changes which could help speed up the process to the benefit of the entire economy, such as -

- maintaining strict monetary policies which assure non-inflationary credit expansion and letting bank lending rates completely free to find their own level.

- removing sectoral lending guidelines entirely (so the tendency towards bad loans is removed) and replacing the resulting gap in funding by sufficiently attractive and narrowly focused tax incentives.

- increasing requirements for banks to provide adequately (even conservatively) for loan losses, including a reasonable general reserve provision which is fully tax deductible.

- improving bankruptcy and collection mechanisms so that banks can enforce their claims on collateral much like they can in most countries.

- improving access to equity funds by moving to the concept of legal transfers for shares, without SEC price setting, at prices set between a willing seller and a willing buyer.

- improving competitiveness within the banking sector by phasing out foreign exchange allocations to banks in favour of a free market system and by withdrawing low interest rate loans to embattled banks, thereby forcing such banks to either become commercial or sell out.

- considering sale of Federal Government shares in banks to the Nigerian public so as to further increase competitiveness and market responsiveness.

Lastly, it is now time to think through removal of controls on capital export. If Nigeria is to play a dominant role in West Africa and if Nigerians are ever to create legitimate multinationals, steps must be taken to remove constraints over transfer of capital. As is well known, the outflow today through the informal markets is enormous and, being illegal, does not return to fully support the development of the Nigerian economy. Considerable creative thought should be given to how capital controls can be totally removed and simultaneously provide such incentives as would reverse the flow of capital - bringing Nigeria's wealth home to build its economy.

The above "breakthrough" ideas have only scratched the surface but they should provide food for thought that Nigeria's future must be built increasingly on equity capital and decreasingly on debt since debt has proven to reduce Nigeria's control over its economy, its access to credit and its rate of economic growth.

<u>Creating an attractive investment climate</u>

SAP itself and enabling conditions addressed by our first three issues are crucial to attract investment. Investment is the critical ingredient for growth and private sector investment is imperative if Nigeria is to sustain a breakthrough 5-10% growth rate.

I will be unusually brief for such an important ingredient of our 1990's Agenda because NACC has already spelled out its views in a position paper to President Babangida on "Attracting U.S. Investment to Nigeria: A Major Initiative Towards Sustainable Growth". The paper is worth further research by interested students of Nigerian investment and is equally relevant to all private sector investors - Nigerian or any foreign nationality.

The paper sets out the views that -

- Nigerian economic policy should move beyond SAP (Structural Adjustment Programme) to encourage sustainable growth through private sector investment,

- FDI (Foreign Direct Investment) is a useful ingredient since it brings specific and unique advantages in terms of job creation, technology transfer, capital inflows, management expertise, and linkage to global markets, and

- private sector investors should be selectively encouraged based on their support of democratic institutions and their demonstrated record of good corporate citizenship as well as their economic and technology transfer benefits.

The paper further recognizes that the existing investment climate is not attractive to the right type of investor and therefore numerous suggestions were made to provide necessary incentives, eliminate bureaucratic impediments and market Nigeria abroad. It is a pleasure to report the Ministry of Industries is following up systematically on these suggestions but I would not want this audience to think that significant private investment will come to Nigeria either quickly or because of minor modifications. There is a major uphill task to attract the right Nigerian and foreign investment.

Let us briefly explore why. First and foremost, private capital goes where it is welcome and where economic returns are commensurate with risk. This is true of both Nigerian and non-Nigerian capital. It is perhaps like saying that water runs downhill. Fundamentally, investment can be attracted but it cannot be forced to happen.

If this truism is accepted, then a second "myth" about Nigeria needs to be shattered once and for all. During the oil boom, Nigeria got the mistaken impression that it was an attractive place to invest and that we could afford to keep foreign investors out while operating porous systems which encouraged Nigerian flight capital. In hindsight, this was never really true and, with today's shrunken economy, it must be accepted that Nigeria (as well as all sub-Saharan Africa) is of marginal interest to the three major trading and investment blocs - which are focused on Europe, the U.S., and Japan. Our own private capital has learnt this lesson well and now our policies must change if we are to attract private investment to help foster Nigeria's growth.

A positive breakthrough response by private investors cannot be expected until three actions on government's part are taken - clear articulation in all policies, budgets and directives that private sector investment is to be pursued and encouraged in preference to public sector investment; clear transition to regulatory systems which monitor compliance with necessary rules <u>after</u> the fact rather than bureaucratic approvals <u>before</u> the fact; and clear demonstration that words will be converted to deeds by launching an effective marketing programme abroad to attract the right type investors.

These three actions can make a breakthrough provided, of course, that the macroeconomic and political situation continue to evolve favourably.

My own observation is that the current mindset is still resistant to private sector investment but that the continued shortfalls of funding are bringing public sector leadership slowly around to the inevitable necessity. An acceleration in this process could mark the start of investor attitude changes which would in turn lead to breakthrough growth.

<u>Improving management and governance in the public interest</u>

This issue provides the "glue" to hold the economic/political/social structure together. It recalls for me words attributed to Peter Drucker which state - "There are no underdeveloped countries, only undermanaged countries".

Drucker was simply stating what we now know that successful countries develop based on their human rather than natural resources and what really counts is how well we organize and manage ourselves.

Recent events have also brought home the lesson that governance systems are increasingly sustainable only if they produce results and those results are distributed in sufficiently equitable fashion.

Our management and governance skills and our institutions accordingly need strengthening during the 1990's and they will increasingly need to move to serve the public interest. What is it that we can constructively do to accelerate these processes, thereby assisting our pursuit of breakthrough growth ?

This issue is obviously large and goes well beyond the confines of this paper, so lets simply sketch the obvious dimensions of what must be effectively addressed -

. both public and private institutions need to be systematically improved - by making them more responsive, accountable, and relevant in serving the public interest.

. bureaucratic processes need to be simplified and in most cases either eliminated or changed to after the fact monitoring rather than before the fact approvals.

. compliance with laws, rules and regulations needs to be improved generally and administered with an even hand.

. government needs to shift towards traditional services - education, health, transport, infrastructure, etc - and to manage these public services efficiently.

. education will need at least double the resources in the future and this should extend to management development throughout both public and private sectors.

In short, there must be a massive upgrade of Nigeria's public and private sector institutions as part of creating an enabling environment for the private sector. By the nature of the task, this must be an evolutionary task, accomplished systematically over perhaps several decades of constant attention and upgrade. But being long term in nature does not make it any less urgent to start today. Moreover, it is a process that will require "all hands on deck" so the starting point is any institution where grass roots leadership can make its efforts productive. Such a massive effort, like a tree, must start at the roots.

SHAPING OVERALL STRATEGY

Despite the length of this paper, the perceptive audience will have been dismayed by the fact that his or her major issues(s) was not touched upon. And you would be absolutely right to think so.

I have deliberately gone above the level of such critical ingredients as education, health, environment, energy, transport, communications, military spending, law and order, democratic institutions, wealth distribution, ethnicity, etc. etc. All of these, and more, involve the rightful ends for Nigerian society and are crucial issues in their own right.

But - there was method in my madness. My simple minded view is that Nigeria's first priority is to bake a bigger cake - and only then can it realistically begin to allocate to the right ends. My focus therefore has been on the means to a bigger cake recognizing the political and social systems must evolve to deal with society's larger ends.

Of course, ends were not ignored but my view has been that Nigeria's political/social systems will break down inevitably unless breakthrough growth can be accomplished. Hence, the emphasis on accelerated, sustainable growth - and the bigger cake in perpetuity.

We all know the enormous difficulties to manage Nigerian effectively and even to stay on seat, let alone talk of policy continuity for the 1990's and beyond. Given these constraints, how must the overall strategy be shaped ?

In my view, there are several key ingredients for a successful recipe, including increased -

- emphasis on market oriented solutions rather than central decisions and controls,
- steps to create the enabling environment conducive to private sector growth,
- dialogue between public and private sector institutions within Nigeria, preferably along the lines of the recently successful Enabling Environment Forum.
- understanding of global developments and comparison followed by tailoring of what works elsewhere to Nigerian requirements,
- efforts to create effective regional investment and trading institutions and mechanisms,
- openness to ideas both from internal and external sources.
- attention to our basic institutions,
- etc.

In other words, the key ingredients are a series of iterative steps that lead towards better economic policy formulation, implementation, monitoring and improvement. It is a process that needs to be put in place. A continuous process of self improvement and innovation.

Most importantly, the private sector should take the initiative in making the process work. My observation is that the private sector has done too little to date and, in fact, has complained unduly about free market forces which pinch their feet rather than pushing to help government with new ideas and reforms which build consistently on the SAP foundation. Based on the record of this government, there will be both a responsible ear and readiness to act. In fact, the major moves since 1985 have been made by government with insufficient response from the private sector. The 1990's Agenda requires a pro-active strategy on the part of the private sector.

It is time for the private sector to do its homework and to approach government with -

- proposals for forums (seminars, workshops, informal dialogues, etc.) where the major issues, priorities and action plans can be discussed and agreed upon;

- specific policy recommendations which include definition of the overall context, priorities, implementation steps, etc. necessary for successful inclusion as an extension to SAP;

- overall broader programmes necessary to address Nigeria's major economic issues and priorities, including objective research, implementation plans, and mechanisms to build public and investor support;

- specific proposals for investments which meet Nigeria's requirements for accelerated, sustainable, and equitable growth.

Various chambers and professional groups should be encouraged to stimulate private sector action and to establish ongoing public/private sector dialogue. Government can then better play its role because it knows there is a partnership with the private sector.

Once this process is started, just like SAP itself, it should be continued until it works and produces specific results. The economic breakthrough will come not from any one or handful of specific reforms but by a cumulative effort that, through persistence and reinforcement of previous reform, will finally reach critical mass, thereby producing accelerated growth.

Global experience shows the process will work and, in fact, alternative systems are being discarded. But only Nigerian experience, by tailoring market oriented concepts to unique circumstances, will prove whether and how it will produce sustainable development in Nigeria.

To fail for want of trying is unthinkable. It is time to take up the challenge and to implement new strategies which build on SAP's foundation and which work for the next generation as well as our own. May the winds of change be at our back and help our progress towards sustainable development in the 1990's and beyond.

DICK KRAMER, MANAGING PARTNER, ARTHUR ANDERSEN & CO.
(Henry Fajemirokun Lecture organized by the Nigerian American Chamber of Commerce -- MAY 10, 1990)