Book 1 - Chapter 4

Segun

HBSAN/LBSAA 1995 PRE-BUDGET WORKSHOP
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STATE OF THE ECONOMY

Any discussion of the Nigerian economy today must be as analytical, objective and balanced as possible. We must avoid extremes, seek to understand different viewpoints, and focus on solutions that work.

We frequently hear pessimistic, even catastrophic, forecasts which largely ignore Nigeria's underlying strengths, including those of the informal sector. Similarly, optimistic views can be heard, primarily from government, which reveal a large gap in understanding of just how far the Nigerian economy has deteriorated in recent years and how poorly it is positioned for future growth.

Let's therefore set the stage for today's deliberations by trying to provide an unbiased analysis of the current situation, by defining the real underlying problems, and by setting out the framework for developing realistic and workable solutions.

Our analysis must look ***internally*** at ourselves and ***externally*** at the world around us.

For our ***internal*** analysis, let's focus on the Structural Adjustment Programme (SAP) and the 1994 Budget as well as the current economic outlook. We will find widespread misunderstanding and major information gaps, both of which have contributed to confusion in economic policy formulation and implementation.

Turning to the ***external***, or global, analysis, we will find that post-Cold War events have tended to marginalize Africa, including Nigeria, and to polarize Western views behind free market and democratic solutions to economic problems. Moreover, there are many economic success stories (such as the East Asian Miracle) which illustrate that the right policies, applied consistently and with discipline over decades, can lead to enormous improvement in per capita income and quality of human life.

At the end, we can recognize that Nigeria is out of step with the rest of the world. Economic development is passing us by and going to more attractive countries. We shall then be ready to ask ***why*** we have reached today's crossroads and ***what*** fundamental economic reforms must be pursued to reach our national VISION. We will clearly see the need for a ***paradigm shift*** to escape the trap we have set for ourselves.

ANALYSIS

Brief review of SAP and the '94 Budget will help us understand the current economic outlook. Our perspective can then be widened to look at global realities and the fundamental lessons learnt from global economic success stories.

SAP was adopted in 1986 in response to collapsing oil prices in the early 1980's and the results of 1970's oil boom policies which mistakenly assumed an unsustainable level of oil revenue. SAP addressed a deteriorating and clearly unsustainable economic situation. Market forces had been stifled by bureaucratic controls over prices, foreign exchange, commodity marketing, investments, etc. Government occupied the commanding heights of the economy and massive oil receipts were neither invested wisely in productive assets or in development of Nigeria's human resources

SAP itself was a bold attempt to open up the Nigerian economy and to unleash free market forces. SAP worked to reverse the 2-3% decline in GDP per annum in the early 1980's. SAP achieved 5% per annum GDP growth for 6 years (1986-1991). SAP worked very well, particularly in contrast to other African countries, and it built considerable external confidence in Nigeria.

Then, things fell apart. SAP was given a bad name, so much so that words like deregulation, free market, subsidy removal, etc. are treated with disdain today. We must therefore ask - what went wrong?

Cutting through the details, which are very well set out in the World Bank study distributed today, SAP was not allowed to work. Self interest forces made sure SAP was not implemented fully and consistently. Government did not have the foresight, or the political will, to carry the public along in support of SAP. Worst of all, the organized private sector did not fully support SAP, culminating in attempts to derail SAP as we will touch on in our 1994 Budget comments soon.

There were six fundamentals of SAP which were half heartedly implemented and therefore results were never achieved. The shortfalls were -

(1) lack of totally free markets for FX and interest rates,
(2) incomplete removal of subsidies, particularly for petrol,
(3) partial and incomplete privatization of public enterprises,
(4) lack of discipline and transparency in government spending
(5) undisciplined and hence unsuccessful, management of domestic and external debt, and
(6) failure to create an enabling environment attractive to private investment.

As a result of these "half measures" and others less fundamental, the nation made enormous sacrifices but fell short of the critical mass necessary to achieve sustainable development and results visibly helpful to the Nigerian people.

The counterattack against SAP picked up momentum from 1990 onwards. It perhaps culminated in the 1994 Budget which reversed critical elements of SAP and which, given time, will collapse of its own weight.

In fact, the 1994 Budget was a product of several forces at work. Lack of clear understanding of SAP, its pros, cons and results. The pursuit of narrow self interest. Reckless spending and runaway inflation, which is typified by around $12 billion channeled to Dedicated Accounts which have been spent with little to show for it. Political reactionism and populist policies which coincided with the need in late 1993 to gain public legitimacy and support. Lastly, and perhaps worst of all, the failure of the organized Private sector to speak out coherently in the national interest and with one voice. In fact, with the Economic Action Agenda readily available to government, we must ask why the 1994 Budget turned out as it did.

The 1994 Budget was apparently a sincere but unworkable effort to control government spending, to improve primary production, and to achieve lower inflation through regulation. Key measures to "freeze" FX and interest rates have totally crippled SAP, without putting a cohesive alternative programme in place. We have therefore turned off the private sector, causing recessionary forces to accelerate the already deteriorating economy, and driving away both Nigerian and external resources, at a time they are sorely needed to turn round the economy. We are witnessing failed economic policies which, at a time of political dominance in the nation's psyche are not properly subject to scrutiny, debate and reforms. It is entirely possible that as economic crisis sets in, it will be attributed to recent strikes rather than to policy failures. There have been a number of efforts to correct existing policies but thus far to no avail. Apparently, there is a major information gap between government and private sector which must be closed if we are to have any hope to see a 1995 Budget which gets the economy on track.

A few examples suffice to illustrate the current outlook -

- FX rates are over N70 to the dollar and interest rates are over 50% in support of massive loans chasing official FX. In addition to creating shortages of goods and increasing demand contraction as prices fully reflect replacement cost, capital flight and reduced FX inflows are combining to produce well over $1 billion shortfall in expected foreign exchange inflows. These forces are combining to push inflation over the 100% mark while unemployment and investment cutbacks are already accelerating in most industries.

- Our major FX earner is being threatened by inability to pay cash calls. Planned capital spending had already been cut by 20% in 1994 and now upstream joint ventures are being further cut back to live within available cash. Apparently, there is an information "gap", since government says cash call arrears are less than $200 m. while industry sources place it near to $900 m. The end result is less exploration and development activity than needed to offset our natural 12-15% annual decline in production capacity. Hence, there is a clear threat that the nation's FX earnings will be in steady decline from mid-1995 onwards until finally scarce FX is made available to reverse the trend.

- The downstream petroleum sector is in even worse disarray. Failure to eliminate subsidies has continued to fuel the deterioration of downstream facilities (particularly in NNPC). Smuggling has increased and become even more entrenched as more hands "own" a piece of the pie. Many are getting rich while the industry itself continues to decline toward the day when Nigeria can no longer supply its domestic refined products requirements.

- Banking has very serious problems. Distressed banks are finally starting to be addressed. Non-banking financial institutions are drying up even faster. Freezes on FX and interest rates have stifled competition, dried up loanable funds for productive purposes, and re-created enormous arbitrage conditions, which further misallocate scarce financial resources.

- Turning to industry, each has its own tale of woe - particularly textiles, FBT, tires, vehicle assembly, etc.

- Agriculture and particularly commodity exporters face disincentives unless they are able, or willing, to export illegally.

- Lastly, external debt arrears are well in excess of $6 billion with no signs yet of acceptable medium term economic plans which would win debt relief.

Perhaps, it is time to balance this negative outlook with three rays of hope. First, the informal sector continues to thrive and expand. Within limits, it provides an underpinning of the entire economy. Second, deficit spending seems to be seriously addressed (although we can expect at least N80 - N100 Bn deficit at year end once domestic debt service is included). Third, there are signs government is listening more as can be seen in initial, though incomplete, steps recently to liberalize the FX system by restoring domiciliary accounts to banks and reopening Bureaus de Change.

Three things are clear from this analysis -

(1) the economy is virtually in free fall,
(2) very fundamental reforms are necessary to restore investor and external confidence, and
(3) the 1995 Budget is critical if turnaround is to be achieved soon.

To complete our analysis, lets look ***externally*** and, very briefly, at the world around us.

What is clear, since the Cold War ended, is that the major powers, having been freed from political competition, are increasingly inclined to force their views as to free markets and democracy on countries that need their help. Being deeply in debt, as Nigeria is, we are virtually forced to accept their economic and political concepts if we want outside support, particularly if we want to qualify for debt relief.

We also know that there are major lessons to be learnt from the global economic success stories. Particularly, there are common ingredients in these success stories and they have been adapted, or tailored, to each country's circumstances.

May I quote from the World Bank's recent publication - the East Asian Miracle (p.5), as follows -

> "What caused East Asia's success? In large measure, the HPAEs (High performing Asian economies) achieved high growth by getting the basics right. Private domestic investment and rapidly growing human capital were the principal engines of growth. High levels of domestic financial savings sustained the HPAEs' high investment levels. Agriculture, while declining in relative importance, experienced rapid growth and productivity improvement. Population growth rates declined more rapidly in the HPAEs than in other parts of the developing world. And some of these economies also got a head start because they had a better educated labour force and a more effective system of public administration. In this sense there is little that is "miraculous" about the HPAEs superior record of growth: it is largely due to superior accumulation of physical and human capital.
>
> Fundamentally sound development policy was a major ingredient in achieving rapid growth. Macroeconomic management was unusually good and macroeconomic performance unusually stable, providing the essential framework for private investment. Policies to increase the integrity of the banking system, and to make it more accessible to non-traditional savers, raised the levels of financial savings. Education policies that focused on primary and secondary schools generated rapid increases in labour force skills. Agricultural

policies stressed productivity and did not tax the rural economy excessively. All the HPAEs kept price distortions within reasonable bounds and were open to foreign ideas and technology."

The study goes on to explain how development was tailored to local circumstances and to detail how specific government intervention assisted in the development process. The most important conclusion is that these similar Asian success formulas generated over 5% GDP ***per capita*** growth over a 25 year period (1965 - 1990). We in Nigeria can learn from their experience and, while also tailoring our solution to our unique circumstances, we can simultaneously regain the confidence of investors and bankers - both here and abroad.

REALITY

Let's now briefly deal with reality - the underlying causes of our economic problems.

Fundamentally, we must get the basics right. We must deal with root causes rather than tinker with existing systems and end results. Our problems are systemic - rather than the fault of a few specific policies or players in the system.

External experience indicates that we must particularly find a Nigerian way to achieve the following -

(1) high levels of domestic savings and investment,
(2) single digit inflation based on fiscal discipline, tight monetary control and deficits funded from private sources,
(3) diversified foreign exchange resources sufficient to fund development needs before our oil runs out,
(4) creation of human skills necessary to support and achieve industrialization, and
(5) steadily improving per capita income and quality of life for all Nigerians.

Our SAP experience and our recent political/economic events demonstrate the need for an economic philosophy, broadly backed by leaders and followers alike, which fosters a stable macroeconomic framework and stimulates investment and sustainable growth.

In order to create a "Nigerian Economic Miracle", we must therefore be ready to analyze our economy realistically, dialogue about the real issues, and join forces to support lasting economic reforms. In plain language, we need to stop fighting over a smaller and smaller national cake and start working together to bake a larger and larger cake from which all players can have bigger slices. To achieve this involves a battle for Nigerian minds which we must move ahead with today.

SOLUTIONS

Today's discussions represent a search for workable solutions. Let's therefore focus on the framework to develop lasting solutions without trying to be prescriptive. After all, the Economic Action Agenda already fills the economic ***prescription.***

In my view, the search for lasting solutions involves a five step process -

(1) defining VISION/MISSION for the nation - thereby starting with the end in mind

(2) developing an ECONOMIC PHILOSOPHY which provides the framework within which economic policy measures can be formulated

(3) defining specific Action Agendas or economic strategies which support the Economic Philosophy and lead to specific policies programmes and implementation.

(4) communicating to the various stakeholders and winning their support, and

(5) monitoring progress and adjusting course as required, based on continuous dialogue between all interested parties.

We have worked hard on (1) VISION/MISSION in past HBSAN pre-Budget reviews. The NES focused on point (3) ECONOMIC ACTION AGENDA and, to a limited extent, point (5) through creating private/public sector dialogue.

Our task today primarily to address point (2). ***Economic Philosophy*** provides the framework, the basis to discuss with other stakeholders, and the "glue" that holds specific policies or action steps together. Philosophy deals with ***what*** we should do to achieve our aims and ***why***? We must be free thinkers to achieve our purpose today.

To the extent time remains, Groups can deal with step (4) which is ***how*** to sell our philosophy and to win widespread support for it.

CONCLUSION

In conclusion, our ***analysis*** shows how deep the problems are and how serious the situation is today. The ***reality*** is that we must attack the root causes with fundamental and long term reforms. The ***solutions*** will require a paradigm shift in our thinking and following the five step process outlined above.

This is exactly what today's workshop is designed to achieve. In my view, the six group sessions (see agenda) are well designed to define conceptual, philosophical foundations for our national economic development. I wish you Happy brainstorming.

DICK KRAMER
September 27, 1994

FURTHER READING

(1) ***Re SAP*** - see NIGERIA STRUCTURAL ADJUSTMENT PROGRAM: Policies, Implementation and Impact. This is a Document of the World Bank published May 13, 1994, which can be requested by citing Report No. 13053 - UNI. Also, a Nigerian perspective is presented by the CBN Study Report - PERSPECTIVES OF ECONOMIC POLICY REFORMS IN NIGERIA. This is a May 1993 publication which can be requested from the Research Department, Central Bank of Nigeria.

(2) ***Re Asian success stories*** - see THE EAST ASIAN MIRACLE: Economic Growth and Public Policy. This is a World Bank Policy Research Report published for the World Bank by Oxford University Press in 1993.