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January 12, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Nigeria - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Nigeria. A draft decision appears on page 26. The background paper on recent economic developments in Nigeria was circulated as SM/83/250 on December 15, 1983.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Acquah, ext. (5)8661, or Mr. Abdi, ext. (5)8666.

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INTERNATIONAL MONETARY FUND

NIGERIA

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the 1983 Consultation with Nigeria

Approved by Oumar B. Makalou and S. Kanesa-Thasan

January 11, 1984

I. Introduction

The 1983 Article IV consultation discussions were conducted as part of a continuing policy dialogue initiated in April on a possible multi-year adjustment program that could be supported by an extended arrangement from the Fund. The Nigerian representatives who have been involved in the discussions include the Permanent Secretaries for the Federal Ministries of Finance (Mr. Abubakar Alhaji) and Planning (Mr. Chikelu); the Governor of the Central Bank (Mr. Ahmed); the Special Advisor to the President for Economic and Financial Affairs (Mr. Edozien); the Budget Advisor to the President (Mr. Onosode); the Chairman of the Productivity and Incomes Board (Dr. Ezeife); the Managing Director of the Nigerian National Petroleum Corporation (Mr. Amu), and other senior officials of the federal ministries concerned with economic and financial matters.

The staff representatives at the latest round of discussions, which were held in Lagos during the period September 7-20, 1983, were Mr. Paul A. Acquah (head-AFR), Mr. Ali I. Abdi (AFR), Mr. Clemens F.J. Boonekamp (ETR), Mr. Reinold H. van Til (FAD), Mr. Emmanuel van der Mensbrugghe (EPAFR), Mr. Moustafa Rouis (IBRD), and Mrs. Lina Turnbull (Secretary-RES). Mr. J.B. Zulu (Director, AFR) and Mr. Mtei, Alternate Executive Director for Nigeria, participated in the discussions. 1/ The report also reflects important elements of the

1/ Following the appointment of a new economic team by the President for his second four-year term, a staff team comprising Messrs. Acquah (head), Boonekamp, and van Til returned to Lagos during December 12-16 for further consultations. Also, staff teams visited Lagos during the periods March 26-April 16, May 6-14, June 7-July 1, and September 7-20, 1983, and Nigerian representatives visited Washington in September and again on October 20 in connection with these discussions. Mr. W. Mahler (FAD) and Ms. L. Ramos (secretary-ETR) participated in the mission in April, and Mrs. A. Selassie (AFR) served as a secretary during the June visit; Mr. Moustapha Rouis, a staff member of IBRD, participated in all these missions, except in the initial staff visit and the one held during May 6-16 which was devoted essentially to building up the statistical base. Mr. J.B. Zulu participated in the April mission, Mr. Sangare, Executive Director for Nigeria, participated in the April and June discussions, and Mr. Ajayi, Advisor to the Executive Director for Nigeria, participated in all but the May and December discussions.

discussions which have taken place during 1983 regarding possible use of Fund resources by Nigeria. 1/ In this connection the staff worked in close collaboration with the IBRD staff who have been conducting parallel negotiations with Nigeria on possible structural adjustment lending in support of a medium-term program for the period 1984-86. The major elements of a possible program for such lending are summarized in Appendix I. Several IBRD sectoral reports and studies undertaken over the past year provided the basis for some of the views developed by the staff of the Fund and Bank and incorporated in this report.

The last Article IV consultation was concluded by the Executive Board on September 22, 1982 (EBM/82/125). The documents for that consultation were SM/82/164 and SM/82/188. Nigeria continues to avail itself of the transitional arrangements of Article XIV.

II. Background

Over the past three years pressures in the domestic economy and on the external payments position of Nigeria, which has grown critically dependent on oil revenue, have been intensifying with the emergence of excess supply in the international oil market. The country is now faced with sharply weakened balance of payments and fiscal positions, a sizable accumulation of trade arrears, low foreign exchange reserves, and a combination of negative GDP growth and rising domestic inflation. The situation assumed the dimension of a financial crisis in the first quarter of 1982, when the oil glut prompted another round of sharp reductions in liftings of Nigerian crude; production plummeted to less than 0.7 million barrels a day (mbd) in March 1982, from an average of 2.1 mbd in 1980, and precipitated the most rapid and largest foreign exchange and fiscal revenue shortfalls experienced by the country in several years. During that quarter, with imports rising at an annual rate of some 15 percent in real terms, Nigeria lost US$2.3 billion in gross foreign reserves, following a balance of payments deficit of US$6.2 billion incurred in 1981 that was financed exclusively by a drawdown of reserves. 2/

In a move reminiscent of their response to similar difficulties brought on by the 1978 oil glut, in April 1982, with immediate effect, the authorities introduced a number of trade and fiscal measures in an

1/ On December 31, 1983 the Supreme Military Council took power; the preliminary indications are that the new authorities will support the general thrust of the policies and the positions taken by Nigeria in the discussions.

2/ As a result of the increasing balance of payments need, in April 1982 Nigeria encashed the outstanding balances of its claims on the Fund under the 1974 and 1975 oil facilities and under the SFF, used its SDR holdings, and drew its reserve tranche (SDR 308.7 million) for a total sum of SDR 662.4 million.

attempt to bring the financial situation under control. The principal policy steps taken included the reintroduction of an advance import deposit scheme, ranging from 25 percent for spare parts and raw materials to as much as 250 percent for luxury and less essential imports; a broadening of the coverage of items subject to import licensing or prohibition; upward adjustments of tariffs, to prohibitive levels in certain cases; and the tightening of administrative controls on imports and other current transactions. More importantly, the foreign exchange budget, used by the authorities under normal conditions essentially for monitoring trade and payments transactions, was deployed as an instrument for curtailing external payments transactions. A monthly limit of ₦ 800 million (about US$1.2 billion) was set on total disbursements of foreign exchange for imports and other international transactions compared with a rate of ₦ 1.2 billion a month for imports for the preceding quarter; the ceiling was subsequently lowered to ₦ 600 million per month for 1983 in January that year, the import licensing requirements were made more restrictive, and the advance deposits were reduced to 10 percent and 15 percent, respectively, for raw materials and spare parts. At the same time, the Federal Government's expenditure commitments, which had been moderated in 1981, were further reduced. A freeze was imposed on certain capital appropriations, with capital outlays being limited to ongoing and high priority projects, and an across-the-board cutback was ordered in regard to others. Also, monetary conditions were somewhat tightened; all lending rates were raised by two percentage points, bringing them into the range of 8.0-14.0 percent; and the annual ceiling on private sector credit expansion, which had remained unchanged at 30 percent for the large banks and 40 percent for the smaller ones over a number of years, was moderately lowered.

Even with the stabilization measures in place, and a recovery in oil output, the external current account and the Federal Government's finances have weakened considerably. Spurred by a US$1.50 per barrel price cut in April 1982, with retroactive effect from January 1, that year Nigeria's crude oil production rebounded, but it reached an average of only 1.29 mbd for 1982 and has been subject to an OPEC production ceiling of 1.3 mbd for 1983, compared with an actual output of 1.44 mbd in 1981 and a capacity of 2.3 mbd. Oil export earnings were sharply reduced to US$12.8 billion in 1982 and are estimated to be only US$11.2 billion for 1983, which is less than half the peak value of US$24.9 billion attained in 1980; fiscal receipts have been similarly reduced. Consequently, despite the sharp administrative cuts in imports implemented by the authorities, the external current account deficit widened in 1982 to US$7.3 billion (10.1 percent in relation to GDP) and is still estimated to amount to US$1.9 billion (2.9 percent of GDP) in 1983, The large external current account deficit in 1982, combined with an underlying weak capital account position, produced a large overall balance of payments deficit of US$6.3 billion in that year, which for the first time was financed in part by the accumulation of trade arrears in the amount of US$4.1 billion (Table 1). In 1983, a net outflow on the

Table 1. Nigeria: Selected Economic and Financial Indicators, 1980-84

	1980 1/	1981	1982	1983 Est.	1984 Proj.
	(Annual percentage change)				
National income and prices					
GDP at current prices	17.1	0.4	3.3	-0.2	18.5
GDP at constant 1977/78 prices	0.4	-5.3	-3.1	-5.4	2.5
Oil sector	-8.0	-31.7	-11.6	0.8	11.5
Non-oil sectors	3.0	1.9	-1.5	-6.4	0.9
GDP deflator	16.5	5.8	6.4	5.5	15.7
Consumer prices	10.0	20.8	7.7	21.0	25.0
Federal government finance 2/					
Federally retained revenue	35.6	-33.2	-8.9	-4.0	42.9
Total federal government expenditure	26.4	4.8	-5.9	21.4	-20.1
External trade (in U.S. dollars)					
Exports, f.o.b.	54.8	-31.7	-27.0	-12.0	13.1
Oil exports					
Value	59.2	-31.2	-25.7	-12.3	13.1
Volume	-12.9	-36.0	-18.4	1.9	13.1
Non-oil exports					
Value	-8.8	-45.2	-67.7	13.4	14.8
Volume	5.2	-44.4	-59.4	8.0	8.4
Imports					
Value	24.4	24.8	-8.4	-39.7	4.9
Volume	11.0	14.1	-14.5	-42.0	-0.1
Effective import-weighted exchange rates	10.3	2.6	5.1	10.3	...
Real (depreciation -)					
Nominal (depreciation -)	7.6	-4.4	3.1	-4.2	...
Terms of trade	52.0	-2.0	-15.0	-17.2	-4.5
Money and credit					
Domestic credit	15.0	73.7	37.2	31.5	...
Federal Government	-6.5	116.8	58.1	44.8	...
Private sector	39.3	31.7	17.8	15.0	...
Money and quasi-money	44.3	16.6	8.9	24.0	...
Velocity of money (period average)	3.9	3.3	3.1	2.6	...
	(In percent of GDP unless otherwise stated)				
Basic ratios					
Consumption	68.5	78.9	83.3	74.0	75.0
Investment	24.5	27.3	25.2	25.1	24.4
Gross domestic savings	31.5	21.1	16.7	26.0	25.0
Federal government finance 2/					
Overall budgetary surplus/deficit (-)	-0.3	-10.6	-11.0	-15.6	-3.5
Domestic budget deficit (-) 3/	-17.3	-16.3	-14.3	-16.4	-8.6
External sector					
Overall balance of payments surplus/deficit (-)	5.1	-6.4	-8.4	-4.5	0.5
Current account balance	5.0	-7.8	-10.1	-2.9	-1.7
External public debt outstanding 4/	4.7	6.4	16.5	26.0	27.2
External debt service (as per cent of exports	3.7	6.1	8.7	16.9	25.4
Including trade arrears	3.7	6.1	8.7	16.9	38.8
	(In billions of U.S. dollars)				
Oil exports	24.9	17.2	12.8	11.2	12.6
Current account deficit (-)	4.3	-6.0	-7.3	-1.9	-1.0
Overall balance of payments defic	4.5	-6.2	-6.3	-2.9	0.3
Reserves (increase -)	-4.5	6.2	2.2	--	--
Arrears (decrease -)	--	--	4.1	2.9	--
Payment on rescheduled arrears	--	--	--	--	-0.7
Payment on other arrears	--	--	--	--	-1.7
Financing gap	--	--	--	--	2.1
Gross official reserves	10.3	4.5	2.0	2.0	2.0
External payments arrears	--	--	4.1	5.2 5/	3.5
Gross reserves in weeks of import	36.4	12.7	6.2	10.2	9.8

Sources: Data provided by the Nigerian authorities; and staff estimates.

1/ The data for national accounts, money, and public finance are on a financial-year basis, i.e., March to April, and on a calendar year basis thereafter; the public finance data for 1980 are for April to December scaled up to a 12-month basis, due to a change of the financial year to a calendar-year basis effective 1981.

2/ Federal government operations are adjusted for the fiscal impact of exchange rate depreciation and partly for receipts from new revenue measures.

3/ Non-oil revenues less expenditures on domestic goods and services; in percent of non-oil GDP.

4/ Based on existing contracts and arrears.

5/ Reduction through rescheduling of US$1.8 billion.

capital account is estimated, which is expected to substantially offset the reduction in the current account deficit achieved largely through administrative cuts of 40 percent in imports during the year; another balance of payments deficit of US$2.9 billion is thus estimated for 1983. As gross official reserves had already been reduced from the peak of US$10.3 billion reached in 1980 to US$2.0 billion (or some six weeks of imports) by the end of 1982, Nigeria continued to accumulate trade arrears during the first part of 1983. The outstanding stock of such arrears rose to US$7.0 billion in August 1983. Subsequent to two rescheduling agreements reached with commercial banks, outstanding trade arrears were reduced to US$5.2 billion at the end of November 1983.

By contrast, Nigeria has remained current in servicing its medium- and long-term debt. As of the end of 1982 total outstanding public and publicly guaranteed disbursed debt amounted to some US$8.0 billion, equivalent to 10.9 percent of GDP. A little more than half (57 percent) of this debt consisted of syndicated Euromarket loans carrying an average residual term to maturity of about 4.9 years and an average interest rate of LIBOR plus 0.8 percent a year. An additional US$ 2.3 billion was owed to financial institutions in the form of export credits with an average remaining term to maturity of approximately 6.8 years and an average interest rate of 7.6 percent per annum. The debt service payments on this debt totaled US$ 1.13 billion, or 8.7 percent in relation to exports, in 1982. On the basis of outstanding contracts, including the rescheduled short-term trade arrears of US$1.83 billion, the debt service burden on medium- and long-term debt is expected to rise to a peak of US$3.6 billion (26.9 percent of projected export receipts) in 1985. Thereafter, the debt service ratio declines rapidly to 12.8 percent in 1988. The debt service capacity of the economy is strained particularly in view of the sharp deterioration in the fiscal and external payments positions, the overhang of a large stock of short-term trade arrears; some of the state governments are especially overextended and considerable administrative problems are also being encountered in monitoring and servicing public debt.

Public finances too have experienced serious deterioration in recent years, not only at the federal government level but at the state government levels as well, as the states also depend overwhelmingly on oil revenues to finance their budgets. The federal government budget, which was broadly in equilibrium in 1980, shifted into a large deficit equivalent to 10.6 percent of GDP in 1981 and 11.0 percent in 1982, and it is projected to widen again to almost 16 percent in 1983. In the absence of systematic recording and reporting on the execution of state budgets, it is impossible to judge precisely the extent of their financial difficulties. However, there is strong evidence that the state governments have not yet scaled down their expenditures to take account of the shrinkage of the oil revenue base. Since April 1982 many state governments have become increasingly unable to meet their external debt payments commitments, 1/ to discharge certain obligations to the Federal Government, or to pay the salaries of school teachers on a regular basis. As a result, the cumulative payments arrears owed by the states to the Federal Government have grown to some N 1.0 billion; in addition the states received most of the federal government budgetary transfers totaling some N 4.0 billion in 1981-82 a factor contributing to the growing borrowing needs of the Federal Government. Since the state governments have no access to external borrowing or to the domestic capital market, except with the guarantee of the Federal Government, they relied mainly on such transfers to finance their budget deficits, apart from domestic payments arrears.

During 1981-82 the annual borrowing of the Federal Government from the domestic banking system was more than N 3.5 billion (equivalent to over 25 percent of broad money at the beginning of each year) to finance the budgetary deficit; such borrowing is estimated to have increased to over N 6.0 billion for 1983. Thus, in a continuation of the pattern established since 1975, the budget has remained the source of strong monetary pressures on the economy, reinforcing the impact on domestic liquidity of the relatively easy credit policy implicit in the guidelines issued by the Central Bank in regard to the extension of credit to the private sector. In 1982 the money supply, broadly defined, rose by 9 percent, although a significant amount of private sector liquidity (some N 1.0 billion or about 6 percent of the total money stock) was sterilized through the advance deposit scheme, and a large balance of payments deficit was incurred during the year. Subsequently, the rate of monetary growth has risen to about 24 percent during 1983, with considerable acceleration becoming evident in the latter half of the year.

The above developments in external trade and in fiscal policy have severely affected domestic growth and price performance. Production continued to weaken as the sharp reduction in imports and the increasingly complex regulations governing external trade began to cause disruptions to economic activity, underutilization of productive capacity, and rising unemployment. It is estimated that real GDP declined by 3 percent in 1982 and dropped by as much as 5.0 percent in 1983, in sharp contrast to the high annual growth rate of about 9 percent recorded in the late 1970s. The shortages of imported consumer goods, moreover, exacerbated inflationary pressures in the economy. The annual rate of increase of the official consumer price index doubled in 1981 to 21 percent. Although the rise of the index was a modest 8 percent in 1982, it understated the underlying rate of inflation, given the reduced availability of imports and the increases in tariffs and other controls. It is estimated that the actual rate was at least 20 percent and that it subsequently accelerated, particularly in the last quarter of 1983. Thus, there has been a reversal of the steady decline in inflation (from high double-digit levels to just below 10 percent) that had occurred in previous years and was especially pronounced in 1980, when import policies in respect of essential consumer goods and raw materials were considerably relaxed.

1/ As guarantor, the Federal Government has met these payments obligations as they fall due.

III. Report on the Discussions

The basic thrust of the discussions was set by the widely accepted diagnosis that Nigeria's present difficulties are rooted deep in the economic and financial policies pursued by the authorities in the wake of the series of oil price increases. It was noted that since 1974 public policy has been tailored closely to expectations of sustained increases in oil revenues with the result that fiscal and monetary policies have been generally expansionary. There have been sharp increases in capital outlays, which were concentrated on infrastructure, while credit policy was actively used to promote private sector investment within high target ranges of monetary growth. Early in this period a major restructuring of civil service pay scales was combined with a sharp rise in wages and salaries, leading the way for similarly large wage settlements in the private sector. In 1981 a national minimum wage was established, which significantly boosted average unskilled labor costs ahead of productivity.

The experience has shown that, whereas these policies helped initially to achieve relatively high rates of economic expansion, growth remained sectorally uneven and the underlying external payments position remained increasingly vulnerable to fluctuations in the oil market. The pattern of investment and production favored the internationally nontradable goods sector, causing the sector to grow at an annual rate of 10.6 percent, well ahead of the rate of 3.8 percent recorded by the tradable goods sectors (Chart 1). In particular, the agricultural sector recorded slow or negative growth, with the consequence that the traditional, non-oil exports, comprising mostly agricultural products, have virtually disappeared, and serious shortfalls in staple food production have been persistent, giving rise to increased dependence on food imports. Moreover, the manufacturing sector, while expanding relatively rapidly, has grown more import-intensive and less competitive behind the protection offered by high tariffs and extensive industrial regulations. Meanwhile, the authorities sought to contain excess domestic demand pressures, fueled by the expansionary policies, and their impact on the underlying external payments position by relying in part on incomes and price guidelines but mostly on the use of an increasingly complex system of import licensing and exchange controls. The exchange rate of the naira was allowed to appreciate in effective terms as a means of countering imported inflation, when the large official foreign reserves were built up. This had the unintended effect of further distorting the domestic cost-price structure and the production incentive system.

Against this background and the medium-term outlook for resources described below, the consensus was reached with the Nigerian representatives on three basic points in the course of the policy discussions: first, that while Nigeria's present difficulties were triggered by the precipitous drop in oil revenues, they do reflect serious structural imbalances and cost-price distortions that have built up in the economy as a result of past economic and financial policies; second, that the international oil market conditions have changed in such a way that Nigeria could no longer realistically continue to frame its economic policies, and in particular its expenditure commitments, on expectations of sustained large increases in oil revenues; and third, that the economic measures introduced in 1982 and 1983 were proving to be disruptive to efficiency in resource allocation, production, employment, and trade, and, more importantly, that they are not suited to dealing with the fundamentals of the economic and financial crisis.

Accordingly, the concern of the authorities was to devise a comprehensive program for stabilization and structural adjustment measures to bring about a fundamental change in the existing pattern of domestic expenditure and production, which could also serve as a basis for Fund support to Nigeria. The objective of such an adjustment would be to revitalize the productive sectors of the economy, especially agriculture and industry; relieve pressures on the external payments position; effect an orderly liquidation of trade arrears; and establish a sound and diversified base for economic expansion at a low rate of inflation under a trade regime relatively free of administrative controls and complex restrictions. The emphasis of the discussions was placed on Nigeria's external payments outlook and the implications of this for fiscal adjustment within an appropriate government capital expenditure program measures to improve the efficiency of public corporations, monetary policy reforms, exchange rate management, tariff reform, trade liberalization, industrial promotion, and energy pricing policies.

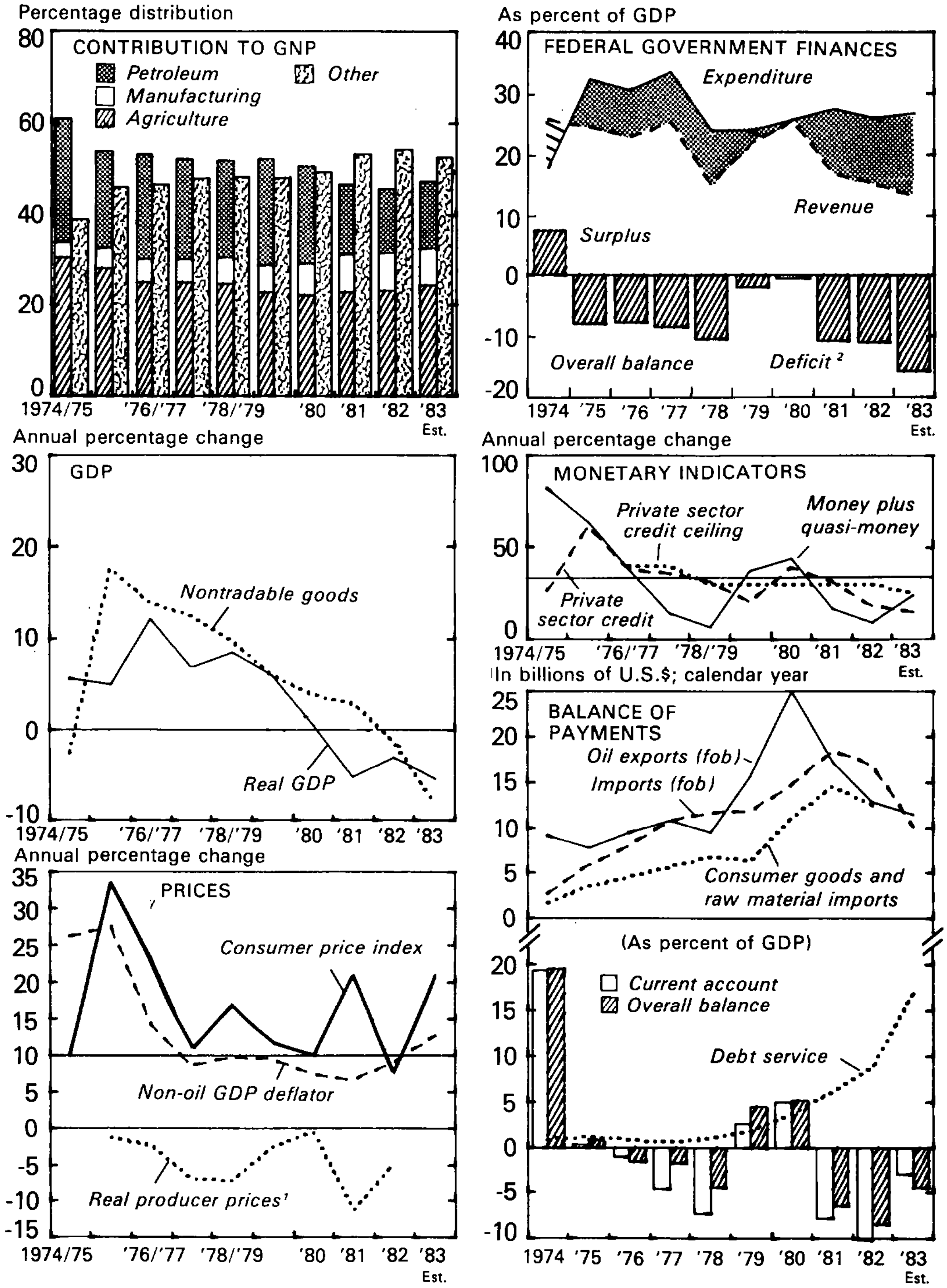
1. External payments outlook

In light of the great uncertainties regarding future developments in the international oil market, the Nigerian representatives agreed that it would be prudent to frame their policies on cautious price and output assumptions for oil. The scenario on the external payments outlook for the period through 1986, which is consistent with the pattern of adjustment discussed with the authorities, is based on the projections that Nigeria's oil earnings would rise at an average annual rate of 8.4 percent from an estimated US$11.2 billion for 1983 to US$12.6 billion for 1984 and steadily to US$14.2 billion in 1986. The working hypotheses are: (i) an unchanged nominal oil price of US$30 per barrel for the period ending 1986 and export volume of 1.15 mbd for 1984, rising to 1.3 mbd in 1986; (ii) a modest recovery of non-oil exports (presently accounting for less than 2 percent of total exports), with receipts growing at an annual rate of 15 percent through 1986 but only to a level about one third the value reached in 1978; and (iii) a marginal increase in real imports in 1984 through 1986, with the import bill projected to rise from US$10.2 billion in 1983 to US$10.6 billion in 1984 and further to about US$12.0 billion in 1986, compared with peak imports of US$18.4 billion recorded in 1981 (Table 2).

CHART 1

NIGERIA

SELECTED ECONOMIC AND FINANCIAL INDICATORS, 1974-83



Sources: Data provided by the Nigerian authorities; and staff estimates.

1 Major agricultural commodity producer prices adjusted for the consumer price index. Commodities included are cocoa (41.2%), groundnuts (12.2%), palm kernel (17.6%), and cotton (29%).

2 Deficit in 1981-83 includes off-budget domestic interest payments.

Table 2. Nigeria: Summary Balance of Payments, 1980-86

(In millions of U.S. dollars, unless otherwise specified)

	1980 1/	1981 2/	1982 3/	1983 4/	1984 4/	1985 4/	1986 4/
Current account	4,310	-6,042	-7,341	-1,933	-990	-990	-525
Exports, f.o.b.	25,956	17,718	12,930	11,372	12,860	13,408	14,544
Of which: petroleum	(24,942)	(17,162)	(12,751)	(11,169)	(12,627)	(13,140)	(14,235)
Imports, f.o.b.	-14,735	-18,390	-16,838	-10,150	-10,645	-11,201	-11,963
Services and transfers (net)	-6,911	-5,370	-3,433	-3,155	-3,205	-3,197	-3,106
Capital account	46	1,385	1,612	-1,009	1,302	525	-1,087
Direct investment (net)	-739	165	358	-158	—	70	140
Other capital (long-term)	651	811	758	2,252	1,142	361	-1,324
Of which: amortization	(-384)	(-583)	(-477)	(-1,052)	(-1,481)	(-1,847)	(-2,155)
Other capital (short-term)	134	409	496	-3,103	160	94	97
Net errors and omissions 5/	189	-1,543	-570	--	--	--	--
Overall balance	4,545	-6,200	-6,299	-2,942	312	-465	-1,612
Financing	-4,545	6,200	6,299	2,942	-312	465	1,612
Reserve movements (net) (increase -)	-4,545	6,200	2,248	--	--	--	--
Arrears	--	--	4,051	1,113	-1,721	-1,721	-1,722
Rescheduling	--	--	--	1,830	-708	-708	-414
Financing gap	--	--	--	-1	2,117	2,894	3,748
Memorandum items:							
Stock of arrears outstanding 6/	--	--	4,051	5,164	3,443	1,722	--
Stock of rescheduled arrears outstanding 6/	--	--	--	1,830	1,122	414	--
Debt service	968	1,084	1,126	1,924	4,992	5,331	5,215
Medium- and long-term: amortization	384	583	477	1,052	1,481	1,847	2,155
Rescheduled arrears: amortization	--	--	--	--	708	708	414
Cash payments on arrears	--	--	--	--	1,721	1,721	1,722
Medium- and long-term: interest	584	501	649	795	927	974	913
Rescheduled arrears: interest	--	--	--	77	155	81	11
Oil exports (mbd)	1.9126	1.2274	1.0027	1.02	1.15	1.20	1.30
Oil price (US$/barrel)	35.63	38.31	34.84	30.00	30.00	30.00	30.00
				(In percent)			
Current account to GDP	5.0	-7.8	-10.1	-2.9	-1.7	-1.5	-0.7
Export growth							
Nominal	54.8	-31.7	-27.0	-12.0	13.1	4.3	8.5
Real	-9.2	-36.3	-19.8	2.0	12.8	4.2	8.5
Import growth							
Nominal	24.4	24.8	-8.4	-39.7	4.9	5.2	6.8
Real	11.0	14.1	-14.5	-42.0	-0.1	0.2	1.7
Terms of trade change	52.0	-2.0	-15.0	-17.2	-4.5	-4.7	-4.6
Debt service to exports							
Excluding cash payments on arrears	3.7	6.1	8.7	16.9	25.4	26.9	24.0
Including cash payments on arrears	3.7	6.1	8.7	16.9	38.8	39.8	35.9
External public debt to GDP 6/ 7/							
Excluding trade arrears	4.7	6.4	10.9	18.2	21.3	17.9	13.5
Including trade arrears	4.7	6.4	16.5	26.0	27.2	19.9	13.5

Sources: Data provided by the Central Bank of Nigeria; and staff estimates.

1/ Revised.
2/ Provisional.
3/ Estimated.
4/ Staff projections.
5/ Including valuation gains (losses -) of US$177 million in 1980, -US$1,273 million in 1981, and -US$199 million in 1982.
6/ End of period.
7/ Based on contracts signed as of end-September 1983; debt prior to 1982 may be underestimated.

On this scenario, which is predicated on Nigeria continuing to follow strong adjustment policies throughout the period, the external current account deficit would decline sharply in absolute terms and move downward steadily in relation to GDP from about 3 percent in 1983 to 1.7 percent in 1984 and to near an equilibrium level by 1986, compared with 10.1 percent in 1982. The relatively small size of the deficits in relation to GDP would suggest that balance of payments viability should be attainable over the medium term, depending on developments in the capital account position, and that there may be room for a more rapid import and GDP growth and liberalization of the import and exchange systems. However, given the present trend in the capital account the outlook now is that of persistent overall balance of payments deficits, resulting in a cumulative external financing gap estimated to amount to US$8.8 billion over the period 1984-86; the annual financing gap widens from US$2.1 billion in 1984 to US$2.9 billion in 1985 and further to US$3.8 billion in 1986. If the present oil production ceiling of 1.3 mbd should remain in force throughout the three-year period and assuming present levels of domestic consumption (about 280,000 barrels a day), the financing gap would increase by an additional US$2.0 billion each year, raising the total financing need to US$14.8 billion for the period.

The main reason for the large external financing problem, even assuming a sharp reduction in the current account deficit, is that large principal payments on public and publicly guaranteed debt fall due in 1984-86, including amortization payments on the US$1.83 billion of arrears on letters of credit refinanced by commercial banks. Such amortization payments are estimated to surge from US$1.1 billion in 1983 to US$2.2 billion in 1984 and to be around US$2.6 billion per year in 1985-86. When these are combined with the servicing burden of the non-rescheduled short-term trade arrears--with payments assumed to be spread evenly over the three-year period on terms identical to those obtained under the refinancing agreement--the gross capital outflows are enlarged by an additional US$1.7 billion annually to some US$4.2 billion per year during this period. This is to be compared with projected inflows of US$1.9 billion per year based on existing contracts. On this basis, and given the historical pattern of direct investment, the capital account position is projected to show a marked deterioration in 1985 and to shift into a substantial deficit in 1986, although the current account is projected to be broadly in balance in that year.

In reviewing this picture of the external payments, the financing requirements, and the implications for the external debt profile, the authorities expressed great concern that their international transactions remain severely constrained by import payments arrears. They stated that they wanted an early settlement through negotiations with the creditors concerned to regularize the situation. The authorities agreed that, for their adjustment effort to be viable, they would need a concrete external financing plan involving the support of their major creditors on terms that would stretch out the burden of the external debt, including the trade arrears, beyond 1986 without jeopardizing the external debt position.

With the above considerations in view, the Nigerian authorities have been actively seeking refinancing of the remaining import payments arrears, which consist mainly of intercompany accounts and some suppliers' credits guaranteed by official agencies. The stock of these arrears has recently remained relatively stable at an estimated US$5.2 billion (excluding US$1.83 billion in the form of outstanding letters of credit refinanced under two separate agreements with commercial banks earlier in the year). In regard to the guaranteed suppliers' credits, the authorities stated that they would prefer to negotiate an agreement with a few major creditors; the same terms could then be offered to the other creditors as well. They have also been examining the possibility of floating bonds on the international capital market to refinance the stock of nonguaranteed trade debt. In view of the size of the financing gaps projected for 1984-86, it may also be necessary to negotiate with their creditors to refinance the amortization payments on some of the term debt, possibly the large syndicated Eurocurrency loans falling due during the period. The staff cautioned against an uncoordinated approach to refinancing the trade arrears, and underscored the need for a comprehensive financing package that is well adapted to the balance of payments needs and ensures a manageable external debt profile. The mission also underscored the importance of using available external financing to support a substantive effort designed to bring about lasting external adjustment.

2. Fiscal issues

The principal issue of fiscal policy discussed with the authorities concerned the appropriate adjustment to be made by the public sector, including the federal and state governments and the public corporations and entities, in response to the prospect of a continued squeeze on oil revenues. Given the oil revenue outlook, only modest increases in federally collected revenues were expected in 1984-86. In particular, federally retained revenues are projected to increase at an annual rate of some 7 percent during the period, assuming unchanged tax policies and converting oil revenues at the prevailing exchange rate. The Nigerian authorities recognized that, without a fundamental adjustment in fiscal policy, they would be faced not only with severe balance of payments pressures but also with unsustainably large fiscal deficits. According to staff calculations the underlying fiscal deficit would rise to over ₦ 7.0 billion annually, or nearly three quarters of the projected federal government revenues during 1984-86. This disquieting prospect reinforced the conviction of the authorities in regard to the necessity not only for mobilization of additional revenues and diversification of the tax base but also for a sharp scaling down of public expenditure.

The staff team noted that, while the authorities had indicated some adaptation in policy at the federal government level in regard to expenditure reduction, the effort made so far has not been orderly or cast in a macroeconomic framework and that it falls well short of the adjustment required. Moreover, the results achieved have been seriously eroded through increased transfers (in the form of grants and loans) to the state governments, to help them meet their expenditure commitments, and to public corporations to assist them to cover investments generally showing relatively low returns and in a number of cases to finance recurrent deficits. Furthermore, the expenditure reductions made since 1981 were concentrated mostly on capital projects, while current expenditure has been kept practically untouched. In the event, as noted above, the Federal Government's overall budgetary deficit and thus its total borrowing requirements have remained high in relation to GDP since 1981 and have risen to over 15 percent in 1983, thus continuing to exert severe strains on the domestic economy and the external payments position. In this regard the staff team expressed strong concern about the difficulties that could be encountered in analyzing fiscal operations and their impact on the economy given that there is no systematic recording of expenditure flows and that comprehensive budgetary accounts are not produced on a sufficiently current basis. By contrast there is a thorough accounting of revenue collections and distribution among the federal, state, and local governments, prepared to meet the statutory requirements of the revenue-sharing arrangements.

a. Federal Government

The scenario of fiscal adjustment discussed with the authorities entailed a reduction of the federal government deficit in relation to GDP to about 4 percent in 1984, and to about 2 percent in 1986; this would imply, without exchange rate change, a fiscal contraction equivalent to about 5-6 percent in relation to GDP in 1984. In this regard the staff pointed out that a considerable amount of revenues could be mobilized from closing the gap between the export price and the domestic price of crude, which gives rise to an economic subsidy (presently estimated at some ₦ 1.5 billion annually) on domestic consumption of petroleum products. Additional resources could also be mobilized through improvements in tax administration and collection and increased taxation of domestic trade by broadening the coverage and rates of excise duties and, in due course, the introduction of a broadly based sales tax and the progressive replacement of certain import quotas with tariffs.

On the expenditure front the medium-term adjustment would focus on two broad areas: the first is in the control of the relatively large current expenditure budget by pruning spending in such areas as current transfers and subsidies and by containing the public sector wage bill, not only as a means to rein in public spending but also as a key part of an incomes policy in an overall demand-management effort. The second is the public sector's capital expenditure program, which has an important bearing on the supply-side of the economy. Drawing on the World Bank staff's assessment, which was based on sectoral investment analysis and review of ongoing projects and existing commitments, the authorities accepted in principle that the Federal Government's capital expenditure program for 1984-86 (including funding for certain investments by public entities) cannot exceed some ₦ 4.0 billion at constant 1983 prices. Accordingly, the authorities have been undertaking a strict reordering of investment priorities around a core list of projects to be carried out over the next three years. The strategy is to emphasize consolidation of viable ongoing projects in industry and agriculture, rehabilitation and maintenance of the transport sector and existing infrastructure, selective addition to oil refinery capacity, and development of the power and energy sectors.

The authorities are strongly convinced, in line with the view of the staff that, while the brunt of the fiscal adjustment will have to be borne by the Federal Government, tight fiscal discipline will also be needed by the state governments, as well as public corporations and entities, in order to bring down total public sector spending in line with available resources and to attain their stabilization policy goals.

b. State governments

In discussing the role of the states in the fiscal effort, the staff expressed serious concern about existing weaknesses in state government fiscal operations and pointed out that certain rigidities inherent in the federal-state financial relations could raise problems for stabilization policy. It was noted in particular: (i) that information on the execution of state budgets is either not available or not sufficiently reliable to allow a meaningful consolidation and analysis of public sector financial operations; and (ii) that the the revenue-sharing arrangements and expenditure responsibilities of the three levels of government, as specified by statute, create the potential that the effectiveness of fiscal measures taken at the federal level could be neutralized by the fiscal operations of the states, given the relatively large share (45 percent) of the lower levels of government in total budgetary resources. For instance, under a policy of exchange rate flexibility of the sort that the staff sees as essential to the adjustment process, a large part of the rise in oil revenue in local currency terms due to a downward movement of the naira would accrue to the states through statutory transfers. In the absence of a sufficient degree of fiscal discipline, the additional resources would broaden the scope for state government spending, in a manner that would be inconsistent with national stabilization goals.

The Nigerian representatives explained that there is now a greater awareness than before in regard to the need to manage the economy as a unit and to pursue at the federal and state government levels policies consistent with the overall national goals. They felt confident that the National Economic Council, on which the states are represented by their governors, would provide an appropriate forum for the needed coordination of policies. The Federal Government has already given a strong signal for a scaling down of expenditures by the state and local governments.

They added that the Federal Government intends to use its financial leverage and power of persuasion to actively induce increased financial discipline and to influence the State's expenditure policies. In this regard there would be steps taken (a) to curtail access of state governments to nonstatutory federal transfers and grants; (b) to establish a firm schedule for rapid repayment of arrears owed by the states to the Federal Government; and (c) to maintain the existing foreign borrowing limits established by the Federal Government, with any future relaxation to be determined within national external borrowing ceilings. In discussing these matters, it was noted that the relatively successful agricultural development programs (ADPs) are being carried out by the states (a constitutional responsibility) and need to be well monitored and adequately financed. To this end, consideration is being given to the establishment of a mechanism, such as direct allocation of a part of the statutory transfers to the state governments as local contributions toward the financing of the ADPs, so that such projects, which are largely externally financed, are not undermined by the expenditure reductions necessary at the state government levels for short-term stabilization purposes. Indeed, agriculture is to be accorded the highest priority, and in this regard the authorities have initiated discussions with the IBRD for technical assistance on a possible institutional arrangement that could address, over time, the issue of mobilization of appropriate resources in support of the capital and seasonal credit needs of the sector. The authorities are considering a review, with technical assistance from the Fund or the IBRD, of the system of federal-state financial relationships in order to strengthen budgetary planning and expenditure control.

c. Public corporations

In discussing the public enterprise sector, the staff noted that, while the Government has channeled substantial amounts of financial resources into these enterprises, the sector as a whole continues to perform poorly. Many enterprises are operating at well below capacity and are experiencing frequent interruptions in the production of goods and services. Meanwhile, a large number of enterprises are incurring substantial operating losses and are unable to contribute to their own investment programs, while others are unable to service their debts and constitute a growing fiscal burden on the Federal Government.

The Nigerian representatives attributed the problems of the public enterprise sector to several factors, including insufficient capital, inadequate efforts to collect accounts receivable, inappropriate pricing policies, excessive government control over investment and pricing decisions, deficiencies in management and accounting practices, and insufficient incentives in the grading and salary structure to attract trained and competent managers. Drawing upon the conclusions and recommendations of a recent Presidential commission and reports by private consulting firms, the authorities took the decision to undertake a far-reaching and comprehensive reform, including implementation of a program of divestiture of enterprises of essentially commercial nature. They intend to review the situation further on the basis of a public enterprise sector study to be carried out by the World Bank during 1984.

3. Monetary policy issues

It has been a long-standing tradition for the Central Bank to accommodate private sector demand for bank credit under relatively loose credit ceilings, supported by a complex system of credit allocation distinguishing between sectors and borrowers, by a rigidly administered structure of lending and deposit rates, and even by guidelines indicating conditions for the geographical spread of commercial bank branches. In discussing the role of monetary policy, the staff urged, and the authorities agreed, that in the future monetary policy should be geared explicitly toward promoting effective economic stabilization and recovery; and that this will entail significantly reducing and containing domestic liquidity and, in particular, domestic credit expansion within relatively low target ranges of growth, combined with more flexible and realistic interest rate policy. Accordingly, monetary policy should provide strong support to a restrictive fiscal policy without losing its overall supply-side focus. Moreover, there was agreement in principle that there should be significant liberalization of the regulations governing the operations of the financial institutions so as to facilitate the process of financial intermediation and mobilization of resources for productive investment. To this end, several important steps were identified: (i) the simplification of the credit allocation guidelines by initially reducing the sectoral credit categories into three, distinguishing only among priority, productive, and other sectors, and possibly phasing out the credit allocation system over time; (ii) relating interest rates more closely and systematically to the prevailing rates on international capital markets, taking into account domestic price increases, and reducing interest subsidies for specific sectors through a combination of rate increases, and a narrowing of spreads; and (iii) restructuring the ratios governing central bank lending activity with a view to giving the Central Bank a more direct leverage on the liquidity base of the commercial banks; this would permit the authorities to pursue an active rediscount policy and gain a tighter control on the growth of domestic liquidity.

4. Exchange and trade policies

a. Exchange system

With the introduction of a number of trade measures in April 1982, Nigeria's exchange and payments system became extremely restrictive, as described in detail in SM/83/250, EBD/82/180, and the 1982 consultation reports (SM/82/164 and SM/82/188). In particular, the introduction in April that year of the requirement of noninterest bearing advance deposits on the opening of letters of credit for imports gives rise to a multiple currency practice. Although the measures introduced under the Stabilization Act (1982) had a maximum statutory duration of one year, they have been maintained (except for modest reductions in the deposit requirements for certain items), beyond the initial one-year period and also beyond the date of April 20, 1983, up to which they were granted Board approval under Article VIII. Moreover, since April 1982, Nigeria has further extended the scope and restrictiveness of the import licensing system. It has also accumulated sizable payments arrears on imports, which introduces another new restriction into the exchange and payments system. The Nigerian authorities, in commenting on these developments, stated that their overall exchange and trade policies are still undergoing a fundamental reappraisal as part of their medium-term adjustment effort. Appropriate steps would be taken to restructure the exchange and trade system as soon as possible, especially in regard to the settlement of the trade arrears. As to the advance import deposit scheme, they explained that it would have to be maintained in some form as a temporary measure, essentially for the purposes of monetary control and as a means to reinforce their demand-management policies.

b. Exchange rate policies

Since April 1974 the Nigerian authorities have shifted from a policy of pegging the naira to the U.S. dollar to an independent exchange rate policy, under which the naira rate is determined on the basis of an import-weighted basket of seven major currencies. In practice, however, the actual quotations are set in a way deemed appropriate to Nigeria's economic situation and in light of the movements of the pound sterling and the U.S. dollar; at times the nominal naira rate has been kept unchanged in terms of one or the other currency for an extended period of several quarters. Thus, the naira was de facto pegged to the pound sterling from April 1980 through June 1981 (and again from July 1983 through September 1983) and to the U.S. dollar thereafter through November 1983. During such periods, when the authorities follow a regime of a de facto peg, the cross rates implicit in the official quotations for the two currencies have tended occasionally to diverge from those prevailing on international financial markets. This leads periodically to broken cross rates, which constitute a multiple currency practice; such a situation emerged for most of the recent period beginning August 1983 but was eliminated in mid-November.

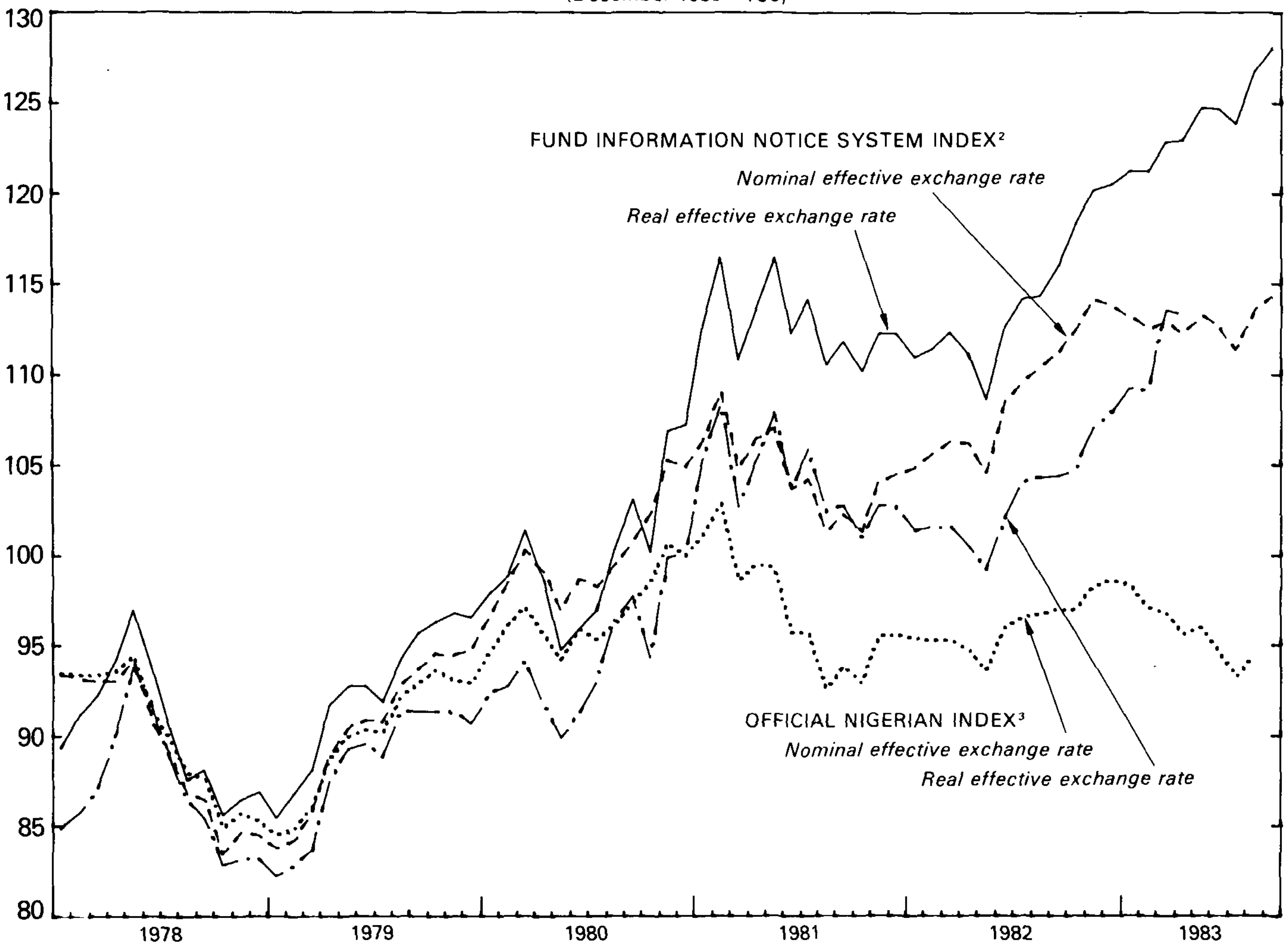
Prior to 1981 the naira quotations were essentially intended to reflect the apparent relative strength of the country's balance of payments and reserve positions and to counter the impact of imported inflation on the domestic economy. Consequently, the import-weighted effective exchange rate of the naira appreciated by some 15 percent in real terms in the three-year period ended December 1980, when there was a sizable accumulation of foreign reserves. From December 1980 through June 1983 the naira appreciated further by 13 percent in real effective terms (Charts 2 and 3); the real cumulative appreciation recorded from 1978

CHART 2

NIGERIA

REAL AND NOMINAL EFFECTIVE EXCHANGE RATES[1], JAN. 1978 - SEPT. 1983

(December 1980 = 100)



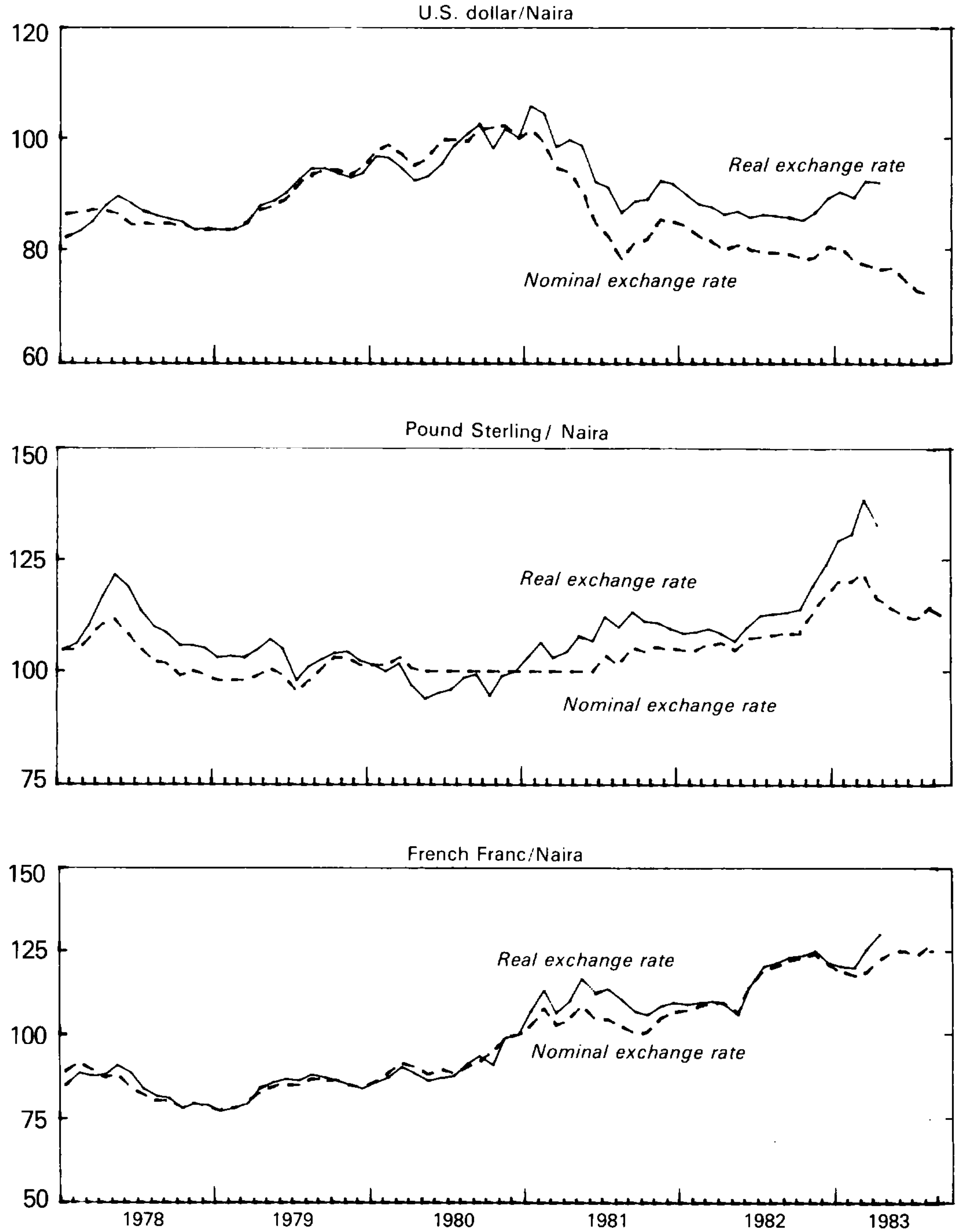
Sources: Data provided by the Nigerian authorities; and staff estimates.

[1] Upward movements indicate an appreciation of the naira.

[2] 36 currency basket used for surveillance of exchange rate policies.

[3] 7 currency basket.

CHART 3
NIGERIA
MOVEMENTS OF THE NAIRA AGAINST SELECTED CURRENCIES[1]
JAN. 1978 - SEPT. 1983
(December 1980 = 100)



Sources: Data provided by the Nigerian authorities; and staff estimates.
[1]Upward movements indicate an appreciation of the naira.

through September 1983 is estimated at 35 percent. In nominal effective terms, the naira has fluctuated within a relatively narrow band since 1980, following a steady appreciation in the preceding three-year period. For much of the period since early 1982, however, the naira quotations have been based on the effective basket rate more consistently than had been customary in the past, and the naira depreciated steadily against the U.S. dollar by 15.1 percent through September 1983.

In discussing exchange rate policy, the staff pointed out that the maintenance of a consistently overvalued exchange rate by the authorities would continue to exacerbate structural maladjustments and the cost-price distortions created in part by inflationary fiscal and monetary policies, the high nominal import tariffs in place, and the use of quantitative and other restrictions, including prohibitions, for industrial protection and, since 1982, mostly for balance of payments reasons. Empirical evidence makes it amply clear that, overall, the exchange and trade policies pursued by the authorities have given rise to a wide dispersion in incentives across different industries, including agriculture. More important, considerably higher net effective protection is being offered generally to more import-intensive light assembly and consumer-goods industries, whereas low to negative rates of effective protection are being given to others, especially export-oriented industries based on local resources and industries producing intermediate and capital goods. The consequence of this has been to place important segments of Nigerian industry at a competitive disadvantage with imports.

The staff therefore took the position that the exchange rate ought to be seen as one of the most potent supply-side policy instruments, particularly as the authorities were concerned about restructuring and diversifying the productive base of the economy. Accordingly, a significant initial exchange rate correction and subsequent flexibility in the management of the national currency should be a necessary ingredient in the package of adjustment measures. It is required to provide the appropriate price correction to the relative cost-price structure and to assist in a move toward a tariff-based effective protection and away from a predominantly quota-based protection and other restrictive trade policies for the promotion of domestic industry. The initial exchange rate depreciation would have to be large enough to offset the real import-weighted effective appreciation that has occurred since 1978 (when the trade and exchange regimes were relatively more liberal and financial policies tighter) and thus restore the profitability of traditional agricultural exports and the competitiveness of domestic industry, and it would also help create favorable market expectations and bolster confidence that the exchange value of the currency is appropriate, and reduce speculative pressures on the naira in the growing parallel market for the currency.

The Nigerian authorities acknowledged that the exchange rate is a general policy instrument that has potentially pervasive consequences for the national economy. However, they have maintained that the costs and benefits involved in the use of this instrument need to be weighed carefully, particularly in contemplating large discrete adjustments in the rate. In their view, given the present situation and peculiarities of their economy, the objectives sought under their economic stabilization and adjustment program could equally well be achieved through a mix of fiscal and other adjustment measures, combined with modest gradual changes of the naira rate to correct for the present overvaluation of the currency. Such an approach, they recognized as not constituting the best possible option in economic terms, but it was, in their judgment, necessary in order to minimize the risks and burdens seen to be inherent in recourse to an exchange rate devaluation and in the overall adjustment process.

c. Trade and industrial policies

Nigeria's exchange and trade system, as noted above, has become greatly encumbered with controls, regulations, and administrative procedures introduced or extended in light of the serious payments problems. In addition to licensing requirements covering a commodity list of 232 items, all merchandise imports are subject to advance registration under Form M and, when in an amount exceeding ₦ 5,000, also to prior clearance under preshipment inspection. Foreign exchange releases for import payments are contingent upon valid documentation in regard to these requirements, including a federal income tax clearance certificate. The system gives rise to large divergencies between financial and real rates of return and thus constitutes a source of major distortions to production incentives and expenditure patterns and a misallocation of resources. For this reason, a fundamental change in trade policies is necessary in order to create an economic environment and an incentive system conducive to efficient trade and industrial diversification. In this regard it was discussed extensively with the authorities that their economic policy objectives would be served well by a restructuring of the external tariff combined with a simplification of the customs code, a redesign of trade and export promotion policies, and a good measure of relaxation of import policies.

There was an agreement in principle on the initial policy changes and the sequence of institutional steps and other measures that could be implemented in the context of such a reform of the external trade system. Among the most important of these would be: (1) rationalizing production incentives around a narrower range of rates by (a) replacing as many quantitative restrictions as possible with appropriate tariffs and (b) reducing peak rates of protective tariffs, e.g., those on certain imported input-intensive consumer goods; (2) simplifying the tariff structure through a dismantling of the Approved User Scheme (AUS), under which substantial duty concessions on imported inputs are provided for selected industries; and (3) strengthening the export promotion measures by a reactivation of the customs drawback scheme (under which duties are reimbursable to export-oriented industries) and by the introduction of appropriate tax credits to encourage the use of local raw materials, especially for export production.

The staff proposed that, to give a strong signal to the commercial and industrial sectors about the commitment of the authorities, the tariff reform would be best carried out according to a preannounced schedule, with the clear intent to reduce dispersion of interindustry incentive levels by compressing the tariff rates on most consumer goods into a narrow range and by raising the overall rates for raw materials and for capital goods which are now mostly taxed at very low rates. To simplify the customs tariff, imports would be classified into three basic broad categories: consumer goods, intermediate goods and capital goods. Initially, relatively lower tariff rates than are now in effect would apply to essential consumption items and high but somewhat reduced rates would be levied on luxury consumer goods and assembled automobiles; intermediate and capital goods would be dutiable at relatively low rates. Over a three- to five-year period the tariffs would be progressively reduced and brought within a low modal tariff band.

For the tariff reform exercise, rates have already been established for the initial year, and provisional target rates have been set for the terminal year of the reform. The tariff rates proposed for the initial year, which is intended to be 1984, remain relatively high, largely for balance of payments reasons. The initial rates would be in the range of 15-60 percent for most products except luxury items, while the terminal rates would be dispersed narrowly in the range of 10-40 percent for most products except luxuries. The World Bank is providing technical assistance in adapting the customs code to the reform and is also ready to assist in determining the appropriate movements in tariffs to be made during 1985 and 1986 toward the established target levels.

The staff also proposed that the reform and simplification of the external tariff is best seen as an essential step in restructuring trade and industrial policy. The annual modifications to the tariff in the movement toward the target tariffs would have to be linked to a progressive liberalization of the import regime whereby (1) quantitative restrictions, including bans maintained for balance of payments reasons, would be systematically replaced by effective tariffs; (2) the relative value of imports on open general license would be progressively and significantly expanded; and (3) the number of items covered by the import licensing list would be significantly reduced or eliminated. The staff also pointed out that, to reinforce the stimulus to production incentives likely to be gained from such a fundamental change in trade policies, there would need to be a simplification of the complex regulations governing private sector investments, particularly the procedures and restrictions on the extent of sectoral participation in regard to foreign direct investment. A sufficiently outward-looking policy, the staff noted, could well result in increased inflow of direct investment and help bolster the weak capital account position in the balance of payments.

The Nigerian authorities received these proposals favorably, and followed with keen interest the technical work (e.g., the reclassification of commodities into the major categories and their clustering within the appropriate tariff bands) being carried out by the IBRD expert. However, no decision has been taken in regard to its implementation, mainly because the specified tariff structure is linked in an essential way to the exchange rate change as well as to the progressive liberalization of the trade system. In addition to the views expressed on the exchange rate policy, they also indicated a good measure of apprehension as to whether domestic industry could withstand a liberalized tariff-based protection system.

Given these considerations, the external policies favored by the authorities for 1984 are likely to be largely inward looking and restrictive of trade. First, this is reflected in their views on exchange rate policy. Second, the authorities are aiming at an increase of ₦ 600 million (US$798 million) in gross official reserves in 1984, which they believe can be achieved through continued severe direct controls on imports. Thus, while steps are being taken to simplify and shorten the import licensing and registration procedures, the thrust of their policies is in the direction of further intensification of the restrictiveness of the exchange and trade system in 1984. The staff has underlined the point that a comprehensive approach to addressing the trade and exchange policy issues is needed in order not to dissipate the gains to be achieved from taking appropriate actions in the fiscal, monetary, and other areas.

5. Energy and agricultural pricing policies

The major distortions in domestic prices are attributable to direct government intervention in two areas: the pricing of domestically consumed energy products and the pricing of certain agricultural inputs and export crops. The prevailing official price of crude oil delivered to refineries producing for the domestic market is presently fixed at US$17.95 per barrel, compared with US$30 per barrel for export sales, implying an economic subsidy rate of 40 percent for domestic use of crude oil. Similarly, for agricultural inputs the explicit budgetary subsidy rate is estimated to be as high as 85 percent for fertilizer and 50 percent for tractors, with smaller rates applying to pesticides and improved seeds. Such subsidies (excluding implicit interest rate subsidies) amounted to some ₦ 450-550 million in 1980, or about 10 percent of federal government current expenditure; in addition, agricultural credit receives a preferential rate of interest six percentage points below the maximum lending rate.

In discussing energy pricing policies, the staff noted that a World Bank staff study of pricing policies and trends in production and consumption in the energy sector provides convincing reasons for the elimination of existing economic subsidies on energy products; first on the general grounds of efficiency in resource allocation and second to shift the structure of domestic demand in such a way as to ensure conservation of Nigeria's relatively scarce resources of oil and effectively promote utilization of its relatively abundant reserves of natural gas and other energy resources. Viewed from the fiscal side, market-related pricing of energy products would generate potentially large revenues, estimated at some 12 percent of total government revenue by 1985. In light of these considerations and in view of the rapid expansion of domestic demand for crude oil at the expense of the exportable surplus, the authorities accept the principle that it would be a sound policy to significantly reduce and eventually close the gap between the prices for domestic and export sales of crude oil. The authorities envisaged to combine this with an appropriate restructuring of the retail prices of gasoline, gas oil, kerosene, and fuel oil, while giving due consideration to income distribution, and other social factors.

As regards the agricultural sector, a number of the subsidies could be phased out with considerable benefit to production and efficiency, if combined with the provision of appropriate institutional support to agriculture. The authorities have recently negotiated with the World Bank a Fertilizer Import Loan 1 (US$250 million), which has as part of its policy conditionality a reduction in fertilizer subsidies to less than half their present levels by end-1985 and to 25 percent by end-1988. It also calls for measures to improve efficiency in the distribution and use of this vital input. But, equally important, producer prices for the agricultural commodities will need to be significantly increased to correct for recent consumer price inflation and to strengthen production incentives in order to reverse the declining trend in output.

IV. Staff Appraisal

Since early 1982 Nigeria has been experiencing severe external payments problems, a sharp and widerspread deterioration in the finances of the Federal Government and the state governments, increasing slack in economic activity, and a high and rising rate of domestic inflation. The country's gross official reserves have declined to a low level, and arrears on payments for imports have accumulated to amounts burdensome to international trade.

The authorities' immediate reaction to the foreign exchange crisis, when it emerged in the wake of the glut in the international oil market, was to quickly intensify the restrictiveness of the exchange and trade system, manipulate the external tariff, and extend administrative controls and other restrictive measures in an attempt to curtail imports to balance the external accounts. Developments since these measures were put in place under the Stabilization Act (1982) and the difficult outlook for the economy provide ample evidence that the ad hoc approach could not be counted upon to resolve Nigeria's present economic problems and are more likely to compound them through their distorting impact on relative prices, economic incentives, and allocation of resources.

The authorities are now understandably concerned by the prospect of continued deterioration in the economic situation, and they have indicated their resolve to take decisive corrective measures. They recognize that, although triggered by recent developments in the international oil market, the present economic difficulties are rooted deep in the structural imbalances and cost-price distortions that have been built up in the economy as a result of past policies. It is also significant that the consensus appears to have emerged that realistic economic policies cannot be formulated around expectations of large increases in oil revenues beyond present levels, and that there is need for fiscal restraint and a belt tightening by all levels of government, as well as by public corporations and other public entities.

The staff has stressed that comprehensive adjustment measures are required to address, in a substantive way, the structural and financial imbalances in the economy and to create the basis for broadly based noninflationary growth and a viable external payments position over the medium term. This will entail a sharp and steady reduction of the fiscal deficit and its domestic bank financing; and restraint on credit and monetary growth within relatively low target ranges, at the same time that far-reaching reforms and structural changes are being carried out on several fronts to increase efficiency and productivity.

The authorities have already given strong indications about their resolve to implement fiscal austerity, credit restraint, and realistic interest rate and other policies to promote financial intermediation and savings. Appropriately, they have initiated a rationalization of the capital expenditure program with a commitment to scale down prospective spending sharply to bring this in line with the reduced availability of resources and to increase its focus on economically viable projects with potentially significant impact on economic diversification and the underlying external payments position. However, firm restraint will need to be exercised on current expenditure through implementation of appropriate recruitment and wage policy, to hold down the public sector wage bill and to support a tight incomes policy in the private sector. A fundamental re-examination of policies is also needed in regard to the transfers (including nonstatutory transfers to states) and subsidies to public entities and corporations, with a view to minimizing their burden on the federal government budget. Given the large size of the underlying fiscal imbalances, expenditure reductions will need to be combined with intensified efforts to mobilize additional revenues and also to diversify the tax base to cushion fiscal policy somewhat against fluctuations in oil revenues. The planned elimination of the subsidy now being maintained on the domestic consumption of crude oil and on refined petroleum products could release substantial resources for the budget. However, there is room for improvement in the administration of the existing tax system and for increasing the scope and rates of excise taxes, and steps should be taken toward the eventual introduction of a broadly based sales tax.

The lack of current and relevant information on the structure and execution of government budgets, which is particularly acute in regard to state budgets, could frustrate effective formulation and implementation of stabilization policies. The staff notes that many of the state governments appear to be delaying adjustment despite their growing financial difficulties. The authorities should use, as contemplated, the financial leverage and moral suasion of the Federal Government to ensure that the expenditure policies of the state governments are consistent with the requirements of national stabilization goals.

There should also be an early implementation of the various reforms (recommended by the special Task Force) of the public corporations, including, as intended, the privatization of those determined to be best run on purely commercial principles, in order to increase their profitability and their potential contribution to the budget and to national savings; price adjustments, where necessary, should be made on a regular basis.

In the staff's view, crucial policy changes are also necessary in the area of the trade and exchange system. External trade has become encumbered by an increasingly complex system of import licensing and administrative controls and excessively high tariffs and quotas, including prohibitions, for industrial protection and, more recently has been used essentially to prop up the balance of payments position, whereas the exchange rate was allowed to appreciate significantly in real terms. A continuation of this combination of trade and exchange rate policies is unlikely to reverse the historical pattern of sectorally uneven growth, increasing dependence on imports, the virtual disappearance of non-oil exports, and the development of high-cost, import-intensive, consumer goods industries. Rather, effective diversification of the domestic production base and the establishment of a competitive and dynamic agricultural and industrial structure will require an appropriate structure of price incentives and cost-price relations for domestic production of nontradable and tradable goods. Serious consideration should therefore be given to the adoption of a comprehensive reform of the external tariff into a simplified and more uniform one that would be more appropriate as an instrument of industrial promotion as well as a device for raising budgetary revenue. The staff has proposed that a reformed tariff-based protection structure, combined with progressive liberalization of imports and exchange restrictions, supported by a flexible exchange rate policy and appropriate demand-management policies, and simplified industrial regulations, would provide a sound basis for structural adjustment and economic diversification.

The staff considers that a realistic exchange rate will be especially crucial to such a rationalization of external sector policies and should be regarded as an integral part of a lasting external payments adjustment as well as a potent supply-side instrument. A viable adjustment process would thus require a significant exchange rate adjustment combined with subsequent flexibility to restore and maintain effective protection rates and restore profitability to domestic agriculture and manufacturing industries. It is to be stressed that, without appropriate changes in exchange and trade policies, the gains from fiscal and monetary policy adjustments cannot be sustained.

Even with appropriate adjustment in policies, the present outlook for the external payments is dominated by large financing gaps for 1984-86, given the large amortization payments due on public and publicly guaranteed debt and assuming liquidation of all trade arrears over this period. The adjustment policies would therefore need to be supported by a comprehensive and well-coordinated package of foreign financing, including debt refinancing, on terms which will contribute to the attainment of balance of payments viability in the medium term. The staff hopes that the authorities will reach an early agreement in the negotiations with their major creditors in regard to the trade arrears and will use the debt relief or new external financing obtained on appropriate terms to support an orderly and lasting adjustment.

Nigeria continues to maintain a number of exchange restrictions under Article XIV. Since April 1982 these restrictions have been progressively intensified. The following measures constitute practices subject to Fund approval under Article VIII: (i) payments arrears on imports have accumulated; and (ii) a noninterest-bearing advance deposit is required on the opening of letters of credit, and the official quotations of the naira have also periodically given rise to broken cross rates, each of which gives rise to a multiple currency practice. The Nigerian authorities have stated that the system of advance deposit is being maintained temporarily, partly for the purpose of monetary control; that the payments arrears are being consolidated with a view to their orderly settlement, through refinancing where possible, and, moreover, that the exchange restrictions will continue to be subject to review in light of developments in their external payments position. The thrust of external policies for 1984 however, suggests that further intensification of the exchange system is likely during the year, which would be inconsistent with Nigeria's needs for adjustment. Moreover, no program has yet been devised for an orderly settlement of the remaining payments arrears on imports. The staff, therefore, does not recommend Board approval of these restrictions and the multiple currency practice at this time.

The staff would encourage the authorities to avoid the re-emergence of broken cross rates, to remove the existing multiple currency practice as soon as possible, and to phase out the system of exchange restrictions progressively as part of a program of restructuring their economy.

It is recommended that the next Article IV consultation with Nigeria be held on the standard 12-month cycle.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Nigeria's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Nigeria, in the light of the 1983 Article IV consultation with Nigeria conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Nigeria continues to maintain several restrictions on payments and transfers for current international transactions, as described in SM/83/250. Since the last Article IV consultation Nigeria has increased the restrictiveness of its exchange system and has accumulated payments arrears on imports. It also continues to maintain a noninterest-bearing advance deposit on the opening of letters of credit, which was introduced on April 21, 1982, giving rise to a multiple currency practice subject to Article VIII, Section 3. The Fund notes that this measure was introduced for balance of payments reasons and maintained temporarily for the purposes of monetary control; the Fund encourages the authorities to remove it, as well as the other restrictions, including the payments arrears, as soon as possible.

I. Fund Relations with Nigeria

IMF data

Date of membership:	March 30, 1961
Status:	Article XIV
Quota:	SDR 849.5 million
Intervention currency and the rate (November 30, 1983):	U.S. dollar; ₦1 = US$1.3359
Local currency/SDR equivalent (November 30, 1983):	₦ 0.7864 = SDR 1
Fund holdings of Nigeria's currency (November 30, 1983):	100.0 percent of quota 1/
Net cumulative allocation of SDRs (November 30, 1983):	SDR 157.16 million
Holdings of SDRs (November 30, 1983):	SDR 25.68 million (or 16.34 percent of net cumulative allocation)
Four phases of gold distribution:	Acquired 115,536.884 troy ounces of fine gold
Direct distribution of profits from gold sales:	US$21.44 million
Last Article IV consultation :	SM/82/188, discussed by the Executive Board on September 22, 1982

1/ Nigeria encashed on April 8, 1982 the outstanding balance of its claims on the Fund under the 1974 and 1975 oil facilities and the supplementary financing facility, with the total amounting to SDR 114.9 million. Further, on April 20 it used its SDR holdings of SDR 238.9 million, and on April 26-27 it drew its reserve tranche of SDR 308.7 million.

II. World Bank Relations with Nigeria

As of October 31, 1983, the Bank had approved for Nigeria 49 loans and two IDA credits totaling US$2,327.5 million. Approximately 40 percent of these commitments has been for infrastructure, 48 percent for agricultural development, and the remaining 12 percent for education, industry, and other sectors. Total disbursements have amounted to US$1,080.6 million, and further substantial commitments are expected to be made during the period 1984-88.

During the last quarter of 1983 the Bank staff began discussions with the Nigerian authorities regarding the elements of a possible medium-term adjustment program that could be supported by structural adjustment lending during the period 1985-88, in addition to a series of sectoral and project loans. The program of policy measures proposed by the Bank staff to the Nigerian authorities was designed to interface closely with the extended Fund facility program currently under discussion with the Fund; indeed, many of the proposed elements of the extended Fund facility program were in fact drawn from the numerous sector studies already carried out by the Bank. The program proposed by the Bank aims to redress the current financial imbalances and, at the same time, to initiate the process of restructuring the Nigerian economy away from an excessive dependence on petroleum.

A key part of the adjustment consists of rationalization of the public sector investment program. The Bank staff has proposed annual capital expenditure limits that are consistent with the reduced availability of financial resources, and budgetary control mechanisms to ensure that actual expenditures remain within the appropriate limits. The Bank staff has also recommended criteria for fully funding high-priority core projects that would yield their economic gains in the immediate future. Some of the large capital-intensive projects currently under way would be postponed. As a general principle, no new projects would be started during the program period unless they were deemed to be of vital interest to the economy.

The Bank staff has also called for a revitalization of the agricultural and industrial sectors through a package of incentives, including increases in selected producer prices, market pricing of domestically consumed energy products, a substantial devaluation of the naira, a reform of the tariff system, the gradual liberalization of the restrictive import system, and export promotion measures. It is envisaged that these measures would be accompanied by efforts to enlarge and diversify the export base through fiscal incentives, the reactivation of the customs drawback scheme, as well as an export guarantee and insurance scheme and the streamlining of administrative and regulatory procedures. To ensure the successful implementation of this program, the Bank staff has proposed a number of specialized sector studies and has offered to provide technical assistance to gather and analyze relevant economic data and to monitor the implementation of the adjustment policies.

NIGERIA - Basic Data 1/

Area, population, and GDP per capita

Area	923,800 square kilometers
Population	
Total (1982 estimate)	89.2 million 2/
Growth rate	2.5 percent
GDP per capita (1982)	SDR 740

	1978/79	1979/80	1980 3/	1981 3/	1982 3/
Gross domestic product and expenditure			(In millions of naira)		
GDP at 1977/78 factor cost	30,234.8	32,033.6	32,173.8	30,470.6	29,531.8
Petroleum	6,449.4	7,512.5	6,914.6	4,719.6	4,171.8
Other sectors	23,785.4	24,521.1	25,259.2	25,751.0	25,360.0
Of which: agriculture, animal husbandry, fishing, and forestry	(7,465.4)	(7,285.6)	(7,149.1)	(6,971.4)	(6,856.3)
manufacturing	(1,778.4)	(1,908.6)	(2,244.8)	(2,508.4)	(2,458.2)
construction and housing	(3,950.3)	(3,856.0)	(4,247.5)	(4,310.0)	(4,255.6)
wholesale and retail trade	(6,203.5)	(6,911.5)	(6,928.8)	(6,919.9)	(6,782.0)
government services	(1,441.7)	(1,511.0)	(1,564.6)	(1,617.6)	(1,523.8)
GDP in current market prices	34,075.3	40,363.2	47,276.8	47,454.8	49,007.7
Gross domestic expenditure in current market prices	35,251.0	38,680.6	43,943.4	50,414.2	53,143.0
Consumption	25,364.7	29,100.4	33,377.6	37,462.5	40,803.0
Investment	9,886.3	9,580.2	11,565.8	12,951.7	12,340.0
External resource surplus or gap (-) in current market prices	-1,175.7	1,682.6	3,333.4	-2,959.4	-4,135.3
			(As a percent of nominal GDP)		
Consumption	74.4	72.1	68.5	78.9	83.3
Investment	29.0	23.7	24.5	27.3	25.2
External resource surplus or gap (-)	-3.4	4.2	7.0	-6.2	-8.5

1/ Unless otherwise stated, all data are on a fiscal-year (April-March) basis. From 1981 onward the fiscal year is January-December.
2/ Based on the 1963 census, which yielded a population count of 55.8 million, and an assumed population growth rate of 2.5 percent per annum since then.
3/ Provisional estimates.

NIGERIA - Basic Data (continued)

	1978/79	1979/80	1980 1/	1981 Est.	1982 Est.	1983 Est.
Budgetary operations of the Federal Government			(In millions of naira)			
Total revenue	7,156	12,228	15,154	13,032	12,340	12,356
Of which: petroleum receipts 2/	(4,809)	(10,096)	(12,354)	(10,010)	(9,251)	(8,663)
Statutory transfers to the state and local governments	-1,407	-3,337	-3,095	-4,975	-4,999	4,818
Federally retained revenue	5,749	8,891	12,059	8,057	7,341	7,538
Current expenditure	2,798	3,584	5,229	4,907	4,866	6,662
Capital expenditure and net lending 2/	4,136	6,064	6,973	7,884	7,173	8,305
Overall deficit (-)	-1,185	-757	-143	-4,734	-4,698	-7,429
Financing						
Foreign (net)	925	93	255	500	264	768
Domestic	260	664	-112	4,234	4,434	6,661
Banking system	(723)	(-97)	(125)	(3,526)	(3,803)	(6,161)
Other	(-463)	(761)	(-237)	(708)	(631)	(500)
Overall deficit in percent of GDP	-3.6	-1.9	-0.3	-10.1	-9.6	-15.2

	1979	1980	1981	1982	1983 Sept. 3/
Monetary survey		(In millions of naira; end of period)			
Foreign assets (net)	3,228.2	5,606.8	2,549.8	1,057.5	688.7
Domestic credit	7,347.9	8,451.2	14,680.9	20,146.9	27,291.9
Claims on public sector (net)	(2,675.1)	(1,943.7)	(6,112.0)	(10,061.4)	(15,737.9)
Claims on private sector	(4,672.8)	(6,507.5)	(8,568.9)	(10,085.5)	(11,554.0)
Money	5,161.2	7,435.5	8,788.9	9,384.5	11,192.0
Quasi-money	3,248.1	4,697.5	5,358.3	6,024.0	7,951.5
Other deposits	186.6	95.8	83.0	2,020.8	4,297.7
Other items (net)	1,980.2	1,829.2	3,000.6	3,775.0	4,539.4
Money and quasi-money (annual percent change)	21.9	44.3	16.6	8.9	22.9

1/ The 1980 budget ran for the nine months April-December between the changeover from an April-March fiscal year to a January-December fiscal-year basis. The data figures are prorated on a 12-month basis.

2/ Includes an amount of ₦ 895 million of revenues from petroleum profit tax earmarked for capital funding of joint venture activities by the Nigerian National Petroleum Corporation in 1981; an amount of ₦ 1,088 million for 1982; and an amount of ₦ 1,000 million for 1983.

3/ Preliminary estimates.

NIGERIA - Basic Data (concluded)

	1979	1980	1981	1982	1983 Est.
Consumer price indices	(Annual percent change; period averages)				
Rural	11.9	9.7	20.8	7.7	...
Urban	11.1	11.4	20.9	7.5	9.2 1/
Composite	11.8	10.0	20.8	7.7	...
Balance of payments	(In millions of SDRs)				
Current account	1,296	3,312	-5,126	-6,650	-1,807
Petroleum exports	12,117	19,171	14,563	11,550	10,440
Other exports	861	779	463	162	190
Imports	-9,167	-11,326	-15,596	-15,252	-9,488
Services and income	-993	-2,364	-2,806	-1,815	-1,910
Other goods, services, and income	-1,221	-2,505	-1,267	-957	-759
Transfers	-300	-443	-481	-338	-280
Capital account	1,044	35	1,175	1,460	-943
Direct investment	236	-568	140	324	-148
Other capital (short) 2/	8	103	347	449	-2,901
Other capital (long)	800	500	688	687	2,105
Official	(756)	(464)	(663)	(664)	(2,105)
Other	(44)	(36)	(25)	(23)	(--)
Net errors and omissions 3/	323	146	-1,307	-516	--
Total	2,663	3,493	-5,258	-5,706	-2,750
Reserve movements (increase in assets -)	-2,663	-3,493	5,258	-2,036	--
Accumulation of import payments arrears	--	--	--	3,670	2,750
Gross official foreign reserves	(In millions of SDRs; end of period)				
Foreign exchange and gold	3,803	7,579	3,126	1,713	1,117
SDR holdings	108	133	239	40	28
IMF reserve position 4/	295	371	446	--	--
Government	4	14	13	23	21
Total	4,210	8,097	3,824	1,776	1,166 5/
Exchange rate movements	(December averages; 6/ December 1980 = 100)				
U.S. dollar/naira	95.0	100.0	85.3	80.6	72.4
Pound sterling/naira	103.0	100.0	104.7	115.8	109.6
Import-weighted naira	92.9	100.0	95.6	98.6	94.4
Real import-weighted index (₦/basket)	90.7	100.0	102.7	107.9	115.8

1/ Year ended June 1983.
2/ Includes trade credit related to petroleum exports.
3/ Including valuation gains (losses -) of SDR 56 million in 1978, SDR 412 million in 1979, SDR 136 million in 1980, SDR -1,080 million in 1981, and SDR -180 million in 1982.
4/ Includes lending to the Fund's oil facility and SFF lending.
5/ End of September 1983.
6/ 1983 data is for September averages, except for real import weighted index which is for June 1983.