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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/22

10:00 a.m., February 13, 1984

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	L. K. Doe, Temporary
J. de Groote	
	X. Blandin
	R. J. J. Costa, Temporary
	M. K. Bush
	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	
	H. A. Arias, Temporary
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
	R. Bernardo, Temporary
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	E. Portas, Temporary
J. Tvedt	A. Lindø
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

Also Present

R. M. Ezeife, Principal Secretary in the Ministry of Finance of Nigeria. African Department: J. B. Zulu, Director; A. I. Abdi, P. A. Acquah, E. A. Calamitsis, S. E. Cronquist, M. Dairi, C. N. Egwim, M. Sidibe, E. van der Mensbrugghe, A. C. Woodward. Asian Department: S. P. O. Itam, R. J. Niebuhr. Exchange and Trade Relations Department: S. J. Anjaria, C. F. J. Boonekamp, S. Kanesa-Thasan. Fiscal Affairs Department: R. H. van Til. Legal Department: J. K. Oh. Research Department: A. Muttardy. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, C. J. Batliwalla, S. El-Khouri, S. M. Hassan, W. Moerke, Y. Okubo, I. R. Panday. Assistants to Executive Directors: M. B. Chatah, M. Eran, G. Ercel, C. Flamant, I. Fridriksson, V. Govindarajan, N. U. Haque, A. K. Juusela, H. Kobayashi, J. K. Orleans-Lindsay, G. W. K. Pickering, M. Rasyid, J. Reddy, D. Robinson, C. A. Salinas, N. Toé, J. C. Williams, A. Yasseri.

1. NIGERIA - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Nigeria (SM/84/17, 1/12/84; and Sup. 1, 2/7/84). They also had before them a report on recent economic developments in Nigeria (SM/83/250, 12/15/83).

Mr. R. M. Ezeife, Principal Secretary in the Ministry of Finance of Nigeria, was present at the meeting.

The staff representative from the African Department said that the recent information communicated to the staff by the authorities contained in SM/84/17, Supplement 1 related essentially to Nigeria's exchange and trade policies. Recent information on other economic policy areas was fragmentary, having been derived mainly from press reports. It suggested that the policy emphasis of the new Government was to be placed on administrative efficiency and economic austerity in general, and on fiscal discipline in particular.

A delegation of senior officials from Nigeria was scheduled to meet the staff and management on February 15, 1984, the staff representative from the African Department explained. The staff expected to be briefed on the latest developments and policy measures, and on the authorities' intention with respect to a possible arrangement with the Fund. Nigeria's 1984 budget, which had been scheduled for release and implementation effective January 1, had been withheld by the Supreme Military Council. The budget, as well as the accompanying monetary and credit policy proposals for 1984, was being re-examined to take account of the priorities of the new authorities and the fiscal implications of the dissolution of certain political institutions and government agencies. The preliminary indication was that that process should be completed by May 1984.

Mr. Mtei made the following statement:

> The economic and financial situation in Nigeria has become increasingly difficult over the past three years. Real GDP declined by an estimated 5.4 percent in 1983, following declines of 5.3 percent in 1981 and 3.1 percent in 1982. Although almost all sectors of the economy shared in the deceleration in economic activity, the situation has been most pronounced in the oil sector, which accounts for the bulk of government revenue and the country's foreign exchange earnings. The continued easing of world demand for oil, caused in part by the global recession, led to a cumulative reduction in petroleum output of more than 50 percent in 1980-82. Consequently, the oil sector's contribution to GDP dropped from 21.5 percent in 1980 to about 14 percent in 1982.
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> The reduction in oil production has had serious implications for government finances and the balance of payments. A drop in oil revenue from ₦ 12.4 billion in 1980 to an estimated ₦ 7.7 billion in 1983 was largely responsible for the widening of the overall

federal government budget deficit from the equivalent of 0.3 percent of GDP in 1980 to about 15.6 percent in 1983. The external payments position also weakened. The current account balance is projected to show a deficit equivalent to 2.9 percent of GDP in 1983, compared with a surplus of 5 percent in 1980. Meanwhile, gross external reserves, which were sufficient to cover nine months of imports in 1980, fell to a precariously low level equivalent to just 1.4 months of imports in 1982 before rising to two months of import cover in 1983. Reflecting these developments, substantial arrears on import payments began to accumulate, compounding the external debt service burden. The debt service ratio reached 16.9 percent in 1983, having grown from 3.7 percent in 1980, and it could reach 38.8 percent in 1984.

The slack in the oil market has heightened the authorities' awareness of the problems associated with the country's critical dependence on oil and of the need to expand production in the non-oil sectors. Accordingly, they have started to devise a comprehensive program for economic stabilization and structural adjustment aimed at revitalizing various productive sectors of the economy and relieving pressures on the external payments position, including effecting an orderly liquidation of trade arrears. Earlier on, they had adopted policies aimed at using oil revenue to expand productive capacity and promote the growth of the non-oil sector within the framework of the Fourth National Development Plan under which a list of priorities for government spending was established.

The Plan accorded top priority to agriculture, which accounted for 12.6 percent of planned public investment expenditure compared with a planned 7 percent share and a realized 7.2 percent under the preceding plan. In 1983, 18.9 percent of total capital expenditure was earmarked for agriculture. River Basin Authorities were established for irrigation, power, and fishing, among other things, while efforts are being made to increase the supply of inputs and to expand extension services to farmers. Steps are also being taken to improve feeder roads. Short-term and medium-term capital is made available to farmers through the Agricultural and Cooperative Banks, the Agricultural Credit Guarantee Scheme, and the Central Bank's credit guidelines to commercial banks. Apart from these arrangements, the authorities have initiated discussions with the World Bank for technical assistance to consider means by which adequate resources could be mobilized in support of the seasonal and credit needs of the sector. The authorities are aware of the importance of maintaining adequate price incentives for farmers, and in this connection it is worth noting that producer prices for the main export crops--cocoa, groundnuts, and palm kernels--are now well above world market prices. The impact of these measures on export performance is difficult to ascertain, as a significant proportion of export crops is now consumed locally by import substitution industries.

As far as foodcrops are concerned, the incentives have led to increased output. In 1981/82 maize and rice production rose by 17 percent and 120 percent, respectively. This explains in part the more than 50 percent reduction in the food import bill from over ₦ 2 billion in 1981 to less than ₦ 1 billion in 1982.

On the budgetary front, the authorities have begun the process of adjustment, which entails belt-tightening, the reordering of priorities, and adjustments by the various levels of government and public enterprises. Thus, in April 1982, budgetary expenditures were cut back by 40 percent, as a result of which total federal government expenditure and net lending in 1982 was lower in absolute amount than in 1981. The budget for 1983 was designed to hold expenditure down at about the 1982 level. The 1984 budget, presented on December 29, 1983, which proposed a 29 percent reduction in government expenditure, is now being carefully scrutinized for possible further expenditure savings, particularly in such areas as current transfers and subsidies, while efforts are being made to contain the public sector wage bill within the context of an overall demand management strategy. A new ordering of investment priorities, focusing on viable ongoing projects in such sectors as agriculture, industry, transport, power, and energy, is also under way. On the revenue side, the price of gasoline was increased in April 1982 and the subsidy element has been reduced to 40.2 percent as a result of the reduction in the oil export price that took place last March. At the same time, import duties on a wide range of goods were increased, and public sector imports became dutiable. Customs administration was overhauled with a view to improving efficiency and increasing revenue.

The states and local governments also have been directed to scale down expenditures to ensure that the burden of adjustment is not borne entirely by the Federal Government. The National Economic Council, to which all state governors belong, provides a convenient forum to effect the needed economic policy coordination to achieve this objective. However, the Federal Government has indicated that it would not hesitate to use the leverage at its disposal to influence states' budgetary behavior and policies, including the curtailment of state governments' access to non-statutory federal transfers and grants, the establishment of a firm schedule for rapid repayment of arrears owed by the states to the Federal Government, and the tightening of ceilings on external borrowing. Apart from this, the authorities are considering a review of the financial relationship between the Federal Government and the state governments, probably with technical assistance from the World Bank, to explore ways and means of strengthening budgetary planning and expenditure control.

The need to reduce the dependence of the parastatals on the government budget and to make them financially viable continues to be emphasized. To this end, the Government has set up a schedule of repayment of loans outstanding to the public corporations. The policy is also to allow increases in prices and tariffs if and when a case for such increases is established. Where weak management appears to be the problem, the authorities have not hesitated to contract the services of international consulting firms to provide the needed management skills. In 1982, a special unit was established in the Accountant General's Office to monitor the operations of public corporations and to make proposals to improve their efficiency. The Government is considering a comprehensive reform of the parastatals under which it may divest itself of unprofitable public enterprises.

Monetary and credit policies continue to aim at moderating inflationary pressures and achieving a healthy balance of payments position. Domestic credit expanded by about 44.8 percent in 1983, compared with 58.1 percent and 116.8 percent in 1982 and 1981, respectively. The authorities are taking steps to encourage a greater flow of financial resources to be channeled into the directly productive sectors. In order to promote banking habits and enhance the effectiveness of interest rates in mobilizing savings, the Central Bank through its guidelines has encouraged the geographical spread of commercial bank branches. The number of commercial bank offices and branches rose from 672 in 1980 to 917 at the beginning of 1983. Interest rates were positive in 1982, although the substantial increase in inflation rate made them somewhat negative in 1983. As part of the economic program under consideration, the role of monetary policy is being reappraised.

In the external sector, import policies aim at promoting industrialization, diversifying the economy, and supporting the balance of payments. As a consequence of increasing pressures on the external payments position, the authorities have found it necessary to introduce new administrative measures to complement tariffs early this year. These measures are not meant to become a permanent feature, as the overall exchange and trade policies are being rationalized and the tariff structure is to be simplified in the context of a medium-term adjustment strategy being formulated. It must however be stressed that trade liberalization is possible only when financing is assured.

On import payments arrears, the authorities are actively seeking refinancing arrangements. Thus far, they have succeeded in reaching agreement with commercial banks in respect of arrears under letters of credit totaling $1.83 billion. Discussions are also under way with other creditors on rescheduling the remaining trade arrears.

On exchange rate policy, the authorities have stated that the objective is to make the exchange rate reflect the strength of the country's balance of payments position and to assist in moderating the impact of imported inflation. Reflecting the deterioration in the external payments position, the currency has been allowed to depreciate by 28.6 percent, from ₦ 1.00 = $1.8718 in September 1980 to ₦ 1.00 = $1.3359 in September 1983. The authorities agree that the exchange rate should be monitored closely so as to reflect economic fundamentals and policy objectives. However, they feel that further exchange rate action has to be gradual, as no devaluation of any magnitude will have any effect on either the output or the price of petroleum. Also, the impact on the traditional export sector should not be exaggerated because of the small size of the sector and because the bulk of what used to be traditional exports are now domestic inputs for the new import-substitution industries. Steps are being taken to prevent the re-emergence of broken cross rates.

In conclusion, the problems facing the Nigerian economy are enormous. Although a reversal in the declining trend in economic activity is expected in 1984, this has to be viewed against the backdrop of uncertainty as to the strength of recovery in the world economy, the continuing deterioration in the terms of trade, and the bunching in debt service obligations brought about largely by import payments arrears and rising international interest rates. More important is a growing financing gap, which has serious implications for the success of any adjustment program without substantial capital inflows. The new Government has accorded top priority to economic recovery, and has reaffirmed its intention to continue the negotiations begun by the previous Administration with the Fund. The authorities hope that an early agreement will be reached on a program which can be supported under an extended arrangement.

Continuing, Mr. Mtei said that his authorities had made the following statement on the staff report:

The staff report for the 1983 Article IV consultation with Nigeria presents a fairly accurate analysis of Nigeria's current economic situation as well as economic policies in place and the views of the Nigerian authorities. The authorities are fully aware of the nature and causes of the economic crisis and are taking steps to effect stabilization and the needed structural adjustments.

The new military administration has braced up to the economic problems as their priority. A pruning review of federal, state, and local government budgets aimed at reducing the large deficits and at reordering priorities is being undertaken. Public corporations are under review, financial discipline and cost-saving measures are being enforced, and a new federal budget is being worked out. Monetary and credit developments have witnessed declining rates of growth. Credit ceilings have been reduced to 15 percent, effective January 1984.

The present level of foreign exchange reserves does not justify full-scale liberalization. Significant adjustments have already been effected in the naira exchange rate, which has been depreciated by 10 percent against the dollar in the past 12 months. Arbitrage is successfully being narrowed. Devaluation on the scale envisaged by the Fund is seen to have doubtful benefits in the Nigerian context, but the authorities are keeping the subject under review. Advance deposits against imports may be removed.

Negotiations with our major creditors with regard to the trade arrears are going on, and the Nigerian authorities expect Fund assistance on conditions that the Nigerian economy can safely bear. The authorities hope to resume discussions with the Fund soon.

Mr. Tvedt remarked that, because of the authorities' weak policy response, the economic situation in Nigeria had deteriorated rapidly in several important respects since the 1982 Article IV consultation. The oil sector had been bound to become dominant in the economy, but it was clear that the authorities' reliance on it had been excessive, and that they had neglected to provide suitable conditions for the development of the traditional export sector. As a result, agricultural exports had virtually disappeared after having been important in previous years, and the 50 percent decline in oil exports in 1981 had had a severe adverse impact. Policy formulation in the second half of the 1970s had been based essentially on the assumption that there would be a rapid growth of oil revenues in future years, but the momentum of those policies had continued well beyond the peak year of Nigeria's oil exports.

During the years of rapidly rising oil export revenues, Mr. Tvedt continued, various administrative problems had emerged. They had become particularly serious when the economy had fallen into recession, as they had added to the difficulties experienced by the authorities in responding effectively to new developments.

Although some of the serious problems facing the economy had to be dealt with in the immediate future, Mr. Tvedt remarked, most of them were essentially medium term in nature and needed to be dealt with as such. The staff analysis and recommendations were fully convincing. A sizable devaluation would have to be a part of a comprehensive adjustment program for Nigeria. The revenues from oil exports were estimated to be only a portion of the expected amount, and a devaluation was the most effective way to revitalize activity in the traditional export sector.

He also agreed with the staff, Mr. Tvedt said, that the ad hoc approach that the authorities had apparently used in the recent past could not solve the problems facing the economy. Indeed, the wide-ranging restrictive measures would exacerbate the difficulties and should be eliminated as a complement to determined exchange rate action. The country's resources needed to be allocated as efficiently as possible, something unlikely to happen within the present policy framework. At first glance, the reduction of the current account deficit in 1983 was striking. However, it had been achieved largely by administrative measures that had caused a 40 percent decline in imports.

If the efficiency of economic policy were to be improved, Mr. Tvedt remarked, the administrative apparatus would have to be strengthened, especially the public finances. Public expenditure would have to be reduced and expenditure control tightened; in particular, efforts would have to be made to gain better control over the finances of the states. In that area, technical assistance from the Fund could be valuable.

The increase in external debt and the debt service burden in 1983, the debt outlook for 1984, and the poor overall balance of payments outlook for the coming three years, Mr. Tvedt said, further underscored the need to undertake quickly an effective adjustment program. It was important to re-establish orderly relations with foreign short-term creditors, and the authorities should be urged to use all possible means to eliminate the large volume of external arrears.

In late 1983, Mr. Tvedt commented, the authorities and the staff apparently were more or less agreed on the root causes of the present difficulties, and on the important aspects of an effective policy approach. The major stumbling block was exchange rate policy. The staff had indicated that the authorities were reluctant to devalue the naira because of the risks and burdens that they felt were inherent in that approach. It would be useful to have a further comment both on the supposed risks and burdens, and on the consequences of failure to take strong exchange rate action at the present stage. A devaluation was easy to implement and could be expected to yield quick and effective results. The overall approach of the authorities to the recent difficulties left much to be desired, and the indications for 1984 were not encouraging. The authorities would be well advised to pay due regard to the staff's recommendations.

Mr. Ismael remarked that the problems facing the economy had intensified since the previous Executive Board discussion of the country, in September 1983. Sizable trade arrears had emerged, and the reserve position had weakened; the fiscal and external payments difficulties had already been serious. He agreed with the staff that the various problems had deeper root causes than the weakening of the international oil market. Past policies, which had emphasized the development of the oil sector, had resulted in a lopsided economy: agriculture had not expanded for the last five or six years, and the existing industries were overdependent on raw material imports. The high degree of protection of those industries and the greatly overvalued naira were causes for concern. The authorities would have to pay more attention to the structural problems and introduce more fundamental policy changes. The problems being medium term in nature, they required medium-term solutions.

The main problem to be dealt with in the immediate future was the balance of payments, Mr. Ismael considered. The sharp deterioration in the reserve position had significantly constricted the flow of imports, leading to shortages, upward price pressures, and unemployment. He had noted the dramatic 42 percent drop in imports in 1983, and, in the circumstances, he sympathized with the authorities in their adoption of ad hoc emergency measures to stop the reserve losses. However, the emergency measures were not an adequate substitute for more rational and durable policies. In the longer run, the ad hoc measures would exacerbate the existing distortions.

He was pleased to see from Mr. Mtei's opening statement and the staff report that the authorities had already taken appropriate steps to address the various issues, Mr. Ismael remarked. They were to be commended for their courage in having implemented austerity measures after the very expansionary policy stance during the oil boom. The new measures should help to ease the strain on both the fiscal and balance of payments positions. The austerity drive on the federal level appeared to be in progress, but more was required on the state level. Tighter control of state operations was important; the states' share of total expenditures was 45 percent. The authorities' growing awareness of the need for better coordination between the state and federal governments was encouraging, and they should be urged to make further progress.

Although recent events had overtaken it, the Fourth National Development Plan (1981-85), particularly the supply-side measures, reflected the authorities' realization of the need for more balanced growth, Mr. Ismael said. In particular, the authorities were to be commended for the top priority given to agriculture, which had been neglected in the past. It was in Nigeria's long-term interest to improve the conditions that were impeding progress toward more balanced growth. The main obstacles were the tariff structure, which provided negative rates of protection on nonpetroleum export industries, and the overvalued naira. The authorities' decision in principle to institute comprehensive reforms of the external trade system was welcome. The rationalization of production incentives, the simplification of the tariff structure, and the strengthening of export-promotion measures were essential for the rehabilitation of the nonpetroleum sector.

Policy choices were particularly difficult in the exchange rate area, Mr. Ismael commented, but several factors suggested that a cautious approach was warranted. Import restrictions and other administrative measures had a specialized and selective effect, while a currency devaluation affected the whole economy. Strengthening the competitiveness of domestic industries was of course important, but he sympathized with the authorities, who felt that, given the present structure of the economy and of consumption patterns, there were risks and burdens inherent in a devaluation. The most immediate effect would be price increases for factories and the general public, unless alternative supplies became available. In all likelihood, however, new supplies would be available only after the benefits of the supply-side measures had borne fruit. It was important to note that the export share of nonpetroleum products was no more than 2 percent, and that 44 percent of imports were consumer items, of which some 87 percent were food and other nondurables.

The staff, Mr. Ismael noted, had not analyzed in detail the consumption pattern or the proportion of manufacturing inputs taken up by industries, but the existence of an import content of manufacturing industries as high as 75 percent would not be surprising. Given the great dependence on imports, although flexible and competitive exchange rates had certain advantages, the immediate impact of a devaluation on the economy would certainly be a cause for concern. On the other hand, if the devaluation were not neutralized by inflation and inflationary expectations, it could restore competitiveness and help to sustain a more viable external position. To those ends, supportive fiscal and monetary measures would be essential.

The authorities were apparently committed to maintaining a monetary policy that supported the overall economic stabilization effort, Mr. Ismael commented. The accommodative monetary and credit policies of the past would not contain domestic pressures on prices. It was likely that, because of the severe compression of imports and the resultant price pressures, the underlying rate of inflation in 1982 and 1983 had been higher than the reported rate. The sharp deceleration in the consumer price index in 1982 and 1983 was surprising, and a further comment on it would be useful.

The introduction of flexibility in interest rates in 1982, Mr. Ismael said, had clearly been a step in the right direction. However, in the light of both price developments and international interest rates, the prevailing domestic deposit and lending rates should be somewhat higher.

The present time was certainly a difficult one for Nigeria, Mr. Ismael concluded. The authorities had made a substantial effort to improve the situation, and he looked forward to an early consideration by the Executive Board of a Fund-supported program for Nigeria. Given the serious structural imbalances in the economy, the World Bank should play a role in the adjustment effort. Finally, the proposed decisions were acceptable.

Mr. Wicks considered that Nigeria was a fortunate country. Some other African economies lacked the natural resources needed to provide the basis for a prosperous economy. The enormous problems facing the Nigerian economy were not the result of a lack of resources; they were a reflection of large structural imbalances and a degree of economic mismanagement by the previous Government.

The Fund would have an important role to play in helping the new Government to improve the economic situation, Mr. Wicks continued, but he agreed with Mr. Ismael that the World Bank should play an equally important role, and he was pleased that the staff and Mr. Mtei had come to the same conclusion. Future papers on Nigeria's economy should include full information on World Bank assessments and operations. There was no point in the Fund's trying to help the authorities to restore balance to the economy as a whole if blockages on the supply side remained. Nigeria was a test case of cooperation between the Fund and the World Bank in an effort to help a member country.

He fully accepted the staff's conclusions and the proposed decision, Mr. Wicks stated. As a rule, the discussion on an Article IV consultation with a country should take place before detailed negotiations began on a program for the same country. The present discussion was timely, as it was clear that there should be early agreement on a Fund-supported program.

Nigeria, like other major oil producers, had been forced to undertake a painful revision of its plans and expectations as a result of the weakening of the oil market during the previous two or three years, Mr. Wicks remarked. The Nigerian authorities themselves would probably agree that the adjustment process had been made doubly difficult because of the extent to which the non-oil trading sectors of the economy had been allowed to decline. In 1983, oil had accounted for more than 98 percent of export revenues and 70 percent of government receipts.

The problems caused by overreliance on the oil sector had been exacerbated by the policy responses to the deteriorating external position, which, in many instances, had taken the form of quantitative restrictions and price controls, Mr. Wicks continued. Such measures further distorted the allocation of resources in the medium term. Those distortions were at the heart of the adjustment problem facing the authorities, and their elimination was a prerequisite for achieving a sustainable external position in the medium run. In the past, the Government had been reluctant to take the action needed to deal with the situation. Fiscal deficits of 10 percent of GDP or more had been financed to a disproportionate extent by domestic bank borrowing, while on the external front there had been substantial recourse to foreign exchange reserves and a massive buildup of arrears in addition to the introduction of direct controls on trade flows. The delay in adjustment that those developments reflected had made the need for new measures at the present stage particularly urgent.

The main structural task facing the new Government was to make the economy less dependent on oil and to permit market mechanisms to function better than they had in recent years, Mr. Wicks remarked. That effort would require action in the fiscal policy and external policy areas, medium-term support from the Fund and the World Bank, and an early refinancing of arrears. The sooner such a program could be introduced, the better.

The possibility of an extended arrangement for Nigeria had been mentioned by Mr. Mtei in his opening statement, Mr. Wicks noted. His own position on such an arrangement for Nigeria was the same as his position had been on an arrangement for Zimbabwe. On the basis of the principles that he had enunciated at the Board discussion on Zimbabwe (EBM/84/3, 1/9/84), he had an open mind on the choice between a stand-by arrangement and an extended arrangement for Nigeria. In that connection, the most important point was that Fund and World Bank assistance should support a medium-term policy framework designed to deal with structural imbalances.

Commenting on the needed adjustment measures, Mr. Wicks said that the fiscal deficit, at 16 percent of GDP, was unsustainable. The authorities' recognition of the need to cut public expenditure was welcome. In the medium term, action to increase revenues would also be necessary.

He agreed with the staff analysis of public expenditure in Nigeria, Mr. Wicks stated. There was certainly scope to cut consumer subsidies. The petroleum subsidy alone accounted for one sixth of total revenues. The new approach to investment priorities should be continued, and the

World Bank should be able to help. The authorities' conviction that state governments and public enterprises must observe fiscal discipline was welcome, but the objective of instilling discipline would be difficult to achieve. The financial information systems urgently needed improvement, so that accurate and current information would be easily available; that would be an essential first step toward improving the system of expenditure control, especially for expenditures by states. World Bank assistance would certainly be helpful in parastatal reform and data provision.

On the revenue side, Mr. Wicks went on, he agreed with the staff that the tax base should be broadened. To that end, the staff had usefully suggested the introduction of an improved tariff system or a sales tax. Technical assistance from the Fund and the World Bank would also be useful on the revenue side.

The main issues in external policy were the level of the exchange rate, the trade restrictions, and the arrears, Mr. Wicks said. He agreed with the staff that a realistic and flexible exchange rate was essential for successful adjustment. The authorities' concern about the inflationary effects of a devaluation was understandable. However, the devaluation would be once for all; the benefits would be lasting. In particular, a devaluation would encourage the growth of non-oil exports and import substitutes: food and export crops would especially benefit, thereby facilitating a possible early return to self-sufficiency in food. A devaluation would also stamp out the recent, worrying growth in the parallel market and would be an important element of tariff reform. In sum, a devaluation would help to bring about a better balance in prices in Nigeria, thereby providing the incentives required to restructure the economy. An exchange rate adjustment was required because the export sector was still small, despite its potential, and because exporting industries had failed to expand and had instead seen their goods diverted into import-substituting industries.

He wondered whether the staff was in a position to suggest what the appropriate level of the exchange rate might be, Mr. Wicks continued. Any reluctance on the staff's part to be specific at the present stage would be understandable, but it might be useful to prepare to exercise ingenuity in achieving an appropriate exchange rate, for example, through a program of phased reductions. Alternatively, it might be appropriate to introduce a temporary dual exchange rate system. Given the particular problems facing the economy and the crucial need for a flexibly managed exchange rate, an inventive approach was needed.

The trade restrictions, Mr. Wicks said, had accentuated the maladjustments in the economy by distorting incentives and blocking market mechanisms. Of particular cause for concern was the staff's conclusion that the exchange and trade systems had given high effective protection to import-intensive industries and low effective protection to export-oriented industries using local inputs. In addition, the import restrictions were difficult to administer and did not provide any revenues to the Government. For those reasons, he agreed with the staff proposal for a simpler tariff-based system, which could usefully be accompanied by a reform of the customs service. Such improvements might well take time. Meanwhile, a strong case could be made for lifting some of the many administrative controls on various aspects of economic life in Nigeria. The controls hampered enterprises, and scarce administrative resources were needed to operate them; they caused a number of other difficulties as well.

In addition to the elements that he had mentioned, Mr. Wicks remarked, successful structural adjustment in Nigeria would have to be accompanied by an agreement on the refinancing of arrears. His authorities strongly agreed with the staff that a coordinated, multilateral approach was required to provide a sound and comprehensive underpinning for any adjustment package. His authorities were actively working toward that end, and he hoped that the Nigerian authorities would soon be able to reach agreement with both insured and uninsured creditors on an early and orderly elimination of arrears that would pave the way for the eventual resumption of normal trade.

Nigeria's debt service ratio was very high--about 40 percent--Mr. Wicks noted. Rescheduling would help to reduce it in the short run, but the burden would remain heavy, and debt policy would have to be cautious. He hoped that future staff papers would treat the debt issue in greater depth, including the effects of rescheduling.

Mr. Nimatallah stated that the proposed decision was acceptable. The discussion gave the Executive Board an opportunity to assess recent economic developments and policies in Nigeria, and to give guidance to management and staff for the likely discussions with the authorities on a Fund-supported adjustment program.

Since 1981, Nigeria had experienced a sharp decline in its export earnings and budgetary receipts due to the weakening of the international oil market, Mr. Nimatallah said. The authorities had reacted by adopting measures to reduce both the fiscal and external deficits, but they had not proved sufficient to reverse the deteriorating economic and financial situation, and serious problems had remained in 1983: real non-oil GDP had registered a further decline; inflation had accelerated; the budget deficit had risen to about 15 percent of GDP; and further trade arrears had been accumulated.

The financial situation was likely to continue to be difficult over the medium term, Mr. Nimatallah noted, particularly as only a moderate rise in oil revenues was expected. Furthermore, the demand on financial resources was expected to increase sharply as a result of the heavy external debt service obligations falling due in 1984-86. Hence, there was an urgent need for the authorities to adopt a credible adjustment program.

Nigeria had always cooperated with the Fund, Mr. Nimatallah observed. Indeed, when Nigeria's financial position had been strong, it had lent money to the institution. At present, Nigeria needed the Fund's help and understanding, and he hoped that the authorities and the staff could agree on a program that would help restore domestic and external balance, thereby greatly facilitating the authorities' effort to reach an agreement with their creditors on debt repayments.

Commenting on fiscal policy, Mr. Nimatallah said that it was clear that the public finances would have to be considerably strengthened over the medium term. The federal budget deficit, equivalent to 15 percent of GDP, was obviously incompatible with the achievement of domestic and external financial stability. There was a need to rationalize both current and capital expenditures immediately, enhance non-oil revenues over time, and strengthen the finances of the state governments and the public enterprises, both of which had constituted a drain on the federal budget. As for the public enterprises in particular, the authorities should be encouraged to implement the recommendations of the special task force, including flexible pricing and private sector ownership of some of the enterprises.

The staff had argued for a "significant" initial adjustment of the exchange rate followed by the introduction of a flexible exchange rate policy, Mr. Nimatallah noted. The staff's judgment was based on the premise that the level of the exchange rate in 1978 would be the appropriate one at the present stage, and that there was a need to reverse the accumulative appreciation of the rate that had occurred since then. As had been made clear during the recent seminar discussion on exchange rates, there were considerable uncertainties about what constituted a sustainable, or equilibrium, exchange rate in industrial and developing countries. In dealing with Nigeria, the staff's use of the real effective exchange rate indicator in determining the required magnitude of the exchange rate adjustment was fraught with uncertainty connected with the choice of the base period, the reliability of the price indices, and the use of weights based on imports rather than on currencies of payment. As a result, judgments about the appropriate level of the exchange rate should be approached with caution.

Another important question in the exchange rate area was what an initial significant devaluation would achieve for Nigeria, Mr. Nimatallah remarked. The staff's analysis was not fully adequate. The problems facing Nigeria's economy were partly short term and partly long term. A significant initial devaluation was not necessary to deal with the short-term financial problems. As only about 5 percent of Nigeria's exports were non-oil items, a devaluation would probably not improve the trade balance in the short run. Regarding the budgetary effects of a devaluation, they had neither been analyzed in the staff paper, nor claimed to be a reason for the recommended budget. Indeed, it was conceivable that the negative effects of a substantial devaluation could more than offset the positive short-run effects. Further comments by the staff on the issues that he had raised would be needed before he was convinced that a significant initial devaluation was necessary.

That was not to say, Mr. Nimatallah went on, that there was no need for a devaluation. Nigeria could perhaps start with a stand-by arrangement designed to tackle the immediate short-run problems, and for that purpose an initial modest devaluation might be necessary. The stand-by arrangement could be followed by either an extended arrangement or another stand-by arrangement, with a view to correcting the underlying structural problems. To that end, a flexible exchange rate policy, together with a package of other policies, would be appropriate. A flexible exchange rate policy would help to achieve the longer-run goals of restructuring and diversifying the productive base of the economy.

A liberal exchange and trade system was an important element of the effort to increase economic efficiency and diversify the productive base of the economy, Mr. Nimatallah remarked. The recently imposed exchange restrictions might have been necessary in the short run, because of the serious foreign exchange situation, but they probably would not have a positive effect beyond the short run, and he hoped that the authorities were aiming at gradually removing all of them.

Tariff reform was also essential for the success of the diversification effort, Mr. Nimatallah concluded. The present tariff system was very complex and distorted incentives for industry and trade. He hoped that the authorities would act soon to reform the tariff system. The Fund was providing the technical assistance that could help the authorities to make such reforms. In sum, Nigeria faced serious economic and financial problems, and there was an urgent need for the authorities to adopt a strong adjustment program. He wished them success in their endeavors.

Mr. Hirao said that he broadly agreed with the staff appraisal. The serious external payments problems facing Nigeria were due largely to developments in the international oil market. However, the authorities' immediate response had been an ad hoc intensification of trade and exchange restrictions, rather than the introduction of decisive measures to correct structural imbalances. The authorities had recognized that the present difficulties were due to deeply rooted structural imbalances and cost-price distortions that had built up in the economy as the result of past policies. Comprehensive adjustment measures based on realistic assumptions were needed to bring the economy back onto a path of sustainable noninflationary growth, and he was pleased that efforts in that direction were being made.

Substantial fiscal restraint was clearly needed at all government levels and by the public corporations, Mr. Hirao remarked. In the Central Government, capital expenditures would have to be rationalized, and current expenditures would have to be restrained, particularly transfers and subsidies. In state governments, the fact that expenditures had not yet been scaled down and transfers were relied on to an increasing extent was a cause for serious concern. Significant progress should be made in quickly improving the system of collecting information on the budgets of state governments. He agreed with the staff that the authorities should be encouraged to use financial leverage and moral suasion to ensure that the expenditure policies of the state governments were consistent with the national stabilization objectives.

He agreed with the staff that the effort to mobilize additional revenues would have to be intensified, Mr. Hirao went on. There seemed to be room to increase the scope and rates of excise taxes, and a broadly based sales tax and diversification of the tax base over the medium term would be desirable. Reforms in the various public corporations would also contribute to strengthening the fiscal position of the Government. In particular, price adjustments by public corporations should be made on a regular basis.

The extent to which the Federal Government had been borrowing from the domestic banking system was a cause for concern, Mr. Hirao said. It had caused the monetary pressures in the economy to increase, and there was a critical need for restraint of credit and monetary growth together with efforts to reduce the fiscal deficit. The flexible and realistic interest rate policy should be maintained, and the effort to increase the efficiency of resource mobilization would be facilitated by a significant liberalization of financial institutions, particularly in the medium term.

On external policy, Mr. Hirao noted that the intensification of the trade and exchange restrictions--although mainly a response to the acute payments difficulties in 1982 and 1983--had been increasingly recognized as having failed to deal with the fundamental causes of the economic and financial crisis. The restrictions were difficult to administer and tended to have adverse effects on efficient resource allocation; the recent intensification of restrictions was inconsistent with the country's adjustment needs. Policies should be aimed at promoting the restoration of an appropriate structure of price incentives and cost-price relations to improve resource allocation, something that was essential if the problems facing the economy were to be solved over the medium term. Simplification of both the external tariffs and the industrial regulations would provide a solid basis for structural adjustment and economic diversification. As for the exchange rate, a realistic and flexible policy would be an integral part of the comprehensive adjustment strategy. Finally, the proposed decision was acceptable.

Ms. Bush stated that she broadly agreed with the staff appraisal and supported the proposed decision not to recommend approval of the intensification of the exchange restrictions and multiple currency practices. She agreed with the staff that the authorities should be strongly urged to adopt a comprehensive program of stabilization and adjustment that would address the structural and financial imbalances in the economy and provide a sound basis for eliminating the existing practices for which Fund approval was required.

Nigeria had the largest population and the most extensive economy of any country in Africa, and it was richly endowed in natural resources, Ms. Bush noted. Unfortunately, the economy had become critically dependent on oil revenues; indeed, the other sectors of the economy seemed to be in a state of advanced atrophy. Because of reduced earnings from oil exports, the authorities had faced since early 1982 an acute financial crisis that was reflected in the serious balance of payments and fiscal positions. In addition, in recent years Nigeria had been burdened with economic and financial policies that had not proved fruitful.

The staff and the authorities had apparently reached a consensus on three vitally important areas that should result in a correction of the current economic and financial policies, Ms. Bush remarked. Nigeria's present difficulties reflected serious structural imbalances and cost-price distortions. Sustained large increases in oil revenues could not be realistically expected, and the recently adopted economic measures did not appropriately address the present economic and financial problems; indeed, they undermined economic efficiency. She fully endorsed the broad objectives of Nigeria's adjustment program described on page 8 of the staff report. It was imperative that the productive sectors of the economy--particularly agriculture and industry--be revitalized. In that connection, involvement by the World Bank was welcome, and she hoped that the negotiations on a structural adjustment loan would be concluded quickly and successfully.

Commenting on the various kinds of measures that should be taken soon to reduce the distortions and strains in the economy, Ms. Bush said that she had been struck by the frequent references in the staff report to inadequate data. It was critically important for the authorities to improve the quality, scope, and timeliness of data on both federal and state financial operations. More accurate and timely information would certainly help the authorities to set and reach their economic goals.

In the fiscal area, Ms. Bush went on, many of the problems seemed to have arisen because of the drain on the federal budget by subsidies to unprofitable public or quasi-public corporations, transfers to state governments, debt repayments on behalf of those governments, the subsidy for domestic oil consumption, and subsidies on certain products used in agricultural production, such as fertilizers and insecticides. The authorities had indicated their intention to make changes in some of those areas in order to relieve the pressure on the budget. Recent studies had noted the inefficiency of pricing policies, management, and accounting practices in the public sector. The authorities had recognized those problems and the need to divest, or substantially reform the operations, of the public enterprises, and they should be encouraged to begin to act forthwith, rather than wait for the completion of further studies.

Elimination of subsidies on petroleum should encourage domestic conservation of that commodity and the development of other sources of energy, such as natural gas, which was reportedly in abundant supply, Ms. Bush continued. The authorities should be urged to restrain transfers to the states, particularly in the area of debt management. As new transfers were to be net of debt payments owed to the Federal Government, the authorities should move cautiously to avoid an inordinate rise in the scheduled amount of transfers, which could offset the benefit of netting out the debt repayments.

The agricultural sector, which received federal subsidies, faced structural problems, Ms. Bush noted. Cost-price distortions had apparently hampered economic activity in the sector. Agricultural activity was influenced by marketing boards and licensed buying agents, and the setting of producer prices in the absence of sufficient technical information on production costs had undoubtedly caused major distortions.

Credit and interest rate policies also seemed to be contributing to the distortions in the economy, Ms. Bush remarked. As a result of sector credit allocation, nontradable goods had been favored over tradable goods, thereby adversely affecting exports. The failure of commercial and merchant banks to meet the targets for credit to favored sectors underscored the incorrectness of the allocation policy. Credit might be more appropriately and efficiently allocated if interest rates were allowed to increase to real positive levels.

On the debt situation, Ms. Bush said, the authorities should be encouraged to continue negotiating with creditors to attain some relief from the heavy near-term maturity schedule. A coordinated multilateral approach to the debt negotiations was preferable to bilateral arrangements. The authorities should also be encouraged to lift or liberalize the import deposit scheme at an early stage. The staff report clearly indicated that the authorities were moving to tighten the scheme, and the 1984 budget provided for only small additional import expenditures. The lack of certain import items needed for industrial revitalization might well hamper economic growth.

The staff had noted that the authorities might look to the capital account as an offset to the sizable current account deficits of the previous two years, Ms. Bush remarked, but that would require a modification of the restrictions on foreign direct investment, some relaxation of credit allocation controls, and changes in other policies that favored companies with majority Nigerian ownership. The fairly liberal policy of regarding 60 percent of profits as dividends could be accompanied by other policies to encourage foreign investment. In sum, while the authorities appeared to recognize the problems that had built up in the economy, she hoped for early and strong corrective actions that would permit Nigeria to regain a sustained positive economic performance.

Mr. Joyce observed that the timing of the discussions was fortunate. A new Government had just taken office, and it had indicated an interest in exploring the possibility of a Fund-supported program. The staff papers described developments and policies that for the most part belonged to the period of the previous administration, but the new Government had expressed its determination to tackle the various economic problems, which had remained essentially unchanged. The present authorities clearly appreciated the gravity of Nigeria's economic situation.

As Mr. Wicks had stressed, Mr. Joyce continued, Nigeria was well endowed with natural resources and was a key country in Africa. At present, however, conditions in Nigeria were particularly difficult, partly because of the weakening of the international oil market, but also because of the failure of the previous administration to introduce appropriate measures.

The task facing the present Government, Mr. Joyce remarked, was to deal quickly with the most immediate problems--particularly the balance of payments--and to begin to make the basic adjustments needed to restore balance to the economy and to pave the way for sustainable growth. These adjustments should be seen in a medium-term context, and policy actions with effects in the medium run would be needed. The authorities should address the most immediate problems, of course, but it was equally important for them to act quickly to begin to make structural changes. It was satisfactory that Nigeria was contemplating a Fund-supported program, and that the World Bank was expected to play a role in helping to arrange financing for a balanced developmental and adjustment package that would reflect Nigeria's short-term and medium-term needs.

He had an open mind, Mr. Joyce said, on whether the Fund-supported program should take the form of a stand-by arrangement or an extended arrangement. The best choice would probably become clearer during the course of further discussions between the staff and the authorities. However, whichever one was chosen, immediate priority must be given to stabilizing the balance of payments and then to proceeding quickly to address the more fundamental problems.

He broadly agreed with the staff's analysis and recommendations, Mr. Joyce stated. The staff reports clearly underscored the need for the new authorities to act decisively and quickly. Fiscal discipline had seriously deteriorated during the previous several years, substantial price distortions had appeared throughout the economy, monetary restraint had been virtually nonexistent, and numerous controls over trade and payments had been introduced, thereby undermining Nigeria's competitive position and leading to the accumulation of a large volume of external arrears.

He agreed with the staff, Mr. Joyce commented, that the authorities should base their policies on cautious assumptions about prices and output in the oil sector. Indeed, it might be useful to develop a series of scenarios for the oil sector based on various price and output assumptions and including contingency measures that could be quickly introduced if the original assumptions proved to be inaccurate. It was important to stress that, if oil sector revenues over the coming several years turned out to be larger than expected, it would be most unfortunate if the authorities used the resulting breathing space to delay the adjustment effort.

In addition to tighter fiscal and monetary policies, Mr. Joyce remarked, the authorities needed to stress supply-side policies to revitalize the productive sectors of the economy. Achieving that objective would require action on a broad front. The most important step that the authorities could take was to correct the misalignment of the exchange rate. The need for a realistic exchange rate supported by significant adjustment in the fiscal sector had become so pressing that it would be excessively optimistic to conclude that there was any scope left for a trade-off between fiscal adjustments and exchange rate adjustments.

He fully understood the authorities' apprehension about the effects of a massive devaluation both on the political situation and on the economy, Mr. Joyce said. A large devaluation would certainly have implications for domestic costs and the rate of inflation. Nevertheless, the exchange rate had to be corrected quickly to offset the real appreciation that had occurred over the past few years. Moreover, the authorities should subsequently maintain a flexible exchange rate policy. In many previous cases, the correction of an exchange rate had subsequently been reversed by a government's rigid attitude toward exchange rate movements. The staff had made a strong case for early action on the exchange rate, and it had stressed that a realistic exchange rate was crucial to improving the competitiveness of Nigeria's agricultural and industrial sectors, reducing its dependence on food imports, and strengthening and diversifying the export base, thereby paving the way for a viable external payments position. The staff had made little mention of developments in the parallel exchange market, and a further comment would be useful. It was his understanding that there had been some improvement in the free market rate in recent weeks.

The deeply imbedded distortions in the economy, caused by excessive controls, regulations, and administrative procedures, had acted as disincentives to domestic production and had seriously hurt the performance of exports, Mr. Joyce considered. Press reports indicated that the complexity of trade policy in general, and of import licensing in particular, had created shortages of raw material imports that had caused some factories in Nigeria to close. That the growing strength of the oil sector during the past decade had been accompanied by a downward trend in the production of most food crops was regrettable, as it had compounded Nigeria's payments problems. He strongly agreed with Mr. Wicks that it was essential for the new Government to remove restrictions as quickly as possible. Moreover, he agreed with the staff that phasing out a number of subsidies would have considerable benefits for both production and efficiency, and also that producer prices, particularly for agricultural commodities, needed to be increased significantly.

Much greater restraint was needed on both the fiscal and monetary fronts, Mr. Joyce commented. In particular, a marked improvement in the fiscal position was essential to support the adjustment program. To that end, there must be greater control over federal expenditures. Some attempts to achieve it had been made in the past, and the new Administration had made an additional effort to restrain and reduce capital expenditure, but current government expenditure would also have to be controlled. For instance, it was important to keep the public service wage bill from growing out of control; the subsidies for domestic consumption of crude oil and refined petroleum products should be abolished as quickly as possible, and the Public Service Corps should be brought under control. The far-reaching and comprehensive reform measures that the staff had described should be introduced by the new Government, together with disinvestment wherever possible.

Greater discipline was also needed in state expenditure, and the Federal Government's control over state spending should be strengthened, Mr. Joyce continued. Some steps to reduce the size of state administrations had already been taken, and they should be accompanied by a determined attempt to restrain state spending. Previous speakers had correctly stressed the essential need for the federal authorities quickly to obtain better information on expenditures. The Federal Government could not hope to control spending either by its own bureaucracy or by the states in the absence of adequate and timely information. He agreed with Mr. Wicks that, in the medium run, the authorities would probably have to introduce additional revenue-raising measures and might have to consider what changes could feasibly be made in tax administration.

As for the outlook for the external economy, Mr. Joyce remarked, he was worried about the present size of the accumulated arrears and the possibility that the large medium-term and long-term amortization of foreign debt--totaling about $4 billion--could coincide with the $1.5 billion current account deficit forecast for the two-year period 1985-86. The financing gap of approximately $6 billion projected for 1985-86 underscored the need for Nigeria to adopt policies of restraint as quickly as possible. Otherwise, the already sizable financing gap could grow larger, as confidence in the financial markets deteriorated.

The projected bunching of debt repayments, Mr. Joyce went on, was a clear indication that insufficient attention had been paid in the past to debt management; the authorities should be encouraged to take the necessary steps to deal with that problem. The previous authorities had planned to maintain the existing foreign borrowing limits established by the Federal Government and to develop a firm schedule for rapid repayment of arrears owed by the states to the federal authorities, and he hoped that the new Administration would take those steps quickly. He strongly endorsed the staff's view that the refinancing and rescheduling of Nigeria's debt should be carried out in a coordinated and comprehensive manner, in a multilateral forum, and as part of a fully articulated economic adjustment program.

He was pleased that the authorities were considering the possible removal of the advanced deposit import scheme, Mr. Joyce observed. Nevertheless, for the moment he supported the staff recommendation for withholding approval of the exchange rate restrictions and multiple currency practice because they were inconsistent with the requirements of a viable adjustment program.

The determination that the new Administration had shown was welcome, Mr. Joyce concluded. He understood the authorities' concern about recent developments and their hesitancy to move too far and too quickly on the exchange rate. However, action on the exchange rate was crucial, and to be effective it would have to be substantial.

Mr. Lovato remarked that the staff reports were unusually detailed and extensive, no doubt because of the size and importance of the Nigerian economy, the severity of the economic imbalances, the explicit emphasis during the lengthy discussions with the authorities on the need for a program of stabilization and structural adjustment, and the inclusion of numerous suggestions for policy changes. He broadly agreed with the staff assessment, and the proposed decision was acceptable.

In the circumstances, Mr. Lovato continued, Nigeria had no feasible alternative but to begin moving along the path of stabilization and rehabilitation of its productive, financial, and institutional apparatus. Given the sizable financing gaps that were likely in the coming period, the magnitude of the accumulated payments arrears, and the deterioration in the country's debt servicing capacity, it was clear that an extensive process of debt relief or refinancing was a necessary precondition for the successful introduction of the adjustment strategy that the staff had recommended. In the present case, as in some earlier ones, the supply of external finance was related to the amount of adjustment that the country had accomplished or was prepared to make. When a country was thought to be making necessary adjustments, the change in creditors' confidence was likely to lead to an increase in the availability of external financing for the country.

The program design that was reflected in the set of policy measures recommended by the staff seemed solid and covered a wide spectrum of corrective policies, Mr. Lovato remarked. Correcting the fiscal imbalance in the public sector was a central ingredient of the policy package preferred by the staff, and achieving that objective was to be approached on various fronts simultaneously. In the Central Government, there was a strong need to overhaul the tax system. Domestic revenues from activities not related to oil were much too small; receipts from direct taxation, particularly on personal and corporate incomes, should be increased. Revenue from indirect taxes had grown considerably as a result of their expanded coverage and the increase in excise duties, but he agreed with the staff that a general sales tax should be introduced in the near future. The budgetary cost of the present subsidies on domestic petroleum prices was remarkably high; according to the staff's estimates, it amounted to roughly 15 percent of federally collected revenues. The Government's intention of implementing a market-related pricing policy for energy products was welcome, given the large revenue benefits that could be expected. He understood the authorities' preference for a gradual adjustment of the retail price structure.

On the expenditure front, Mr. Lovato went on, the importance of a carefully devised and monitored capital outlays program, including an appropriate selection of public investment projects in cooperation with the World Bank, should be emphasized. Effective fiscal discipline would include control of the local authorities and public corporations, whose finances had been a growing cause for concern. The state governments had had considerable autonomy in collecting receipts and in making spending decisions, which had sometimes been inconsistent with national policies. The public corporations had registered sizable operating losses, and their various forms of inefficiency had been widely documented.

Commenting on monetary policy, Mr. Lovato said that he supported the authorities' intention of moving from a heavily regulated system of credit allocation to greater reliance on market instruments. The most crucial steps were a tightening of the Central Bank's control of the liquidity in the banking system, and paying closer attention to the links between international and domestic interest rates and to the effects of inflation on both deposit and lending rates in order to prevent large and persistent misalignments.

The sizable appreciation of the exchange rate in real effective terms had clearly had an adverse effect on the competitive performance of the traded-goods sector, Mr. Lovato remarked. Hence, there was considerable merit in the staff's suggestion for devaluing the naira and for subsequently managing the exchange rate in a more flexible manner than in the past. Such actions would shift some output from the nontraded-goods sector while stimulating exports and import substitution in agriculture and manufacturing. The exchange rate adjustment could be combined with a liberalization of the import regime away from the quota-based restrictive system and toward a tariff-based scheme of effective protection. Simultaneous actions on the exchange rate and trade fronts would be mutually reinforcing and would help to restore the comparative advantage of Nigerian industry.

However, Mr. Lovato continued, he questioned the staff's description of the "right" magnitude of a devaluation. There was no assurance that a large discrete nominal devaluation would yield a real devaluation of an equivalent size, particularly in the light of the likely inflationary response of the economy to a devaluation. A further comment on the matter would be helpful. What kind of complementary measures in the tax and subsidy areas might be introduced?

There was still a sizable difference of opinion between the staff and the authorities on the best course of action for the trade system, Mr. Lovato noted. Recent policy developments seemed to run counter to the expectation that Nigeria would undertake a liberalization of the complex administrative machinery that had been established mainly to restrict imports and to deal with related balance of payments problems. The general architecture of the tariff reform proposed by the staff, and a phasing out of the quotas and import licensing system, would be central elements of a strong strategy of adjustment. The recent intensification of the trade and exchange restrictions was disappointing, and it naturally raised doubts about the authorities' inclination to relax the existing direct controls on imports and foreign payments.

Commenting on the external debt outlook, Mr. Lovato said that the staff projections were broadly acceptable as an indication of the debt servicing problems that were likely to face Nigeria in the near future. The arrears on import payments were particularly worrying. Complex negotiations between Nigeria and a trade creditors' group, with a view to reaching a refinancing agreement, had been started. Suppliers' credits should be treated no differently from commercial bank lending in an overall rescheduling exercise.

Mr. Grosche stated that he broadly agreed with the staff analysis and fully accepted the staff's recommendations and the proposed decision. The staff had clearly highlighted the serious economic problems facing Nigeria since the turnaround in the world oil markets. The ad hoc measures that the authorities had introduced in 1982 had been unsuccessful, perhaps even counterproductive. Despite those measures and the recovery in oil output, the external accounts and the government finances had considerably weakened. The problems facing Nigeria's economy were clearly reflected in the fact that 98 percent of exports and 70 percent of public revenues stemmed from the oil sector. Any adjustment program aimed at placing the economy on a sound footing would have to attack the structural distortions. The staff recommendations for meeting the adjustment needs of the economy were fully appropriate.

As the staff and Mr. Mtei had noted, the authorities were willing to introduce corrective measures, Mr. Grosche continued. While the staff report included some evidence that the authorities were not prepared to accept all the staff's policy suggestions, it seemed fair to conclude that there were a number of encouraging indications. For instance, the staff and the authorities seemed agreed that the problems facing the economy were due mainly to structural imbalances and cost-price distortions that had accumulated as a result of past policies. Moreover, the authorities had agreed that it would be prudent to base their policies on cautious oil price and output assumptions, and they had accepted the staff's conclusion that monetary policy should play a greater role in promoting stability. The authorities had agreed in principle that the regulations governing the operations of the financial institutions should be significantly liberalized. Agreement had also been reached in principle on the initial policy changes on a sequence of institutional steps to reform the external trade system.

He was worried about five policy areas, Mr. Grosche remarked, the first being state and local government finances. The staff had reported that steps would be taken to impose increased financial discipline on all levels of government, including the public corporations. Did the staff feel that the actions would be effective, thereby constituting an important precondition for the successful implementation of a Fund-supported program? In the second area, the federal budget, the authorities had indicated their intention to implement fiscal austerity, but their efforts thus far--especially with respect to current expenditure--had clearly been inadequate.

As for the third area, Mr. Grosche continued, the authorities' approach to refinancing the trade arrears, it seemed to be somewhat uncoordinated, and a more comprehensive financing package was called for. In the fourth area, the external economy, the thrust of the authorities' policies in 1984 had been to make the exchange and trade system even more restrictive than it had already been. The system should be liberalized to encourage trade and the diversification of exports. As for the fifth area, the exchange rate, all the available data indicated that the naira was considerably overvalued. A crucial element of an adjustment program would be an initial correction of the rate, followed by a flexible exchange rate policy.

The adjustment policies that the staff had mentioned in its report were an appropriate response to the problems facing Nigeria's economy, Mr. Grosche considered. The staff should continue its negotiations with the authorities on a possible Fund-supported adjustment program.

Mr. Polak recalled that, during the previous discussion on Nigeria, Executive Directors had noted the overall deterioration in the country's economic situation. At that time, however, there had seemed to be two small lights in the otherwise dark picture, namely, some signs of a revival of agricultural production, and the still moderate size of the external debt. Since then, even those two lights had been extinguished, as overall agricultural production had fallen despite heavy subsidies, and the external debt ratio had increased from 6.5 percent in 1981 to 26 percent in 1983, while as a percentage of exports the debt service had nearly doubled, from

8.7 percent to 16.9 percent. Moreover, the general debt situation had become bleak, and external payments arrears had emerged and grown to nearly half of exports. In the circumstances, he fully endorsed the staff appraisal, which stressed the need for comprehensive structural changes.

He was particularly concerned about the distortions in the pricing system that had hampered economic activity in Nigeria, Mr. Polak remarked. The most serious was the substantially overvalued currency, which had appreciated by 15 percent since 1981-82 and by 30 percent since end-1978 in real terms, while conditions in the oil market had changed from a boom to a glut. It was understandable that a country heavily reliant on oil exports should have a somewhat overvalued currency, but when the glut had occurred the authorities should have changed their exchange rate policy to encourage trade in commodities other than oil. The authorities had not made such a change; their conclusion that the problems caused by the overvalued exchange rate could be dealt with by more stringent fiscal policies rather than an exchange rate change was disappointing.

The exchange rate was clearly far out of line, Mr. Polak went on, and an adjustment program could be successful only if a severe correction of the rate were made. He hoped that the authorities in Nigeria would show the same courage that the Indonesian authorities had shown a year previously in somewhat similar circumstances. The Indonesian Government had decided on a sharp devaluation of the rupiah despite sharing many of the same reservations expressed by the Nigerian authorities and some Executive Directors.

A second important price distortion was the underpricing of domestic energy products, particularly oil, which had been accompanied by a rapid expansion of the domestic demand for oil, Mr. Polak continued. Still another price distortion was the heavy subsidization of certain agricultural imports, such as fertilizers and tractors. The subsidy system had not been sufficient to make agriculture profitable, and it had distorted the use of the subsidized imports.

Instead of relying on the exchange rate to reverse the deterioration in the external markets, Mr. Polak noted, the authorities had introduced widespread trade and payments restrictions, and the staff had indicated that the most recent information showed that the restrictive trend had intensified in the previous several weeks. The resultant 40 percent decrease in imports was clearly not a long-term solution to the trade problems facing Nigeria. The staff's suggestion for replacing the restrictions by a proper exchange rate policy and a suitable tariff system was sound and, indeed, absolutely essential for improving the present economic situation. The authorities had no choice but to adopt a comprehensive adjustment program.

Such a program, Mr. Polak went on, would have to have an important financial component. The staff's conclusions on the fiscal position, including transfers to the states, were appropriate, and the Federal Government's decision to use its financial leverage over the lower bodies to improve the fiscal situation was welcome. The Federal Government itself would have to increase taxation and reduce its current expenditure in addition to making the reductions in investment expenditure that it had already made. At the same time, monetary policy, which had been lax, should be recast within the framework of an overall program.

The authorities would have to face the debt problem, Mr. Polak considered, and negotiate a realistic plan to deal with the arrears with commercial creditors. The data provided by the staff indicated that further general debt rescheduling in the coming several years would probably be unavoidable.

Carrying out the complex set of measures needed to improve the present situation constituted a challenging task that would have to be performed in difficult circumstances, Mr. Polak remarked. The Fund and the World Bank should continue to provide all possible technical assistance in the elaboration of a consistent policy framework, with a view to providing financial support as soon as possible.

Mr. Doe commented that the performance of the economy during the previous few years had been unsatisfactory. The considerable decline in oil production in 1981 and 1982 in response to the unfavorable development of exports had had adverse ripple effects throughout the economy. Real GDP had fallen by more than 5 percent in 1981 and by 3 percent in 1982, export earnings and government revenues had decreased--especially in 1981--while credit to the Government had expanded considerably, and the current and overall external balance had moved from a surplus to a deficit beginning in 1981. Moreover, external payments arrears had begun to accumulate, and, despite a marginal increase in oil production in 1983, economic and financial problems had remained serious, as real GDP had fallen for the third consecutive year, the rate of price increases had accelerated, and the budget deficit of the Federal Government was estimated to have reached a record high for recent years of nearly 16 percent of GDP.

The origins of the various problems facing the economy had been amply described by the staff and Mr. Mtei, Mr. Doe remarked. They reflected the influence of both exogenous factors and inappropriate domestic policy initiatives. He was pleased that the authorities had concurred in the staff's analysis of the root causes of the poor performance of the economy and the need to correct policies in many areas.

He supported the authorities' aim of combining a financial stabilization program with a program of structural reform, Mr. Doe said. The central feature of the structural adjustment effort should be a well-articulated plan for diversifying the productive base away from the great reliance on the production and exportation of crude oil. Accordingly, the vast agricultural potential of the country should be exploited more effectively, and more attention should be paid to import substitution and to export-oriented industries. He fully agreed with the staff that a piecemeal policy approach was unlikely to result in rapid progress toward a viable economy. Given the magnitude of the imbalances in the economy, durable positive results could be achieved only by a coordinated attack on all fronts.

Commenting on public finances, Mr. Doe said that he welcomed Mr. Mtei's statement on the goal of reducing outlays by the Federal Government and state governments in 1984. He was pleased that the authorities agreed with the staff that restoration of fiscal balance would require both a decline in spending and an increase in revenue through an appropriate tax reform and improved tax administration. A revenue structure less dependent on oil-related revenues would reduce the vulnerability of government receipts to adverse fluctuations in oil exports. He agreed with the staff that both current and capital federal expenditure should be reduced. As for the state governments and public enterprises, the need for increased fiscal discipline could not be overemphasized. The call for closer scrutiny of their financial operations should be heeded quickly, particularly in the light of the large transfers that they received from the Federal Government.

The authorities' more realistic expectations about oil prices and output, Mr. Doe remarked, should provide the basis for the formulation of a sound financial and structural adjustment program. The agreement between Nigeria and some of its commercial bank creditors on the payment of arrears under letters of credit was welcome, but it should not overshadow the need for a coordinated approach to the external debt and arrears problem in the context of a coherent overall macroeconomic policy framework.

The staff had provided abundant information on the exchange restrictions in effect in Nigeria and the distortions that they created, Mr. Doe said. The restrictions, largely quantitative in nature, had been introduced essentially in response to the shortage of foreign exchange. He had noted with interest Mr. Mtei's statement that the import restrictions were temporary. He hoped that the other restrictions were not meant to be permanent, and that the discussions between the authorities and the staff on the use of the exchange rate as a rationing device for foreign exchange would be concluded satisfactorily.

The authorities' recognition of the need for change in a number of important policy areas was encouraging, Mr. Doe concluded. The requirement of a coordinated multidirectional effort to solve the problems facing the economy should be stressed. The adoption and implementation of the needed measures should not be delayed. The chances for success of an adjustment effort in Nigeria would depend on the provision of solid support by bilateral donors as well as by members of the commercial banking and international financial communities. The ongoing negotiations between the Fund and the authorities should be completed quickly.

Mr. Alhaimus said that the Nigerian authorities had faced growing economic problems during the past three years and had reached the critical stage at which difficult policy actions would have to be taken to reduce the unsustainably large external and domestic imbalances. To a considerable extent the circumstances in Nigeria were similar to those of several other large member countries that had experienced a financial crisis in recent years. All those countries had required international understanding and cooperation. In Nigeria, however, much would depend on how specific features of the economy were taken into account in the formulation of advice given to the authorities.

The immediate cause of the recent financial difficulties in Nigeria--and, indeed, in many other member countries--was adverse conditions in the world economy, including the long recession and the shifting trade patterns, Mr. Alhaimus continued. A sharp decline in oil exports and a deterioration in the terms of trade had reduced Nigeria's export receipts in 1983 to less than half the level of 1980. At one stage, Nigeria had been singled out for intensive pressures by oil corporations, thereby seriously reducing its oil production.

The effects of the sharp fall in oil income had been felt throughout the economy, although the fiscal position had been particularly hurt, Mr. Alhaimus went on. Despite the changing conditions, government expenditure had remained high, as the authorities had had difficulty in reversing the well-entrenched expectations generated by the high oil revenues of previous years. Much of the present difficulties could have certainly been avoided if the change in the prospects for the economy had been detected earlier and if sufficient steps had been taken to depart from some of the established fiscal policies and practices.

He was encouraged to note, Mr. Alhaimus said, that the economy was the main preoccupation of the Nigerian authorities and public, and that considerable progress had been made in gaining a better understanding of the nature of the problems facing the economy, the kind of basic policy approach that was needed, and the various measures that should be introduced. A consensus had apparently been reached with the staff on the root causes of the present problems, the principles on which future policy should be based, and the nature of past policies. The most important principle that the authorities had recognized was that without fundamental adjustment in fiscal policy, they would be faced not only with severe balance of payments pressures but also with unsustainably large fiscal deficits.

The staff had also reported that the authorities had already given strong indications about their resolve to implement fiscal austerity, credit restraint, and realistic interest rates to promote savings, Mr. Alhaimus went on. The authorities were convinced that the brunt of fiscal adjustment would have to be borne by the Federal Government, and that tight fiscal discipline would also be needed by the state governments and public corporations. They appropriately intended to use their influence to ensure a better fiscal performance at the state level, and they intended to enhance revenues by improving the tax system and by increasing the prices of domestically consumed crude and refined petroleum products. In structural reform, considerable attention was being given to agriculture, in keeping with staff and Executive Board recommendations on previous occasions. The new plan gave top priority to agriculture, and some tangible results were already apparent.

That was not to say, Mr. Alhaimus continued, that all the needed steps had been taken. The problems facing the economy were enormous, as Mr. Mtei himself had stated. Considerable efforts and sacrifices were needed to reduce the high level of current fiscal expenditure, streamline and rationalize state finances, deal with the escalating external debt service burden, and effect the structural adjustments that were indispensable for adjusting the economy to the changing prospects for oil exports.

The authorities had shown considerable willingness to introduce any strong measures that could be reasonably expected to deal with the problems facing the economy, Mr. Alhaimus remarked. It would therefore be unfortunate to fail to finalize a Fund-supported adjustment program because of the still pending issue of the devaluation of the naira. The case for a substantial devaluation such as that recommended by the staff was highly controversial, and the authorities understandably harbored doubts about it. He himself shared the doubts expressed by Mr. Ismael and Mr. Nimatallah. The authorities had not denied the need for an exchange rate adjustment in a careful and gradual way. It would also be unfortunate to place excessive emphasis on the restrictive trade measures introduced by the authorities. Those measures were an understandable response to the crisis circumstances, and one could not reasonably expect them to be drastically changed in the present uncertain financial situation of Nigeria. On the whole, much could be achieved by a better appreciation of the specific features of the present economic situation in Nigeria.

Mr. de Groote said that he generally agreed with the staff's appraisal and would stress some of the essential parts of an adjustment effort by Nigeria. Nigeria had suffered from drawbacks typical of a country that was overwhelmingly dependent on a single commodity for its external and fiscal receipts. Vagaries in the world markets had aggravated some of the underlying weaknesses of the economy, such as the serious misallocation of resources.

Any feasible adjustment effort should begin by setting appropriate incentives, and, in that connection, the exchange rate would play an essential role, Mr. de Groote went on. A depreciation of the naira would admittedly have only limited effects on exports in the short run, but it would stimulate domestic production--particularly in agriculture and industry--and slow imports. To ensure that the benefits of the initial exchange rate correction were maintained, it would be useful to introduce a flexible exchange rate system; in that connection, the experience of Zaïre might be useful. Statements by the authorities, reported in the press, on their refusal to adjust the exchange rate were dismaying and reflected a misunderstanding of the effects of an adjustment and of a floating exchange rate regime. There was an obvious need for a corrective increase in import prices. An exchange rate adjustment would not be expected to have an immediate effect on demand for Nigeria's exports, but it would immediately affect the supply elasticity of exports by restoring the financial position of the export and import-substitution sectors. It would also affect the elasticity of fiscal receipts. The easiest way to encourage the development of the manufacturing sector and of new export activities was to maintain an exchange rate that did not stimulate imports.

An exchange rate adjustment would also greatly contribute to improving the fiscal situation, Mr. de Groote considered. Fiscal receipts depended greatly on oil exports, and substantially larger revenues in local currency could be collected if a more realistic exchange rate were in place. The fiscal situation also called for an increase in expenditure control on both the federal and state levels, and technical assistance from the World Bank and the Fund in that area could be useful. In the light of the marked change in oil revenue, there was good reason to review the revenue-sharing arrangement between the federal and local governments. Should no such change be possible, it would be essential to limit strictly other transfers to local authorities, as it seemed rather difficult to maintain control of expenditure by the states and local governments. In addition, monetary policy should be adjusted to enable it to contribute to a better allocation of scarce financial resources.

The inappropriate exchange rate was reflected in the large-scale use of barter arrangements, Mr. de Groote noted. The practice was widespread in countries that maintained unrealistic exchange rates, and it implied substantial transaction costs while permitting large profit margins that bore heavily on consumers. There was no better alternative to the use of money in international transactions; nor was there a better substitute for market-oriented prices in ensuring that supply and demand were kept in equilibrium at minimum cost to consumers. The large-scale use of barter arrangements in Nigeria and other countries, and particularly the costs involved, should be studied in greater detail by the staff.

The situation in Nigeria called for close collaboration between the Fund and the World Bank, Mr. de Groote stated. In some areas, such as administrative and tariff reform, the World Bank's expertise would be highly valuable; the Fund should recommend appropriate macroeconomic policies. However, he would be reluctant to see the World Bank become involved in Nigeria before the exchange rate, monetary, and fiscal situations were brought back on track under a Fund-supported program. World Bank support for structural measures could not be effective in the absence of appropriate demand management and balance of payments policies.

Still, Mr. de Groote continued, even if the authorities implemented appropriate policies, they would need help from the international community to relieve the external financing constraints. The substantial repayments due in 1984-86 would have to be stretched out over a longer period. There would be great advantage in adopting a global approach to the refinancing of all forms of external debt. Nigeria was probably one of the cases in which debt repayments could be usefully linked to the evolution of its export proceeds. He hoped that the authorities recognized the need to resort to exchange rate policy to correct the present imbalances, thereby paving the way for access to a substantial volume of Fund assistance over the longer run.

Mr. Malhotra said that he broadly agreed with the staff appraisal. Nigeria was a dramatic example of a country that had suffered a major reversal as a result of overdependence on a single commodity. For more than a decade, economic policies in Nigeria had been aimed at collecting and absorbing oil revenues. The situation of plentiful revenues had changed during the previous two years, and the economy faced enormous problems that were, however, solvable, particularly in the light of the substantial endowment of resources.

Reduced international demand for oil and the softening of oil prices had adversely affected Nigeria's GDP growth, fiscal revenues, external reserves, and external debt position, Mr. Malhotra noted. Since real oil revenues were unlikely to regain the levels of 1980-81, it was imperative that the authorities undertake structural adjustment to diversify the economy and increase export and import-substitution capacity. Mr. Mtei had shown that the authorities were fully aware of the need to make major policy adjustments, and some of the actions already taken, especially in the fiscal area, indicated their commitment to a serious adjustment effort.

In the past, Mr. Malhotra remarked, the overdependence on oil had resulted in neglect of the agricultural sector, which had been an important contributor to exports. The authorities had recently decided to take measures to revive agriculture, including increases in the prices of agricultural commodities. Better incentive prices constituted the most important instrument for ensuring an increase in agricultural production.

The structure of industrial investment should be reviewed, Mr. Malhotra continued. The authorities had established a committee for that purpose, and it had already made some recommendations. World Bank technical assistance in that area would be useful.

In the macroeconomic policy areas, Mr. Malhotra remarked, a sound fiscal policy could make a crucial contribution to solving some of the major problems facing the economy. The budget deficit, equivalent to about 16 percent of GDP, was far too large and was clearly unsustainable. In the short run, expenditure reduction would perhaps be the most important way of improving the budgetary position, and Mr. Mtei had indicated that the authorities were paying full attention to that requirement. Expenditure discipline at both the federal and state levels was essential, as was improvement in expenditure efficiency. Such efforts naturally took time, and they should therefore be begun urgently.

On the revenue side, Mr. Malhotra went on, there was scope for introducing some important measures. Domestic prices of oil and oil products were considerably subsidized and could probably be raised quickly, thereby helping to contain growth of domestic oil consumption, generate substantial resources for the budget, and reduce the large budget deficit. Many other countries had found that reducing oil subsidies was an important part of a sensible energy policy and helped to strengthen public sector revenues. In addition, early implementation of the staff suggestion for introducing a general sales tax could yield quick results. Vigorous action to increase the prices of public sector entities could also help improve the fiscal situation.

Monetary policy had been expansionary, Mr. Malhotra remarked. The authorities were aware of the need for a restrained monetary policy, and effective measures should be taken early.

The imbalances in the external sector were serious and called for remedial measures, Mr. Malhotra said. Apparently there was a major difference of opinion between the authorities and the staff about the appropriate approach to the exchange rate. Action on the exchange rate front was needed, but he sympathized with the authorities, who felt that a gradual approach was preferable to an immediate large discrete devaluation. There seemed to be a widely shared view that a major exchange rate change would not have a substantial impact on exports in the immediate future, although it would certainly have beneficial effects on exports in the medium term. He agreed with Mr. de Groote that the main impact of a large exchange rate adjustment would be on the import side. However, there had already been considerable constriction of imports as a result of several, essentially administrative, steps that the authorities had taken. Those measures had perhaps not been the most desirable ones but had probably been unavoidable in the given circumstances. In the light of the present trade situation, he agreed with Mr. Wicks that some inventive resolution of the exchange rate issue was called for.

The exchange rate issue was controversial in terms of both its economic and political implications, Mr. Malhotra remarked, but it was not the crucial issue for the immediate future. Rather, fiscal and pricing policies, especially the promotion of agricultural output, would be the more important elements of adjustment. An adjustment program should stress the fiscal side--particularly improving revenues, bringing expenditures under control, and making prices more rational--and include a restrained monetary policy. A mechanism should be devised to ensure that, over time, as the various imbalances in the economy were corrected, an adjustment of the exchange rate would also take place. One feasible solution, which Mr. Nimatallah had mentioned, would be a relatively small adjustment of the exchange rate at the outset of a program, followed by additional changes over time.

The exchange rate issue should not stand in the way of the conclusion of an arrangement, Mr. Malhotra considered, as a delay would have adverse consequences for Nigeria. The country's financing needs were acute, and an improvement in confidence was urgently required. An arrangement should therefore be finalized as soon as possible.

The accumulation of arrears because of the difficult foreign exchange situation had complicated Nigeria's debt position, Mr. Malhotra remarked. Moreover, the maturity profile of the debt had worsened abruptly. Reducing arrears was crucial for restoring confidence in Nigeria, and effective management of the external debt would doubtless engage the attention of the authorities. A rescheduling or restructuring of Nigeria's debt should take into account not only the country's present difficulties, but also the longer-term viability of the economy, which was well endowed with resources and could certainly be brought back on track with the adoption of sound adjustment policies. The authorities, the Fund, and commercial banks should cooperate in restructuring the Nigerian debt in a reasonable fashion.

Mr. Blandin said that the difficulties facing the economy were undoubtedly the result of inadequate economic and financial management over a number of years. The oil glut that had begun in 1981 had not been foreseen to any extent by the previous authorities; hence they had not tailored their economic and financial policies to meet possible difficulties.

Moreover, the authorities had failed to adjust the economy to the new external environment, despite all the signs indicating that it would be long lasting. As a result, imports had continued to increase substantially in 1981 and had remained at an unsustainable level in 1982. Imports had not been reduced until 1983, although to a level higher than in 1979, and mainly because of the acute shortage of foreign exchange and the adoption of a number of restrictions on external trade and current payments.

The evolution of the budgetary situation was astonishing, Mr. Blandin remarked. The overall deficit of the Federal Government had increased from almost nothing to about 10 percent of GDP in 1981 and 1982 and to 15 percent in 1983. When the deficits of the state governments and public corporations were added to obtain the overall deficit of the public sector--the concept generally used by the Fund--the deficit was approximately 20 percent of GDP.

Since fiscal policy had been consistently inappropriate, and credit and monetary policies had been lax, Mr. Blandin continued, the increase in the rate of inflation was not surprising. As the staff had noted, the official consumer price indices did not reflect the underlying strength of inflationary pressures as fully as the evolution of the money supply. Since 1978, the rate of inflation might well have been between 50-60 percent higher than that recorded by the official consumer price indices.

The previous authorities had persistently maintained a policy stance that had resulted in a steady appreciation of the real effective exchange rate, Mr. Blandin remarked. The staff had calculated that, on the basis of official indices, the appreciation had been 35 percent since end-1980. When the actual rate of inflation was taken into account, however, the overvaluation had probably been between 75-100 percent since 1978, which seemed a better index base year than 1980. The exchange rate of the naira against the CFA franc on the flourishing parallel market was apparently one fifth of the official rate. The growing distortion of the exchange rate had caused corresponding distortions in the whole price system that had been particularly harmful to agricultural production; producer prices had consistently been kept lower than was needed to provide sufficient incentives for production. As a result, food output had dwindled, and agricultural exports--once the main source of external revenues--had nearly disappeared.

Despite the various incorrect policies, Mr. Blandin continued, Nigeria would not have been squeezed into the present difficult situation, with more than $5 billion in trade arrears, if the large revenues from oil exports had been carefully invested in selected productive projects designed in particular to generate additional foreign exchange revenues through an increase in new exports. In fact, much of the export revenues and the external borrowing had been wasted. A sizable portion had been used for consumption, and investments had been based on a sizable overestimation of the country's absorptive capacity. The previous Government had undertaken a number of infrastructure projects without securing the financing for the corresponding recurrent expenditures on maintenance.

Investments in the productive sectors had suffered from huge cost overruns, a lack of skilled labor, poor management, and cumbersome administrative regulations. As a result, the net contribution of the investments to foreign exchange earnings had probably been negative.

In many policy areas, Mr. Blandin noted, the authorities' action had been precisely the opposite of what had been called for. Nigeria would greatly benefit from access to Fund resources that were used to undertake a necessarily painful adjustment effort. The Fund's support should be augmented by that of the World Bank, which certainly had an important role to play in Nigeria.

A number of preconditions would have to be met before an extended arrangement for Nigeria could be approved, Mr. Blandin considered. First, there should be a preliminary and sizable devaluation. The recent examples of Ghana and Zaïre showed that such a step was feasible. Second, there was an obvious need for a sizable fiscal adjustment; the deficits of the Federal Government and state governments should be cut at least in half. To that end, the figures on the budgets of the state governments would have to be much more precise. The larger the devaluation, the easier the fiscal adjustment would be, as the local counterpart of fiscal revenues from oil exports would increase in proportion to the size of the devaluation. Third, adequate pricing policies must be implemented. Agricultural producer prices in particular should fully reflect world prices after taking into account the effects of the devaluation. Fourth, the authorities should eliminate all the exchange restrictions and settle quickly all remaining arrears on trade payments in an orderly manner. The three years suggested by the staff for the settlement of the arrears represented the maximum period acceptable. An agreement with the creditors on the settlement of the arrears should be a condition for an arrangement to become operative. Fifth, the investment program would have to be fully reappraised under World Bank supervision. Sixth, the investment program should be closely monitored by means of frequent reviews, and a Fund resident representative and technical assistance should be provided in order to ensure the prompt implementation of all the measures under a Fund-supported program.

The authorities would have to make a substantial effort to tackle the difficult problems facing the Nigerian economy, Mr. Blandin concluded. He was pleased to note in Mr. Mtei's opening statement that the new Administration had already recognized the need for some important corrective actions. Finally, he fully endorsed the staff appraisal and accepted the proposed decision.

Mr. Arias stated that the proposed decision was acceptable. The economy had faced economic and financial problems in recent years, particularly as a result of the substantial decline in oil revenues. In the light of the difficult economic situation, the authorities had expressed their determination to undertake structural adjustment measures to reorient the economy. Some measures had already been introduced to control government expenditure. Expenditure control should be strictly maintained, and the mechanisms for increasing revenues should be improved.

The authorities' intention of replacing the quantitative restrictions with tariffs was welcome and could take place gradually, Mr. Arias commented. Assistance from the World Bank would be useful. As for the exchange rate, his position was similar to that of Mr. Nimatallah. The staff could usefully comment further on its recommendation for a rapid devaluation rather than a gradual adjustment consistent with the process of adjustment to be made in other areas of economic policy. Finally, he supported the authorities' intention to approach the Fund for its support of an adjustment program.

Mr. Zhang remarked that there was a difference of opinion between the staff and the authorities about the advisability of a substantial devaluation. The authorities had made a convincing case against such a move. The effect of a devaluation on import prices was important because of the large volume of consumer goods and raw materials that had to be imported. The staff had not stated its case in any great detail, and the provision of information on the elasticities involved would help Executive Directors to decide whether or not a devaluation was called for. In any event, a devaluation should not be a precondition for the acceptance by the Fund of an arrangement with Nigeria.

Mr. Salehkhou observed that economic conditions in Nigeria had deteriorated since the previous Article IV consultation with the country. The manufacturing sector, which was heavily protected and therefore had a high-cost structure, had suffered from underutilization of capacity, unavailability of supplies, and a loss of competitiveness due to inefficiency.

In the external sector, Mr. Salehkhou went on, there had been a continuous erosion in the purchasing power of oil and other exports, and the authorities had responded by tightening administrative controls over imports and other current transactions. In addition, certain capital appropriations had been frozen, capital expenditure had been limited to ongoing high-priority projects, and monetary policy had been tightened. Such stabilization measures, however, seemed to have been reflected in improvements only in the current account deficit, which had fallen from 10.1 percent of GDP in 1982 to 2.9 percent in 1983. In 1983, however, the net outflow of capital was expected to offset the reduction in the deficit.

The deterioration in the external position had been reflected in a drawdown of foreign exchange reserves and in a large accumulation of trade arrears, Mr. Salehkhou remarked. Although Nigeria had remained current in servicing its other larger-term debts, the external situation would probably intensify the pressure on the country's debt service capability. Continuation of the present trends would cause serious debt-servicing problems in the future; more than half the debt had an average maturity of five years at commercial market rates.

In the real sector, Mr. Salehkhou went on, production had been hampered by sharp declines in imports and by administrative and trade restrictions. Real inflationary pressures had increased, and agriculture, once the most important source of livelihood for the population, had gradually lost its momentum.

Nigeria was experiencing some of the problems that had faced many oil exporting countries as a result of continuous declines in their real incomes, Mr. Salehkhou noted, but the problems were not due only to the general deterioration in the external environment. There was a clear need for the Government to introduce a comprehensive and coherent stabilization program. How far had the negotiations on a program progressed?

There was also an urgent need for the authorities to improve the collection and processing of statistics on the economy, Mr. Salehkhou said. Without reliable data, predictions and policy pronouncements might prove to be haphazard. For instance, there were wide divergencies in agricultural data provided by the various sources in Nigeria. The root causes of the data discrepancies should be explored, and Fund technical assistance might well be useful.

A major revaluation of agricultural policy should be undertaken to determine the bottlenecks and to devise a short-term and long-term blueprint for the revival of agriculture, Mr. Salehkhou considered. In particular, an assessment of the costs and benefits of ongoing agricultural projects, such as the River Basin Authorities and the Green Revolution, should be undertaken. Given the paramount importance of agriculture as an alternative to the dwindling role of the hydrocarbon sector, a further comment on the role played by World Bank project loans in Nigeria's agricultural development would be welcome.

The authorities agreed with the staff on the basic fact that the naira was overvalued, Mr. Salehkhou noted. The authorities apparently favored a more gradual exchange rate adjustment while granting that it might not be the best possible course of adjustment. Any exchange rate adjustment should strike a balance between the need for a rapid external improvement and the need for sufficient time to spread out the burden of adjustment. An exchange rate adjustment should take into account the volume of export earnings from oil revenues, the price elasticity of which depended greatly on factors other than the exchange rate. Emphasis should be placed on appropriate fiscal and monetary measures to complement any exchange rate adjustment.

Much remained to be done in the effort to rationalize the public corporations, Mr. Salehkhou remarked. The major weak spot in that sector and in the agricultural and domestic energy sectors was pricing policy. Price adjustments were a crucial part of the effort to revitalize those sectors. Nigeria was well endowed with natural resources and had a relatively good supply of labor, and he hoped that, with the resolve and good judgment of the authorities, progress would eventually be made. The proposed decision was acceptable.

The staff representative from the African Department commented that there seemed to be widespread agreement that the exchange rate was overvalued, and that the main issue was the extent to which the overvaluation should be corrected and the speed at which the correction should be made. In favoring an adjustment that would bring the rate back to the 1978/79 level, the staff had not claimed that that rate was an equilibrium one. The staff had chosen 1978/79 as the base year because the fiscal, monetary, and trade policy mix prevailing at that time had been broadly consistent with the payments position; there had been a significant tightening of demand management policies at that time, and the trade system had been relatively liberal. It was true that import licenses had still been issued in 1978/79, but apparently only about 60 percent of the licenses issued had actually been used; the evidence suggested that the demand for imports at the time had been fully satisfied. In addition, a study by the World Bank suggested that a correction of the overvaluation that had taken place since 1978 would make most of Nigeria's domestic industries competitive.

A correction of the exchange rate to offset the appreciation of the real effective rate since 1978 should be judged in the light of the policies that would be adopted in support of the exchange rate adjustment, the staff representative continued. The staff had advocated certain demand management policies and, even more important, a rationalization of the external tariff. The trade sytem was cumbersome, and tariff rates, which ranged from 0 to 500 percent, were a major source of the distortions in the economy. One major issue to be addressed in any structural adjustment effort would have to be the external trade policies, the customs tariff in particular. The World Bank, in collaboration with the Fund, had undertaken a study of the external tariff structure and had suggested a new structure that appeared reasonable and had been submitted for examination by the authorities.

The staff believed that the crucial problems facing the economy were in the exchange and trade policy fields, the staff representative observed. It was confident that the authorities were committed to implementing demand management policies, and the issue was whether or not the gains from those policies could be sustained without a rationalization of trade policy. Executive Directors had made comprehensive comments on the case for and against an initial large devaluation as opposed to a gradual adjustment of the exchange rate.

The question had been raised, the staff representative recalled, whether the official price indices appropriately measured inflation in Nigeria, and whether the staff calculations of the real appreciation of the exchange rate were accurate. It was true that the movements in the consumer price index had occasionally been unexpected. In 1982, for instance, the deceleration in the rate of inflation had been surprising in the light of the relative decline in import growth together with the continued rapid expansion of the money supply. The staff felt that, in the light of the reduced volume of imports in 1983 and the continued domestic bank financing of the budget deficit, the underlying rate of inflation was probably somewhat higher than the increase in the consumer price index, but that development had been taken into consideration in the staff report.

If information on the state budgets had been available, the staff representative commented, the overall public sector fiscal deficit would certainly have been larger than the one reported in SM/84/17. The staff could not say precisely how much larger it would be, but some of the states' deficit had already been financed through the federal budget in the form of transfers to the state governments. The volume involved was reflected in the arrears that had been accumulated by the states vis-à-vis the Federal Government; they were equivalent to about ₦ 1 billion over a period of two and one-half years. The staff had encouraged the Federal Government to use its financial leverage to control the growing budget deficits.

The World Bank was actively involved in Nigeria's agricultural sector, the staff representative explained. Integrated agricultural development programs, heavily financed by the World Bank, were being implemented by the states. The contribution of the state governments to the financing of the programs had been a problem, but the World Bank staff had been working closely with the Nigerian authorities for some time to determine how best to increase the efficiency of the agricultural development programs. There had been signs of progress in the agricultural sector in 1982.

In SM/84/17, the staff representative noted, the calculation of the financing gap had been based on the assumption that the arrears would be repaid over a three-year period. The staff had not meant to suggest that it preferred a period of settlement of precisely three years. Rather, it had meant to highlight the extent of the external financing gap.

The staff had been discussing the possible provision of technical assistance with the authorities, the staff representative remarked. The World Bank was already providing technical assistance in debt reporting, and the Fund was considering providing technical assistance in debt monitoring and management. The authorities appeared to have an open mind to receiving any assistance that would alleviate the administrative problems and increase the efficiency of their adjustment effort.

The Fund staff had been working closely with the World Bank since the authorities first expressed an interest in an adjustment program, the staff representative commented. The progress that had been made was reflected in the number of sectoral analyses that had already been completed. For instance, the capital expenditure program had been reviewed on a project-by-project basis. The capital expenditure program took into account not only sectoral analyses, but also the analysis of ongoing projects and projects that were to be implemented in 1984-86.

A study had been made of the industrial incentive structure, the staff representative from the African Department explained, and it was the origin of some of the recommendations concerning tariff reforms and an exchange rate adjustment and supporting policies. A major study on the revised customs code, including a detailed structure of taxes after an already completed exchange rate adjustment, had been placed at the disposal of the Nigerian Government.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted without meeting in the period between EBM/84/21 (2/10/84) and EBM/84/22 (3/26/84).

2. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 84/114 through 84/116 are approved. (EBD/84/33, 2/6/84)

3. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to an Executive Director and an Advisor to an Executive Director, as set forth in EBAP/84/30 (2/8/84) and EBAP/84/32 (2/9/84), is approved.

APPROVED: August 6, 1984

JOSEPH W. LANG, JR.
Acting Secretary