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SM/86/137
Supplement 1

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INFORMATION

July 8, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Nigeria - Staff Report for the 1986 Article IV Consultation

The attached supplement to the staff report for the 1986 Article IV consultation with Nigeria has been prepared on the basis of additional information. A corrected proposed decision appears on page 9. The correction is as follows:

Para. 2, line 2: for "Sections 2 and 3" read "Section 2"

Mr. Allen (ext. 8381) or Mr. van der Mensbrugghe (ext. 8667) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

NIGERIA

Staff Report for the 1986 Article IV Consultation
Supplementary Information

Prepared by the Staff Representatives for the
1986 Consultation with Nigeria

Approved by A.D. Ouattara and W. A. Beveridge

July 7, 1986

I. Introduction

In the period since the 1986 Article IV consultation discussions, a staff team visited Lagos from May 19-23 to conduct further policy discussions with the Nigerian authorities. 1/ The staff team met with Dr. Okongwu, Minister of Finance; Dr. Kalu, Minister of National Planning; Mr. Bello, Permanent Secretary of the Federal Ministry of Finance; Mr. Abubakar Alhaji, Permanent Secretary of the Federal Ministry of Planning; Mr. Falae, Secretary to the Federal Military Government; Mr. Ahmed, Governor of the Central Bank of Nigeria; and other senior officials concerned with economic and financial matters. On the last day of the mission, Mr. Ouattara met H.E. President Babangida, Head of State. The mission discussed the elements of an adjustment program to cope with Nigeria's present economic difficulties. Since the Article IV consultation discussions in March 1986, Nigeria has also entered into contact with its official and private creditors with a view to rescheduling its external obligations. The present paper supplements the information contained in the staff report (SM/86/137, 6/13/86). A corrected decision is contained in section VI.

II. Recent Economic Developments

The decline in oil export earnings has continued to be the dominant feature of Nigeria's economy. The spot netback price of Bonny light, Nigeria's premium crude, averaged about US$18 per barrel in the first quarter of 1986, compared with an average spot price of about US$26.80 per barrel in the corresponding period a year earlier (Table 1). In the second quarter of 1986, the average spot netback price of Bonny light is estimated at about US$15 per barrel compared, with an average price of over US$28 per barrel in the spring of 1985. The average level of production in both the first half of 1985 and 1986 is estimated at about

1/ The staff team was led by Mr. Ouattara (head-AFR) and comprised Mr. Allen (AFR), Mr. Quirk (ETR), and Mr. van der Mensbrugghe (AFR). Mr Archibong, Advisor to the Executive Director for Nigeria, participated in some of the discussions.

Table 1. Nigeria: Spot Netback Values of Bonny Light in U.S. Gulf Coast, 1985-86

(In U.S. dollars per barrel)

	1985	1986
January	25.67	22.59
February	26.55	16.49
March	28.09	14.77
April	28.92	14.71
May	27.92	16.36
June	25.57	13.52 1/
July	27.39	
August	26.84	
September	27.70	
October	28.78	
November	29.19	
December	27.06	

Source: Petroleum Intelligence Weekly.

1/ First two weeks of June only.

1.5 million barrels per day. Thus, on account of declining prices, Nigeria's oil earnings in the first half of the year are estimated to have fallen from approximately US$6.4 billion in 1985 to US$3.8 billion in 1986.

Though oil receipts provide 70 percent of government revenue, the impact on the budget in the first quarter of 1986, albeit pronounced, has been less severe than might have been expected because of several endogenous factors. Total revenue of the Federation account in the first quarter of 1986 declined by only 13.8 percent (to ₦ 2.8 billion) in comparison with the corresponding outcome in 1985. The decline in dollar oil receipts was offset somewhat in naira terms by the naira's 15 percent depreciation vis-à-vis the U.S. dollar. A depreciation of the naira has a net overall beneficial impact on the budget as long as the price of oil is above US$13 per barrel. In addition, contributions to the National Economic Recovery Fund--which stem from surcharges on wages and salaries, the reduction in the petroleum subsidy, and a 30 percent import levy--amounted to ₦ 445 million in the first quarter and thus directly increased federal government revenue. However, the revenue outcome will undoubtedly be lower in the second quarter in view of the lower average price of oil. Based on the approved 1986 budget, expenditure for the first quarter of 1986 was budgeted at ₦ 2.8 billion. In view of the anticipated cashflow problems, however, warrants amounting to only ₦ 2.1 billion were released.

After maintaining a fixed rate pegged to the U.S. dollar for nearly three months, the authorities depreciated the naira to US$0.9904 in the last week of March 1986 and thereby dropped the value of the naira below the dollar for the first time. Subsequently, the gradual downward crawl of the naira has continued, and by June 24, 1986 the exchange rate was ₦ 1 = US$0.8681, thus representing a 13 percent depreciation since the beginning of the year. In view of the recent movements of the U.S. dollar in the international currency markets, the depreciation of the naira in nominal effective terms was 13.4 percent from end-December 1985 to end-May 1986. The depreciation of the naira in real effective terms is of similar magnitude, as the divergence in inflation rates has continued to be small.

III. Nigeria's Structural Adjustment Program, July 1986-June 1988

Following the Article IV consultation discussions in March 1986 and Nigeria's approach to its creditors in the London and Paris Clubs for a rescheduling of its debt, the Nigerian authorities have elaborated a structural adjustment program to cover the period 1986-88. The staffs of both the Fund and the World Bank gave comments and suggestions during the drafting process. The program has now been adopted by the Nigerian Government and was announced to the nation by President Babangida in late June 1986.

The adjustment program covering July 1986 to June 1988 provides for the continuation and strengthening of the policies contained in the 1986 budget, taking into account the fall in the price of oil. It maintains tight fiscal and monetary policies with a view to restraining inflationary pressures and overcoming the balance of payments problems while strengthening structural and supply oriented measures. The program aims at establishing a realistic exchange rate, the liberalization of exchange and trade controls, and the further reform of the tariff structure. The program is designed to reduce controls in the economy and strengthen market forces, to allow appropriate pricing, particularly for petroleum products and public enterprises, and to rationalize and privatize a number of the latter.

The program recognizes that the naira is at present substantially overvalued. To overcome this it proposes to establish a second-tier foreign exchange market in the latter half of 1986. This would be a free interbank market through which public and private sector transactions, visibles and invisibles, would be channelled. The official exchange rate would only continue to apply to the servicing of past debt and to payments of Nigeria's contributions to international organizations. The resources for the second-tier market would come from non-oil and invisible export earnings, Nigeria's holdings in domiciliary accounts, the proceeds of an IBRD Trade Policy and Export Development Loan, now being negotiated, new commercial bank loans, and, most importantly, from that part of oil revenues not needed for the official market. Convergence of the dual exchange rates would occur before the end of the structural adjustment program during which time the depreciation of the official rate would be continued. At the end of the period, the two rates would be unified and all transactions would take place at the lower freely floating exchange rate. With the introduction of the second-tier market, the 30 percent import surcharge levied since the start of the year, as well as exchange controls and import-licensing requirements on transactions through the second market, would be eliminated. The new exchange rate is expected to give a considerable stimulus to non-oil exports. The IBRD is also giving technical assistance in the area of export promotion, where amongst other measures, documentation requirements are being simplified and streamlined.

Fiscal policy aims to contain the federal government budget deficit to within 3 percent of GDP, a level similar to that achieved in 1985 before the most recent fall in oil prices. This will be achieved through further expenditure cuts, aided by the fiscal impact of the exchange rate change. Capital expenditures will be concentrated on maintenance and the timely completion of a limited group of core projects.

Expenditures on the wage bill will be constrained, through policies of keeping wage increases to less than the rate of inflation and allowing attrition and a broad hiring freeze to restrain numbers. Higher priority will be given to expenditure on supplies, and maintenance work will be favored over new projects. Transfers to parastatals will be halved in 1986 and those to commercial parastatals eliminated by the end of the program period. In view of the uncertainties surrounding revenue projections, spending will be adjusted quarterly in the light of available resources. Should revenues exceed projections, priority will be given first to a further reduction in the fiscal deficit and second to an increase in operating and maintenance expenditures.

The revised federal capital expenditure program reflects a number of recommendations by the World Bank. The thrust of capital expenditure is to be on maintenance, rehabilitation, and the timely completion of viable ongoing projects. New projects will only be embarked upon where they clearly contribute to the economic recovery process and where their funding is fully established. Capital expenditure in agriculture will be directed to the Agricultural Development Projects (ADPs) sponsored by the World Bank, and to small scale irrigation projects. Industrial investment in the gas sector, including the Warri-Lagos pipeline, is planned. The development of the new federal capital, Abuja, and further investments in the petrochemical and steel sectors will be limited until reviews have been completed.

Nigeria's parastatal sector includes over 100 commercially oriented enterprises at the federal level alone. Those enterprises which operate in a fully commercial manner are to be privatized, and the sale of equity has already started for some of these. Others will remain fully or partly state-owned, but will be required to generate as much of their own financial resources as possible. Guidelines will be issued on the efficient operation of these enterprises. Finally, after ending the monopoly of the six commodity marketing boards early this year, the Government has announced its intention to wind up their activities before the end of 1986.

The expansion of net domestic credit is to be limited to 5 percent in 1986 and 6 percent in 1987, or less than envisaged at the start of the year. After reducing the number of sectors subject to sectoral credit allocation to four in 1986, the number will be reduced to two in 1987, and the system eliminated in 1988. To reduce the high level of liquidity in the banking system, commercial banks are to deposit by end-1986 the domestic counterpart of external payments arrears with the Central Bank in blocked accounts. Interest rates are to be kept under review with the aim of keeping them positive in real terms, the spread between lending and borrowing rates is to be reduced, and the sectoral interest rate differential eliminated.

In agriculture, the adjustment program aims to increase the production of food, raw materials for domestic industry, and exportable cash crops, as well as to raise rural employment and income. The establishment of an appropriate exchange rate and the elimination of the commodity boards should contribute to providing the appropriate structure of incentives. By 1988 Nigeria should become self-sufficient in maize and virtually self-sufficient in rice. Production of palm oil is also expected to increase rapidly.

Industrial strategy aims to encourage the use of domestic inputs, maximize the growth in value added in manufacturing, promote export-oriented industries, encourage small- and medium-scale industries, and reduce administrative controls that hamper development and domestic and foreign investment. An appropriate exchange rate and tariff structure are vital to this effort, together with a rational export promotion policy. The procedures for approving foreign investment are to be streamlined, and all new foreign investment and dividend remittances are to be channelled through the second-tier market. A white paper is under preparation on industrial policy and the incentive system, and close collaboration with the World Bank will be maintained in this area.

IV. Contact with Creditors and Financing Needs

As noted in the staff report (SM/86/137, pp. 15-17), Nigeria approached its London and Paris Club creditors in March and April 1986 to request a rescheduling of maturities falling due in 1986 and subsequent years. The London Club approved a moratorium on principal repayments on medium- and long-term debt falling due in the period April 1, 1986-June 30, 1986. Paris Club creditors indicated that the prompt conclusion of discussions with the Fund on a stand-by arrangement would pave the way for a rescheduling and for a progressive normalization of their financial and trade relations with Nigeria. On June 12, 1986, Nigerian representatives again met with commercial bank creditors in New York, inviting the Fund and the World Bank also to be present at the meeting. The Nigerian representatives presented their medium-term adjustment policies, noted that the staffs of the Fund and the Bank had helped in that elaboration, and indicated that discussions with the Fund would be continued during a staff visit later in the summer. The Nigerian representatives asked for an extension of the moratorium and for the reopening of trade credit lines, which had been suspended as a result of the incurrence of new arrears on letters of credit in 1986. They also noted that the closing of the financing gap in Nigeria's balance of payments in 1986 and 1987 would require a combination of rescheduling and new money. The commercial bank creditors agreed to extend the moratorium until end-September, arranged to meet Nigerian representatives again in late August, and noted that the reopening of credit lines was a matter for discussion between Nigeria and individual banks.

Table 2 shows revised balance of payments projections for Nigeria, which were prepared by the staff. It replaces Table 4 of SM/86/137 (p. 16) and presents a clearer picture of Nigeria's immediate financing needs. It differs from the previous table in the following ways: (1) the assumed level of domestic oil consumption is revised downwards, although production remains unchanged; world price assumption was marginally adjusted in view of developments in the past few months; (2) projections for non-oil exports are revised upwards in response to the new policies and in line with IBRD projections; (3) external debt data have been revised; (4) the current account includes interest on all

Table 2. Nigeria: Balance of Payments Projections, 1986-91

(In millions of U.S. dollars)

	1986	1987	1988	1989	1990	1991
Current account	-2,218	-1,878	-1,469	-1,089	-948	-867
Trade balance, f.o.b.	1,766	1,587	2,168	2,634	2,861	3,042
Exports	7,766	7,857	8,720	9,481	10,016	10,519
Petroleum	(7,367)	(7,355)	(7,982)	(8,650)	(9,039)	(9,446)
Other	(399)	(502)	(738)	(831)	(977)	(1,073)
Imports	-6,000	-6,270	-6,552	-6,847	-7,155	-7,477
Services (net)	-3,710	-3,146	-3,294	-3,355	-3,412	-3,502
Investment income	-2,731	-2,115	-2,232	-2,256	-2,267	-2,307
Of which: scheduled interest 1/	(-2,521) 2/	(-1,895)	(-2,002)	(-2,017)	(-2,016)	(-2,045)
Nonfactor services: credit	233	236	262	284	300	316
Nonfactor services: debit	-1,212	-1,267	-1,324	-1,383	-1,445	-1,510
Transfers (net)	-273	-320	-343	-368	-397	-407
Capital account	-906	-1,050	-1,164	-878	-207	-51
Direct investment	368	386	405	425	447	469
Medium- and long-term capital (net)	-1,527	-1,459	-1,536	-1,267	-644	-510
Gross official borrowing 3/	(1,179)	(981)	(623)	(376)	(250)	(86)
Scheduled amortization 3/	(-2,604)	(-2,482)	(-2,310)	(-1,945)	(-1,318)	(-1,073)
New autonomous borrowing	(26)	(207)	(293)	(366)	(424)	(477)
Private borrowing (net)	(-128)	(-165)	(-142)	(-65)	(--)	(--)
Short-term capital	253	24	-34	-37	-10	-10
Overall balance	-3,124	-2,928	-2,633	-1,967	-1,155	-918
Financing	-2,739	-1,709	-1,709	-1,709	-427	-39
Reserve movements (- increase)	--	--	--	--	--	-39
Arrears accumulation (net) 4/5/	-6,555	--	--	--	--	--
Rescheduling of arrears (net) 6/	3,816	-1,709	-1,709	-1,709	-427	--
Financing gap	5,863	4,637	4,342	3,676	1,582	957
Memorandum items:						
External debt						
Total	22,682	24,316	25,556	26,321	26,831	27,279
Central Bank of Nigeria	6,303	4,594	2,886	1,177	750	750
Short-term	(750)	(750)	(750)	(750)	(750)	(750)
Rescheduled arrears	(5,553)	(3,844)	(2,136)	(427)	(--)	(--)
Unrescheduled arrears	(--)	(--)	(--)	(--)	(--)	(--)
Medium- and long-term debt	10,516	9,222	7,828	6,626	5,982	5,473
Financial	(6,931)	(5,324)	(3,708)	(2,401)	(1,658)	(1,093)
Multilateral	(1,463)	(1,790)	(2,129)	(2,475)	(2,850)	(3,224)
Bilateral	(1,120)	(1,152)	(1,086)	(948)	(793)	(637)
Suppliers'	(1,003)	(956)	(905)	(802)	(681)	(519)
Cumulative financing of gap	5,863	10,500	14,842	18,518	20,100	21,057
Debt service (in percent of exports of goods) 6/	130.1	82.0	72.5	62.2	39.2	31.4
Oil production (mbd)	1.50	1.55	1.60	1.65	1.65	1.65
Oil exports (mbd)	1.25	1.30	1.35	1.40	1.40	1.40
Oil export price (US$ per bbl)	16.15	15.50	16.20	16.93	17.69	18.49

Source: Staff projections.

1/ Net of interest earnings on the Central Bank of Nigeria's foreign assets.
2/ Includes overdue interest for the 1984-85 period on the arrears rescheduled in 1986.
3/ Based on end-1985 commitments converted at May 1986 exchange rates.
4/ Figures for arrears are estimates derived on the basis of information provided by the Exchange Control Department and the International Remittance Office of the Central Bank of Nigeria. A considerable part of these arrears has not been recognized by the Nigerian authorities and may turn out not to be legitimate.
5/ Assuming that all arrears are eliminated by end-1986. This is assumed to be achieved by means of rescheduling for the 1982-83 arrears and by means of a cash payment against the arrears incurred thereafter.
6/ Assuming that the arrears accumulated in 1982-83 and rescheduled in 1986 are amortized over the 1986-90 period.

arrears and on the financing required to fill the financing gap; (5) all end-1983 arrears, whether recognized yet or not, are assumed amortized according to the schedule agreed in 1984; and (6) all arrears accumulated thereafter are assumed eliminated in 1986. As can be seen from this table, the staff tentatively estimates Nigeria's exceptional financing needs in 1986 and 1987 at US$10.5 billion. Closing this gap will require the rescheduling of principal payments on debt and of arrears, new money flows from commercial banks and the World Bank, and the resumption of trade financing. The World Bank has indicated its willingness to provide new money in the form of a Trade Policy and Export Development Loan to be channelled through the second-tier foreign exchange market. It is also, however, possible that the assumed import levels in 1986 and 1987 may be unattainable.

V. Staff Appraisal

The policies contained in Nigeria's medium-term adjustment program represent an important step toward the resolution of its current problems. Taking into account the halving of oil receipts in 1986, the program builds on the substantial fiscal adjustment achieved in 1984 and 1985 to keep the fiscal deficit to within manageable limits. Fiscal policy is now to be complemented by an exchange rate policy and a wide range of other structural and supply-oriented policies that should allow the needed restructuring of Nigeria's economy. The policies now being adopted include many of those recommended by the March 1986 Article IV consultation mission. The Fund staff views the recent discussions and actions as a very encouraging development, deserving of the support of the international financial community. The staff would urge the authorities to implement this policy package as rapidly as possible. This view is shared by the staff of the World Bank, and, in the context of the structural adjustment program, the World Bank is prepared to support the authorities' efforts in the form of a Trade Policy and Export Development Loan.

The staff believes that on the basis of these policies it should be possible to put together a fully specified adjustment program that could be supported by the use of Fund resources. The elaboration of such a program would require the more precise specification of policies in a number of areas, and of their timing. Further work will also be needed to quantify the impact of these policies on the fiscal, monetary, and balance of payments positions, to assess the need for further policy measures, and to judge the feasibility of closing the financing gap. Quantified performance criteria and a monitoring mechanism will also need to be established. It is hoped that these tasks can be completed during a further staff visit in late July this year.

VI. Corrected Proposed Decision

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

1. The Fund takes this decision relating to Nigeria's exchange measures subject to Article VIII, Section 2, and in concluding the 1986 Article XIV consultation with Nigeria, in the light of the 1986 Article IV consultation with Nigeria conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. As described in SM/86/158, Nigeria continues to maintain restrictions on payments and transfers for current international transactions in accordance with Article XIV, Section 2, as well as other restrictions evidenced by external payments arrears, allocations under the foreign exchange budget and limitations on the availability of foreign exchange for foreign travel, remittances of expenditure income, certain types of foreign studies and services, which are subject to approval under Article VIII, Section 2(a). The Fund urges the authorities to adopt comprehensive adjustment policies to resolve Nigeria's external payments difficulties and to remove these restrictions, including payments arrears, as soon as possible.