CHAPTER SIX

THE GROWTH AND MANAGEMENT OF DOMESTIC DEBT

6.01 The issue of debt management has assumed significance because of its impact on the liquidity structure of the economy, the opportunity it provides monetary authorities to influence the pressure of total demand and its implications for fiscal policy.

6.02 The management of domestic debt in Nigeria is entrusted to the Central Bank of Nigeria under Section 35 of the Central Bank of Nigeria Act of 1958 and subsequent amendments. The Central Bank performs four main functions with respect to domestic debt management. These are:

a) advising the government as to the timing of floatation of debt instruments and terms of issue;

b) advertising for public subscriptions to the issue;

c) collecting the proceeds of issues on behalf of the government, supervising the issue of certificates and warrants and maintaining proper books of accounts in respect of receipts and disbursements; and

d) paying interest and principal on due dates and managing a sinking fund set up to facilitate redemption.

6.03 In the course of performing these functions, the Central Bank of Nigeria guarantees the issue of government securities or debt instruments in the primary market by underwriting any amount not subscribed by the banks and non—bank public. The Central Bank thus extends credit to the Federal Government to meet under—subscription of any offer. The Bank also supports a secondary market to facilitate trading in government securities.

6.04 Although the present size of domestic debt is largely a reflection of the need to finance the budgetary gap of the government, domestic debt instruments have served an additional objective of being used develop the

money market by creating an avenue for investment of short term funds.

Growth of Domestic Debt

6.05 Before the 1980s, the ratio of domestic debt outstanding to Gross Domestic Product (GDP) was generally low, averaging only 10.7 per cent between 1960 and 1979. However, there was a substantial increase in domestic debt obligations brought about by the need to finance the Nigerian Civil War between 1967 and 1971 as the debt/GDP ratio averaged 17.1 per cent during the war time period. Between 1980 and 1993, the ratio averaged 32.5 per cent reflecting the increased reliance by the Federal Government on funds from internal sources generally and credit front the Central Bank to meet its budget deficits.

6.06 In 1980, domestic debt outstanding, comprising Treasury Bills, Treasury Certificates and Development Stocks amounted to N7.92 Billion and represented 15.9 per cent of GDP. Table 6.1 shows that between 1984 and 1993, domestic debt outstanding increased by an annual average of 31.2 per cent to N262.32 billion, while the debt/GDP ratio jumped to an average of 32.5 per cent. The increase was largely accounted for by new issues of government securities which were to provide finance for the budgetary gaps of the Federal and State Governments. The practice of roll—over whereby matured Treasury Bills and Certificates are liquidated by re—issuing new ones of the same amount partly explains the continuous growth in the level of domestic debt generally.

6.07 Another factor that partly contributed to the rapid growth of domestic debt was the mode of servicing external debt obligations of the Federal Government. When the Central Bank services the external debt obligations that are due without the Supply of necessary Naira cover by the Federal Government, the bank debits the Federal Sub—Treasury Account at the Central Bank with the cost of Servicing the external debt obligations thereby raising the level of Ways and Means Advances. At the end of the year, when there are no funds to defray these Advances, in accordance with statutory requirements, the Federal Government often directs that the Advances be liquidated by issuing debt instruments such as Treasury Bills, Certificates or Bonds to refinance the advances.

Structure of Domestic Debt

6.08 The portfolio of domestic debt in Nigeria presently comprises four securities. These are Treasury Bills which accounted for 39.4 per cent of

TABLE 6.1 – DOMESTIC PUBLIC DEBT OF THE FEDERAL GOVERNMENT

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domestic debt outstanding at the end of December 1993; Treasury Certificates, 13.9 per cent; Treasury Bonds, 45.2 per cent, and Development Stocks, 1.5 per cent. Treasury Bills and Certificates are largely short—term debt instruments with maturity tenors of 90 days, one year, and two years. However, during the second half of 1993 when Open Market Operations (OMO) was introduced as an instrument of monetary policy, Treasury Bills of very short tenor varying from 27 to 62 days were transacted largely in an attempt to enhance the competitiveness of these instruments in the money market. Treasury Bonds and Development Stocks are basically long term debt instruments with maturities varying from 5 to 25 years. however, the long—term tends to shorten as the instrument approaches maturity. These debt instruments are reviewed further below:

6.09 Treasury Bills: At the end of December 1980, Treasury bills outstanding amounted to N2.12 billion and accounted for 26.8 per cent of the total domestic debt outstanding. There was a continuous resort to this facility resulting in substantial growth in the level of Treasury Bills outstanding during the review period. At the end of 1993, Treasury Bills outstanding amounted to N103.33 billion. The growth of Treasury Bills in particular is affected by the three main reasons earlier stated as influencing the growth of domestic debt generally.

6. 10 The issue of Treasury Bills is governed by statutory limitations which however have been easily revised upward by the Federal Government to ease credit accommodation by the Central Bank. The Treasury Bills Ordinance of 1959 which authorized the issue of Treasury Bills stipulated that the amount of Treasury Bills outstanding at any time shall not exceed 10 per cent of the estimated revenue of the Federal Government. The Treasury Bills Ordinance of 1961 revised the amount of Treasury Bills that could be outstanding to 20 per cent and the limit was further revised upward to 40, 50, 85 and 100 per cent between 1962 and 1969. In 1970, the statutory limit was re—defined and raised to 150 per cent of the estimate retained revenue of the Federal Government and the gross revenue of the States.

6.11 Treasury Certificates: In 1980, Treasury Certificates outstanding amounted to N2.73 billion and accounted for 34.5 per cent of the total domestic debt. By 1985, Treasury Certificates outstanding had almost tripled to N 6.65 billion while its share of domestic debt dropped to 18.1 per cent. In 1990, there was a special issue of Treasury Certificates of N27.3 billion which brought the level of Treasury Certificates

outstanding to N 34.22 billion representing 40.7 per cent of outstanding domestic debt. Treasury Certificates outstanding stood at N 36.58 billion at the end of 1993.

6.12 The issue of Treasury Certificates is also governed by statutory limits. The Treasury Certificate Decree No. 40 of 1968 stipulated that Treasury Certificates outstanding at any time should not exceed 50 per cent of the estimated revenue of the Federal Government during the year. This was revised upward to 60 per cent by the Treasury Certificates Decree No. 32 of 1969. Treasury Certificates like Treasury Bills are issued to meet the budgetary deficits of the Federal Government and are subject to the practice of roll—over which results in its continuous growth.

6.13 Development Stocks: Development stocks were first floated in 1946 by the British Colonial Administrators to provide finance for economic development. A sinking fund was established for redemption of both the principal and interests on the securities. After independence, successive administrations continued to float development stocks to provide development finance. From a paltry sum of N5.3 million in 1960, Development Stocks outstanding rose to N 3.1 billion by 1980 and accounted for 38.8 per cent of the domestic debt outstanding. The level peaked at N4.8 billion in 1987 and started to decline as a result of the decision by the Federal Government in 1988 not to float new ones for on—lending to State Governments. In addition, the State Governments were granted moratorium of three years on the repayment of outstanding development stocks. At the end of 1993, Development. Stocks outstanding declined to N3.7 billion and accounted for 1.5 per cent of the outstanding domestic debt.

6.14 The issue of Development Stocks is subject to statutory limitations. Section 2 of the Finance Decree No. 32 of 1969 stipulated that the level of Development Stocks outstanding at any given time should not be more than 75 per cent of the Central bank of Nigeria's total demand liabilities. Over the years, there has been compliance with the statutory limit.

6.15 Treasury Bonds: Treasury bonds were introduced in 1989 in an attempt to minimize debt service payments that would arise from the policy of interest rate deregulation adopted under the Structural Adjustment Programme (SAP). When the auction system for the floatation of Treasury Bills and Certificates was to be introduced in November 1989,

the Federal Government requested that part of the outstanding short term securities be converted to fixed interest bonds. Consequently, N20.0 billion of Treasury Bills outstanding were converted to bonds, "styled as the 5 per cent Federal Republic of Nigeria Treasury Bonds 2004 - 15". The bonds carry a fixed interest rate of 5 per cent and are wholly held by the Central Bank. A sinking fund was established for the redemption of the bonds on the same basis as Development Stocks. A moratorium of 15 years was proposed while no redemption would be effected until February 2004. In the same manner, Treasury Bills of N11.79 billion were converted to 10 per cent fixed interest bond in 1992 to partly finance Ways and Means Advances granted to the Federal Government. At the end of 1993, new issues of Treasury Bonds amounting to N86.89 billion were made to refinance Ways and Means Advances outstanding. This brought the level of Treasury Bonds outstanding to N 118.68 billion, representing 45.2 per cent of total domestic debt.

6.16 **Outstanding Domestic Public Debt:** As at December 31, 1993, the total outstanding domestic public debt stood at N 262.32 billion made up as follows:

	N 'Billion
Development Stocks	3.73
Treasury Bills	103.33
Treasury Certificates	36.58
Treasury Bonds	118.68
	262.32

6.17 **Ways and Means Advances:** Ways and Means Advances are not debt instruments that can be traded in the money market. Rather, the facility represents an overdraft provided by the Central bank to meet the cash flow problems of the Federal Government. For instance, when the budget is announced, the Federal Government normally projects its revenue from taxation and other sources for the fiscal year. Such receipts would not be realised until after the first month whereas the supply of government services is continuous and begins from the first day of the year. Therefore, there is need for some credit facility which,

in accordance with statutory provisions, should be settled once the revenue starts to flow in. The Central bank of Nigeria Act 1958, CAP 30 as amended, empowered the Central Bank to grant temporary advances in the form of "Ways and Means" to the Federal Government up to 25 per cent of its estimated recurrent budget revenue. The statutory limit was revised downward in the Central Bank Decree 24 of 1991 which provides for only 12.1/2 per cent of the estimated current budget revenue as "Ways and Means Advances" to the Federal Government. The Advances are expected to be liquidated at the end of each fiscal year. In practice, however, the statutory limits had not been enforced mainly because it has not been feasible to reject Federal Government cheques when the Treasury accounts are not funded. The Central Bank has always refinanced these Advances by new offers of Treasury Bills or Certificates.

6.18 Between 1980 and 1993, Ways and Means Advances to the Federal Government were in excess of the statutory limit for nine years while the Ways and Means Advances as a ratio of the estimated budget revenue was over 50 per cent for six years. Tables 6.2a and 6.21b point to Government's heavy reliance on Central Bank credit between 1989 and 1993, as a major source of deficit financing with its adverse implications for the attainment of macro-economic stability.

The Mechanics of Granting of Ways and Means Advances

6.19 Apart from the Federation Stabilization Account, the only other major account maintained with the Central Bank for the Federal Government is the Sub-Treasurer of the Federation's (STF) Account. it is this account that enjoys the Ways and Means Advances granted by the Central Bank anytime the available credit balance on the account is insufficient to absorb the payments. The usual sources of credit into this account are:

a) Federal Government share of the Federation Account;

b) independent revenues of the Federal Government;

c) cash backing for AIEs issued to the Federal Pay Offices for transferred services on behalf of Federal Ministries/Departments;

d) draw-down on foreign Loans, if any;

TABLE 6.2a – GROWTH OF WAYS AND MEANS ADVANCES

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TABLE 6.2b – COMPOSITION OF WAYS AND MEANS BETWEEN 1989 AND 1993

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e) proceeds from Treasury Bills, Certificates or Bonds issues;

f) loans recoveries from States and Parastatals;

6.20 On the other hand, the debits passed to this same account (STF's) emanate from:

a) Mandates issued on Central Bank for local and foreign payments based strictly on Recurrent and Capital Expenditure Warrants for any given period;

b) cheques drawn by the Sub-Treasurer for payment of personnel and overhead costs of the Office of the Accountant-General of the Federation;

c).. funding of the Federal Pay Offices based strictly on AlEs issued for their internal administration and AIEs cash-backed by Federal Ministries/Departments;

d) repayment of Debt Instruments such as Treasury Bills, Certificates and Bonds.

e) Interest on Ways and Means.

6.21 The Central Bank grants the Ways and Means Advances according to the mandates issued by the Office of the Accountant-General of the Federation (OAGF) and it renders monthly bank statements. It is significant to note that warnings from the Bank to the OAGF on the inordinately high level of Ways and Means Advances has had little or no impact on the trend of the outstanding rising debit balances of the account. The Bank does not grant any other overdraft facilities to any Federal Ministry or Agency.

Ownership of Domestic Debt

6.22 During the first two decades after independence, the ownership structure of domestic debt instruments was dominated by non-bank public. However, from 1978, the absolute and relative holdings of debt instruments by the Central bank became prominent as the Federal Government relied more on these instruments to raise short and long term finance for its budgetary needs and on-lending to State Governments. Between 1980 and 1993, holdings of debt instruments by the Central Bank averaged 58.6 per cent with the

increasing dominance in the early 1990s as the Bank's holdings between 1989 and 1993 averaged 69.3 per cent. Holdings of government securities by commercial banks averaged 19.4 per cent compared with 1.6 per cent by merchant banks. Holdings by non-bank public, including mandate investments by the Central Bank accounted for 22.0 per cent.

6.23 Between 1989 and 1992, there was a marked decrease in average holdings by commercial and merchant banks. However, available data in Table 6.3 shows that at the end of 1993 this trend has been reversed as Central Bank holdings dropped to 59. 1 per cent from 84.5 in 1992 while holdings by commercial and merchant banks accounted for 11.5 and 7.4 per cent, as against 3.2 and 0.2 Per cent in 1992, respectively. This points to the success of Open Market Operations which was introduced in the second half of 1993, in a bid to further attract investors to patronize government securities.

Maturity Structure of Domestic Debt

6.24 Between 1981 and 1993, short-term debt instruments of not more than two years accounted on average for 79.6 per cent of the total debt outstanding. The share of short-term debt instruments was exceptionally high in 1988 as short—term instruments accounted for 90.7 per cent of the outstanding domestic debt. Domestic debt instruments of ten years maturity and above accounted on average for 2.9 per cent between 1980 and 1993. Medium term debt instruments of two to five years accounted on average for 1.2 per cent of the debt stock. The high growth in the level of short term debt instruments during the review period resulted largely from continuous re—issue of maturing Treasury Bills and Certificates and the utilization of these short—term finance to meet the budgetary needs of the Federal Government.

Legislative Power of the Federal Government to Raise Credit

6.25 The Federal Government exercised its legislative lower to raise permissible credit from the Central Bank. For instance, the Federal Government can borrow:

a) 150.0 per cent of the estimated retained revenue of (he Federal Government and the gross revenue of State Governments through Treasury Bills;

TABLE 6.3 – OWNERSHIP OF FEDERAL GOVERNMENT DEBT INSTRUMENTS

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b) 60.0 per cent of the estimated revenue of the Federal Government during a financial year through Treasury Certificates;

c) 75.0 per cent of the Central Bank's total liabilities through Development Stocks; and

d) through the conversion of part of the outstanding Treasury Bills to Treasury Bonds without the Bonds being regarded as part of Treasury Bills for the purpose of observing the statutory regulations.

6.26 The overall permissible credit is a multiple of the retained revenue of the Federal Government. It is therefore doubtful if there is any intention to repay The debt from retained revenue. Nevertheless, interest payments on the domestic debt continue to grow as the principal increases from year to year.

The Genesis of Federal Government Budget Deficits

6.27 Nigeria's recourse to internal borrowing to finance its development programmes dates back to the early sixties. The first National Development Plan (1962-1968) envisaged 50% of planned expenditure to be financed from Foreign sources. It turned out that foreign loan constituted only 25% of realised capital investment. Government had to fall back on domestic sources for provision of needed funds to finance development.

6.28 In the mid-seventies, the economy witnessed a substantial inflow of resources through oil exports. As a result, Government decided to embark on the implementation of gigantic development programmes designed to accelerate the pace of development and growth. A number of industries sprang up during the period which depended on imports of capital goods and raw materials. ~ was also huge investment iii the provision of infrastructure such as roads, bridges, buildings, airports and seaports, power supply and telecommunication, etc., which had significant import components. Social services (health, education, sports) and public administration expanded tremendously, thus exacerbating the huge cost of sustaining these developments.

6.29 In spite of the oil boom of the 1970s, the demand for imports was such that the oil earnings were not enough to meet the country's quest for rapid economic expansion and industrialisation. Consequently, the country had to resort to borrowing in the late 70s anti early 80s to augment its earnings from

oil export. Tue deteriorating economic scene which started in 1978 reached critical levels in 1983/84 when the oil prices plummeted. The Nigerian economy had become so dependent on resources from oil and imports that when the oil fortunes dwindled in the early eighties, public expenditure, general consumption and production patterns could not respond immediately to the shortfall in earnings and this resulted in substantial fiscal deficits. For instance, in 1984, the Federal Government retained revenue amounted to N6.94 billion, while its total expenditure for the year (recurrent and capital) reached N9.55 billion, resulting in a deficit of N2.62 billion. By December 1993, the level of deficit, had reached N 101.13 billion in spite of the relatively huge Federal Government retained revenue of N73.4 billion that fiscal year. Table 6.4 shows details of Federal Government deficits spanning the period 1984-1993.

6.30 All the deficits were financed through Ways and Means Advances by the Central Bank of Nigeria which were converted into debt instruments by the end of each financial year. It is important to emphasise that the granting of Ways and Means Advances was automatic. Whenever it was noticed that there was insufficient funds in the Account of the Sub—Treasurer of the federation with the Bank to meet Government obligations, the Central Bank had to grant the Advance automatically to meet the shortfall.

Management of Domestic Debt

6.31 The growth of domestic debt in Nigeria between 1980 and 1993 was a result of the Federal Government's continued reliance on credit from the Central Bank to finance its budgetary deficits. Also, the issue and Management of domestic debt has succeed in meeting the objective of developing the local money market. However, the financing of government deficit by relying on borrowing from the Central Bank affected policy decisions concerning the amount of short—term instruments to be issued, the rate of issue and the level of holdings of these debt instruments by the Central Bank. Consequently, the money market defined as the market for short—term loans became completely dominated by the government securities while the interest rates on these securities were determined administratively. This was largely responsible for the high level of holdings domestic debts instruments by the Central Bank.

6.32 The advantage of the fixed interest policy was that the debt service of the Federal Government was being minimized as the Federal Government was

TABLE 6.4 – FEDERAL GOVERNMENT BUDGET DEFICITS

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borrowing cheaply from the Bank. In simple terms, the credit accommodation simply represented printing of high powered money to finance government spending. The heavy dependence on this facility is largely responsible for the creation of excess liquidity in the financial system and the acceleration of inflationary pressures in the economy. In addition, the expenditure of such deficit finance raised from the Central Bank also affected demand for foreign exchange and was partly responsible for the continuing depreciation of the Naira.

6.33 The adverse consequences of Federal Government's undue reliance on Ways and Means Advances have been brought to the attention of the Federal Government over the years. However, as pressure on the government finances increased, there was a continuous recourse to this facility.

6.34 Under the Central Bank of Nigeria Decree No. 24 of 1991, the Bank is charged with the responsibility of managing the national debt which consists of both foreign and domestic debts. Specifically Section 34(i) of Decree No. 24 of 1991 provides that "the Bank shall be entrusted with the issue and management of Federal Government Loans publicly issued in Nigeria, upon such terms and conditions as may be agreed between the Federal government and the Bank." Relying on the provisions of Section 33(i) of the Decree, the Bank has been prompt in granting advances to the Federal Government to tide it over deficiencies of its budget revenue. In doing this, it charges a rate of interest determined by the Bank, which currently attracts a margin of one per cent over the minimum rediscount rate (M RR).

6.35 This also helps to swell the level of the Advances. For instance, in 1993, the interest on Ways and Means Advances alone stood at N5.9 billion, it is evident that although the Central Bank is aware that the advances outstanding at any time should not exceed 12.1/2% of the estimated recurrent budgeted revenue of the Federal Government for the year, it has been found deficient in enforcing that provision. At best, it had once threatened to dishonour mandates issued after the statutory limit had been reached and on other occasions merely drawn the Federal Government's attention to the unduly high level of Ways and Means Advances and the need to stay within the statutory limit. It lacked the courage or the will to enforce the statutory limit requirement by refusing to honour cheques drawn on the Sub-Treasurer of the of the Federation's account.

6.36 Equally disturbing is the fact that no serious effort had been made to reduce the level of the domestic debt stock through adequate annual budgetary

provision to that effect. Any serious banker should be concerned not only with granting overdraft facilities to its valued customer, but also should devise ways and means of ensuring that the overdraft is repaid. The Central Bank in its management of the domestic debt seemed to be satisfied with conversion of the Advances to debt instruments of very short tenor (usually 90 days) and routinely rolling them over at maturity without any serious effort to get the Federal Government to effect their redemption at maturity.

6.37 The Office of the Accountant-General of the Federation (AGF) also has an important role to play in the management of Federal Government finances. The office has responsibility under the law to account for the receipts and payments of the Government of the Federation has the duty to alert the Federal Government whenever its expenditure outstrips its income in any given period. As a way of stemming the growth of Ways and Means Advances, it introduced the principle of cash backing which required that no expenditure should be incurred without the available fund. This measure was adopted in 1988 to replace the internal Bank Adjustment. (IBA) whereby the Authority to incur Expenditure (AIE) was the ultimate instrument to spend. In the course of our deliberations, evidence was adduced to the effect that the office of the Accountant-General had always striven to hold the Budget Office in check by refusing to cash-back whenever it was observed that the level of Ways and Means Advances had risen beyond the statutory level, but had to succumb to pressures from the Presidency.

6.38 However, as an arm of Government, the extent to which the Office of the AGF can resist such pressures is limited when compared with the powers of the Central Bank to enforce the provisions of the statutory limit on Ways and Means Advances contained in the Decree establishing it. Consequently the experience of live years of operating cash hacking in the public accounting system has not achieved the desired result of checking the growth of Ways and Means Advances.

6.39 It was also revealed that although there was regular consultation between the Budget Office and the Office of the Accountant—General of the Federation on the cash—flow situation before the quarterly warrants were released, there was no such consultation when Authorities to Incur Expenditure (AIEs) were issued for extra-budgetary expenditure as neither the Budget Office nor the AGF's Office could do much to influence the level or deter the frequency of extra—budgetary expenditures which emanated from the Presidency. The two offices saw themselves as victims of a system they can neither influence nor resist.

6.40 Our interaction with the office of the Accountant—General of the Federation further revealed that there is no formal mechanism, apart from converting the Ways and Means Advances Co debt instruments at the end of the financial year, for eventual liquidation or reduction of the Debt Stock over tune. What exists is the arrangement in which the Debt Instruments maturing are repaid by the Central Bank and simultaneously re—issued to provide more accommodation for bridging the shortfall in revenue. This further explains the continuous growth in the level of domestic debt stock. There is, however, provision for payment of interest from the Consolidated Revenue Fund Charges Vote when due, which perhaps explains the apparent levity by the Central Bank in arresting the continuous growth of the debt stock, so long as interest payment due to it is enhanced and guaranteed. This posture was, however stoutly defended by the immediate past Governor of the Central Bank who insisted that the issue of revenue derived from the Ways & Means Advances by way of interest payment was incidental and did not in any way influence the Bank's attitude to the Advances.

6.41 It was, however, clear that the Federal Government, on its part, has paid very scant attention to the management of the domestic debt over the years. It sometimes acted as if the debt did not exist and had established no mechanism for its amortisation. Proposals made in the past by the Central Bank to use either its operating surplus or the Gulf War windfall to offset part of the domestic debt did not receive the support of the Federal. Government. Besides, the 1994 Budget does not contain adequate provision for domestic debt repayment, in spite of the Federal Government's current posture of operating a balanced budget: only N 1.00 billion was budgeted for domestic debt repayment as against the debt service requirement of N40.0 billion during the fiscal year. While commending the Central Bank of Nigeria for making proposals to the Government on how to reduce the country's domestic debt, the Panel supported the Government's rejection of the Central Bank's proposal to use the Gulf War windfall to reduce the country's domestic debt. We believe it would have been more appropriate to use such funds to build up the external reserves.

<u>Significance of the Size of the Debt for the Macro-economy</u>

6.42 A number of questions agitated the minds of members of the Panel on the figures relating to our domestic public debt on the one hand, and the management of the debt on the other. First, at what point could we say that the size of the public debt was too large? A comparative analysis of our debt/GDP ratio, which runs currently at between 31and 32 per cent over the

last two years, with those of a few selected advanced countries, showed that the size is relatively not too large, if we are dealing with absolute quantities. In UK., for instance, the ratio has often run at between 30 and 40 per cent, at over 25 per cent in Canada, over 30 per cent in the USA and 60 per cent in Italy. What is important is how the resources created by the debt are utilized and funded. The outcry in Nigeria is therefore directed, not at the absolute size or its ratio to the GDP but at the impact of the source of its funding, which is the Central Bank, and the direction of its use on the macro-economy, which was mostly to finance government non productive consumption.

6.43 Secondly, is there a crowding out of private debt? Available evidence suggests that there is no clear crowding out. The explanation for this obviously lies in the fact that the public debt was financed almost entirely out of public funds by the Central Bank. There is therefore no diminution of resources from private financial sector for private debt except in so far as the Central Bank, from time to time, mops up private liquidity, even though it could be assumed that if the public debt were not that large, there might have been greater volume of private debt which could have been channelled into viable private investments. The relative isolation of the public from the public debt means that the pressure on interest rates was not as high as it would have been if the pub1ic debt had been financed mostly out of private funds, however, the Central Bank's mopping up operations also had some deleterious effect on the level of interest rates and to some extent contributed to the growth of widespread financial distress in the system manifested by the failure of some banks and many financial houses in the period 1992-1994.

6.44 The primary impact of the growth in the size of the public debt must be sought in the distortion of allocation of resources, unusual growth in private and public consumption because of the nature of the sources of funding for the debt. It is, indeed, this which may crowd out private investment which requires ether conducive environment to grow. Secondly, the direction of public expenditure away from production to consumption as a result of the easy money available to government is distorting. Thirdly, the short-term maturity of the debt instruments, held mostly by the banking system, in particular the Central Bank, also had a debilitating effect on the economy. The effect would certainly not be the same if the debt had longer maturities as these would not create unpredictable changes in the demand for money.

Reduction of Size of the Debt

6.45 Another question relates to the reduction of the size of the debt. There are only two ways of reducing the size of the debt: paying it off, or writing it off by way of relief or by way of accepted default. Government is not in a position to pay it off except by accumulating new debt instruments;

6.46 Repayment Mechanisms: The Central Bank by December 1993 securitized nearly half of the outstanding short term debt into longer term maturities by converting the WAMA and Treasury Bills into bonds. What does this mean? The same creditor has simply swapped one form of IOU's into another form of IOU's. It has no immediate impact whatsoever on the macro-economy until the bonds are disbursed to private stakers. The Central Bank is in effect buying back its own debt. It may relieve the immediate pressure for the borrower but it creates a moral hazard in making it easier on its conscience to raise more short term obligations.

6.47 Pricing of Debt Instruments: The question of how to determine the price at which to sell new debt instruments is relevant here. In Britain, since 1976, the Government has retained a "Government Broker" from a private firm of Mullens and Company for the marketing of government debt. Even when the stock is put out to tender, there is a minimum reserve price for the tender; and the practice had also been to hold a "tap" stock of debt bought in by the Bank of England to be used to stabilize prices of gilts. The idea of selling at market prices to clear the market does have its own risks, namely, that the time lag between the announcement of a stock to be sold and the actual sale introduces a stochastic element into the pricing. We believe that while we must condemn outright and unequivocally the practice of the Central Bank warehousing the bulk of the issues of debt instruments, the choice of an alternative medium for disposal of such instruments ought to be carefully studied. The pricing of the instruments is bound to affect the prices of other financial assets in the market.

6.48 **Write Off or Default:** It would be absurd to foresee the situation in which the Central Bank agrees to a write off of the debt which it holds or accept a default on the part of Government; this would be as reprehensible as continuing to generate more debt instruments and holding them in the form of WAMA or Treasury Bills.

6.49 Reduction of the Burden of Debt: The real burden of the debt, seen in the size of the debt service obligations, is mostly as it affects allocative efficiency. Since the transfers are from the Central Bank to the Central Bank and not from one private pocket to another, there is in fact no re-distributional effect and there is, in reality, little other burden except in the impact on the general price level and the consequential rapid increase in inflationary pressure. The process of securitization of the debt does not affect this burden except in so far as it may reduce the income from interest for the Central Bank.

Revenue Generation

6.50 The issue of revenue generation featured prominently in the Panel's deliberations. The Panel observed that although the Federal Government had adopted a number of measures to boost its revenue generation efforts, its budgeted revenue targets were not always met especially during the past three fiscal years (1991-1993). The oil sector continued to account for the bulk of total government revenue and any changes in the oil fortunes abroad were immediately transmitted to the domestic economy. For instance, in 1993, although federally-collected revenue increased by 0.2 per cent from N138.62 billion in 1992 to N 138.87 billion in 1993, this increase however fell short of the budget estimate of N 156.99 billion by 11.5 per cent. While there was unmitigated growth in government expenditure, there was no corresponding effort to match this growth with increase in revenue generation. Ministries and government agencies tended to see their role primarily as executing those projects under their supervision and paid little or no attention to how funds were generated to finance those projects.

6.51 This was compounded by the fact that the system made no provision for penalties for not achieving budgeted revenue targets or rewards for meeting or exceeding those targets. Although budget statements always laid emphasis on the need to intensify revenue generation and collection by government agencies, it appeared there was no mechanism to enforce those policy statements, except in so far as the Federal Ministry of Finance was expected to monitor the revenue returns of all Ministries and Departments as well as Extra-Ministerial Agencies of Government monthly. It is the strong view of the Panel that a system of reward and punishment should be built into the revenue generation drive, if the budgeted revenue targets must be attained by government. Serious effort must also be made to diversify the economy so as to reduce our dependence on the oil sector and enhance our revenue generation from non-oil sources.

6.52 The Panel also observed that not all federally collectible revenue was captured in the budget. The system of dedicating some quantities of crude oil to special priority projects made it difficult for the Budget Office to have a total picture of the revenue accruable to the Federal Government in any fiscal year, especially where the Budget Office had no access to the details of the in-flows to, and out-flows from, the Dedication Accounts kept by the Central Bank. This arrangement made it possible for the President to operate through the Central Bank what the Budget Office described as a "parallel" or "shadow" budget, with the resultant distortion in the allocation of available resources.

6.53 The Panel believes that it would facilitate effective implementation and monitoring of Budget programmes if all the resources available to Government were pooled and properly allocated on the basis of agreed criteria as part of the annual budgetary exercise and not segmented into special or dedicated accounts whose disbursements are not subjected to normal rigorous government accounting procedures with built-in mechanisms for accountability and transparency. The Panel further identified the operation of duty exemptions and waivers on certain imports by government as another source of leakage in the revenue generation and collection machinery which should be plugged.

6.54 Recommendations

i) The Panel believes that to achieve the objective of minimising the use of Ways and Means Advances as a means of financing the deficit in the Budget, concerted effort by the revenue generating/collecting Agencies of Government such as Federal Inland Revenue Service, Nigeria Custom Service, Nigerian National Petroleum Corporation, Nigeria Ports PLC, National Maritime Authority must be made. It is imperative that they should be made to intensify their efforts to generate more revenue.

ii) The Agricultural sector of the economy, which has been neglected since the discovery of petroleum in the early 60s, should be given greater attention. Before the advent of oil, cash crops such as cocoa, cotton, groundnut, rubber sustained the national economy admirably. To reduce continued dependence on oil serious effort must be made to diversify the economy and to explore new sources of revenue.

iii) If the use of Ways and Means is to be reduced, the Budget Office should learn to exercise restraint in the use of AIEs in granting additional allocation or advance against future allocations. This practice makes cash flow management difficult. In an era where there is constant shortfall in budgeted revenue to meet expenditure, it is unwise to impose extra burden on the Consolidated Revenue Fund thereby increasing resort to use of Ways and Means Advances.

iv) The Bank is an institution assigned with the responsibility to manage public debt. Therefore it should demonstrate its ability to do so by invoking the provision of Section 33 Sub-Section 3 of the Central Bank of Nigeria Decree No. 24 of 1991 which clearly states the upper limit of Ways and Means Advances. One way of doing this is to refuse to honour Federal Government cheques once the statutory limit is reached. This will go a long way to restore sanity to the system and infuse greater budget discipline.

v) As much as possible, the Government should rely on the advice of both the Budget Office and the Office of the Accountant-General of the Federation in matters relating to management of its finances. It is common practice for the Presidency to issue directives to disburse fund which were not budgeted for, thereby throwing all previous commitments to stay within the budget into disarray. The Federal Government should desist from operating a parallel budget through the use of Dedication and other Special Accounts.

vi) To demonstrate its commitment towards seriously addressing the problem of domestic debt management, the Federal Government should make adequate provision annually in the Budget for the servicing and repayment of domestic debt.

vii) The present system of converting the WAMA and Treasury Bills into Bonds which are still warehoused by the Central Bank has no immediate impact on the macro-economy. For the securitization to have any effect, both the Central Bank and the Government must agree to impose strict limits to the size of the debt and freeze its ceiling for the moment while the stock is being reduced. The Central Bank should thereafter begin to sell the existing debt to private agents at prices that would enable the market to be

cleared.

viii) The bottom-line to all this is fiscal discipline by the Federal Government. The Federal Government should review its priorities and learn to live within its budgetary provisions. Undue reliance on Central Bank funding should be drastically reduced because of its adverse consequences for effective monetary management and the problem it creates for the attainment of macro-economic stability. Undue reliance on high powered money should be shifted to less inflationary sources of financing. The Bank should adopt measures which should enhance the use of the market in more depth for the creation of any further debts for the Federal Government.

ix) The Central Bank of Nigeria Decree restricts the Bank to 12.5 per cent of the fiscal revenue for the year as the upper limit of the advances it can grant to government under Ways and Means Advances. However, as the manager of the external debt portfolio of the Federal Government, the Bank is obliged to meet debt commitments on certain categories of debt as and when due, whether or not there is sufficient Naira cover for it in the Account of the Sub-Treasurer of the Federation. Where there is insufficient Naira cover and the account is debited this becomes a source of deficit and may cause the Bank to exceed the 12.5 limit. To safeguard against such happening:

a) The Federal Government must from the onset specify which category of expenditure will qualify for cover under the Ways and Means arrangement and stand by it; and

b) The Federal Government should be more aggressive in sourcing and mobilising revenue receipt from sources other that oil.

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