

immediately remove the total amount of outstanding bills for collection already approved from the current foreign exchange demand. Instead, promissory notes should be issued and payments be spread over time after some moratorium. It is further suggested that the use of Bills for Collection thereafter be stopped completely. In order to enhance the acceptability of the suggested promissory notes as an international financial instruments, efforts should be made to reduce (or possibly totally remove) all the bureaucratic delays that now attend to the debt conversion programme at the Bank. Since the Notes are being converted at a discount, and the official exchange rate is applicable for conversion, the Naira amount should be paid without unnecessary hassle.

7.49 What seems to be called for here is in effect, a REVERSAL of the current policy as there is clearly no route available for modifying it, The current policy cannot be sustained over time.

SECTION III

EXTERNAL DEBT MANAGEMENT

7.50 The size of Nigeria's external debt has grown quite phenomenally since the early eighties. Debt service, now running at over 4 per cent of the Gross Domestic Product, has created tremendous pressure on government finances and this in a period of declining revenues. Coupled with the population growth, estimated at between 2 and 3 per cent per annum, it follows that unless the debt problem is effectively addressed, it would be extremely difficult to put the economy back on a sustainable path of recovery and growth. Global attention has been focussed since 1982 on finding solutions to the international debt problem. Several proposals and menus have been offered, but their relevance and application have varied from country to country reflecting the peculiarities of individual countries and depending on the degree of debt overhang and whether the main components are geared to multilateral agencies, bilateral or private creditors. Debt management has thus become complex and highly sophisticated requiring professional handling. The Central Bank of Nigeria under Section 34 of the CBN Decree 24, 1991, and

the Federal Ministry of Finance jointly have the responsibility for managing the country's external debts.

Structure of External Debt

7.51 As at 31st December, 1993 the estimated total debt stock was US\$28.72 billion. Of this figure, the private debt outstanding amounted to US\$5.264 billion or 18.32 per cent of the total stock. The private debt is broken down into US\$2.105 billion London Club debt and US\$3.159 billion of uninsured short term trade arrears. As at 31st December, 1993 the official debts, at US\$23.47 billion, accounted for 81.68 per cent of the total debt stock. The Paris Club debt alone totalled US\$17.71 billion and represented 61.64 per cent of the country's total debt. The multilateral debts accounted for US\$4.71 billion or 16.37 per cent while non-Paris Club bilateral debts amounted to US\$1.05 billion or 3.65 per cent. The private debt are made up of uninsured short term trade debts that were contracted through the medium of bills for collection, open account etc. and the commercial banks' debts contracted through loans amid/or letters of credit (often referred to as the London Club

debts). On the other hand, as Tables 7.4a and 7.4b show, the official debt component constitutes the Paris Club debts (i.e. debts insured by export credit agencies of Paris Club members), multilateral debts (that is, debts owed to 11 World Bank, African Development Bank (ADB), European Investment Bank (EIB), etc, and other non-Paris Club bilateral debts. A brief articulation of the types of debts is given below:

7.52 Multilateral Debt: The multilateral debts are debts owed to the International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), the African Development Bank (ADB), Economic Community for West African States (ECO WAS) Fund and other multilateral institutions. Nigeria became a member of the IBRD in 1960 and IDA in 1961. The two affiliates of the World Bank Group provide development loans and credits respectively to its member countries, and lending by them is direct to governments or to publicly-owned institutions upon guarantees provided by the Government. Nigeria obtained her first loan of US\$28 million from the World Bank in May, 1958 to finance a railway expansion project. The portfolio of the Bank's loans and credits to Nigeria has since increased

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TABLE 7.4b – EXTERNAL DEBTS – COMPOSITION (% Distribution)

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substantially. The Bank's investment in Nigeria was initially concentrated on infrastructural development, but it has since spread to virtually all sectors of the economy.

7.53 As at 30th June, 1993, a total World Bank commitment to its Nigerian operations amounted to US\$ 7.2 billion, spread over 98 projects and programmes. The loans for 11 projects totaling US\$242.3 million have been fully drawn and repaid, while the loans and credits for another 45 projects totalling US\$3.2 billion have been fully drawn-down and are being serviced. The loans and credits for the remaining 42 projects, totalling US\$3.7 billion are at various stages of draw-down. On the whole, a total US\$4.3 billion remains undrawn. As at 31st December, 1993, out of a total of US\$ 28.72 billion external debt about US\$ 3.66 billion was owed to the multilateral institutions.

7.54 Nigeria was re-admitted into IDA eligibility towards the end of 1983. At present, Nigeria borrows a mix of IBRD and IDA. Since the beginning of 1992, however, the country has been accessing less of IBRD facility in favour of IDA. IBRD loans carry 20 years repayment period (including 5 years grace), variable interest averaging about 7.5% per annum and a commitment fee of 0.7% (currently reduced to 0.25%) on the undrawn balances of the loans. On the other hand, IDA credits are repayable over 35 years (including 10 years grace), interest free, with a service charge of 0.75% per annum on the amounts withdrawn and yet to be repaid. Nigeria is therefore gradually moving away from IBRD in favour of IDA facilities with a view to reducing loan/credit service costs. It must be emphasized however, that IDA facilities are very limited and are being accessed by increasing number of countries who are becoming eligible for its resources. There is therefore no assurance that additional IDA facilities would be available as and when required. This underlines the need for Nigeria to utilize the entire IDA allocations yearly in view of the high grant element involved in this category of loan. It should be noted that credits extended by the JMF, the World Bank, the regional Development Banks can not be rescheduled.

7.55 During the period between 1986 and 1991, Nigeria signed a number of bilateral and multilateral Agreements for loans and grants to either

support the implementation of her Structural Adjustment Programme (SAP) or for the execution/development of critical vital projects. Some of the loans were sourced from multilateral institutions such as the World Bank and the European Economic Community (EEC). Bilateral Agreements were also signed with the Governments of Japan, Federal Republic of Germany, the United Kingdom and the United States Agency for International Development (USAID). There are other agreements between various overseas creditors and the Federal Government for the execution of projects including those in telecommunication, irrigation, refinery, petro-chemical, etc. In most of these agreements, the conditionality attached to the loans was that of IMF.

7.56 Paris Club Debt: Paris Club came into existence in 1956 when a number of European countries came together to renegotiate outstanding balances in their bilateral accounts with Argentina. Since then, it has become the major forum for rescheduling/refinancing official debt. The Club meets at the request of the country seeking to reschedule its external debt. The meetings are chaired by a senior official of the French Treasury which also provides a small staff to act as the Club's Secretariat. Before considering any proposal to reschedule any debt, the Club must ensure that the debtor country is a member of the International Monetary Fund (IMF) and has in force a stabilization programme with the Fund. Terms agreed during negotiations with the Club are embodied in an agreement known as the Agreed Minute. The Minute establishes general guidelines for the rescheduling of Paris Club debts and serves as a basis for the bilateral agreement which the debtor country must enter into with each creditor country that is participating in the rescheduling exercise.

7.57 Paris Club debt consists not only of loans that were granted to, or guaranteed by the Federal Government of Nigeria or any of the States or parastatals, but also trade arrears that were insured by the Export Credit Agencies of the member countries of the Club. These private sector insured trade arrears had their legal status changed into official debt when the Federal Government assumed responsibility for them. As at December 31, 1993, the outstanding Paris Club debt amounted to US\$13.15 billion, made up of US\$4.11 billion of short term debts and

US\$14405 billion of medium and long term debts. The debt outstanding represents 63.23 per cent of the total debt stock of US\$28.72 billion and needs to be adequately addressed to enable the country get out of the debt overhang. Nigeria first approached the Club for debt rescheduling in 1986 and ever since has had three agreements with the Club.

7.58 London Club Debt: The London Club debts cover arrears on letters of credit as well as arrears of maturities on medium and long term loans that were owed to the commercial banks. As at 31st December, 1993 the London Club debt outstanding amounted to US\$2.1 billion representing 7.16 per cent of the total debt stock of US\$28.7 billion. Out of the outstanding amount, the sum of US\$2.05 billion or 99.47 per cent has been fully collateralized with US Treasury Zero Coupon Bonds. Consequently, the debt service obligations on this category of debt is now limited to interest payments only. Historically, trade arrears were built-up as a result of the downturn in the economic fortunes of the country following the collapse of the oil prices in early eighties which led to a drastic reduction in the foreign exchange earnings.

7.59 Promissory Notes: These are the Notes that were issued by the Chase Manhattan Bank, New York, on behalf of the Central Bank and guaranteed by the Federal Government in respect of trade debt arrears that qualified for refinancing during the 1984 through 1988 refinancing exercise. They are, therefore, different from the Federal Ministry of Finance promissory notes which are included under the London Club debts. The trade debts were strictly private sector debts; their legal status and maturity changed when the Federal Government assumed responsibility for them. The total value of promissory notes that were issued as at 18th March, 1988 when the refinancing agreement was concluded amounted to US\$4.8 billion; however, as at 31st December, 1993 the amount outstanding had declined to US\$3.159 billion representing 10.98 per cent of the total debt. The Central Bank is solely responsible for the management of this category of debt and services the debt without reference to the Ministry.

7.60 Others: These are debts which are owed to other creditors not mentioned in any of the above categories. They include bilateral debts

owed to non-Paris Club members such as Singapore, Russia etc. and to foreign contractors.

DESIGN OF EXTERNAL DEBT MANAGEMENT STRATEGIES

7.61 The design of debt management function consists of six major elements, namely organization, co-ordination, operational arrangements, accounting and analysis. These elements relate to debt management as one integrated activity in the following manner:

7.62 Organization: The Federal Ministry of Finance and the Central Bank, as the two organs of government responsible for debt management are expected to hold meetings regularly to review strategies for the management of the nation's debt. The two bodies represent the country in negotiations with the external creditors both at the multilateral and bilateral levels. The Bank prepares and carefully articulates position papers for negotiations with the creditors. It also provides technical advice in all matters relating to the banking arrangements as well as information on the economy, including the balance of payments and the financing gap. It is responsible for processing short-term private sector debt while the Federal Ministry of Finance processes the medium and long-term debt as well as official short-term debt.

7.63 Co-ordination: Both the Central Bank and the Federal Ministry of Finance periodically reconcile the debt data with the creditors.. The Ministry co-ordinates and processes all external borrowing requests by all arms of government including parastatals and State Governments.

7.64 Operational Arrangements: All debts are serviced strictly in accordance with the terms of the agreements. With regard to the Paris Club debts, the Bank processes the demand notes from the creditors in respect of Short Term Debts (STD) and seeks the approval of the Federal Ministry of Finance for payment to be made. The Ministry authorizes payments by means of mandates issued by the Accountant-General of the Federation to cover all payments except those to Promissory Note and Par Bond holders. In the latter case, the Bank processes the claims and remits funds for interest due directly. In all cases, the Bank always verifies the authenticity of each payment mandate with Ministry before

any payment is effected. Procurement of new loans is the responsibility of the Federal Ministry of Finance. Most new loans are project-fled and are procured in accordance with the external borrowing policy enumerated in the February 1988 Guidelines, the highlights of which were the placement of an embargo on new loans, and the directives to State Government to restrict their external borrowing to the barest minimum.

7.65 Accounting: The Central Bank keeps records of all categories of debts as regards their stock, amortisation, interest and arrears thereon. The Paris Club agreements provide that an escrow account should be opened through which all payments would be made to the members and the account was opened with the Bank of England. The operation of the account ensures that payments to the creditors go to the true beneficiaries.

7.66 Analysis: The Bank and the Ministry together with foreign consultants carefully analyze the existing loan profile, exchange rates, international interest rates and developments in the economy and prepare memoranda on proposals for debt relief for presentation to our creditors. Regular reports are also prepared for the information of Management of the Bank and the Government.

7.67 Appointment of Consultants: The handling of the external debts is not only tedious but also complex. For that reason, countries take steps to engage the services of internationally reputable firms, as consultants, to advise and assist them. The Nigerian government engaged the services of the firms of S. G. Warburg & Co. Ltd, Kuhn Loch Lehman Brothers International Inc. and Lazard Freres, Paris/New York, who signed an agreement with the Federal Ministry of Finance on March 3, 1983 designed to assist and advise the Ministry on handling Nigeria's overall external financial situation. The Central Bank of Nigeria was not a party to the contract agreement. Based on the mandates received from the Federal Ministry of Finance authorising payments to S. G. Warburg & Co. Limited, a total sum of US\$15.52 million, was paid to the Consultants in the period June 13, 1983 through November 26, 1992. The last payment was effected on November 26, 1992, and the agreement would still be deemed to be in force since there is no

indication that there has been a formal termination. The Central Bank has expressed its dissatisfaction with the performance of the Consultants. But the Ministry of Finance has stoutly contested the position of the Central Bank. The Consultants had performed creditably at the earlier stage of the rescheduling of the Paris Club debts, but the Central Bank has been unable to bring up to date its own records. Consequently, there is always a divergence between the figures published by the Ministry of Finance and by the Central Bank. In the view of the Ministry, this cannot be blamed entirely on the Consultants. The truth is probably somewhere in between in that all these parties are at fault in not pursuing vigorously the updating of records of arrears on Paris Club debts.

EXTERNAL DEBT MANAGEMENT EFFORTS

7.68 Over the years, the country has taken steps to address the problem of the external debt through the following: refinancing of promissory notes for London Club debt, rescheduling of Paris Club debt, buy back operations, and debt conversion.

Refinancing of London Club Debts

7.69 The handling of the London Club Debts involved the following:

US\$ Promissory Notes to Private Trade Creditors

7.70 With the collapse of the oil prices in the early eighties, occasioned by the glut in the international oil market, Nigeria's economy which was, and still is, heavily dependent on its oil earnings as the main source of foreign exchange, suffered a major downturn. The consequent drastic reduction in foreign exchange earnings made it impossible for the country to meet its obligations to creditors resulting in a massive build-up of trade arrears. The foreign creditors reacted by refusing to open new lines of credit, thus compounding the economic problems facing the country. As a result of this development, the Federal Government decided to seek relief by refinancing the international suppliers of the goods and services. It also sought an agreement of a similar nature with the Export Credit Agencies, who had insured or guaranteed the trade

arrears which were contracted through Bills for Collection, Letters of Credit, Open Account and other transactions.

7.71 Towards the above end, in April 1994, the Central Bank made a proposal under which private foreign creditors under the purview of the London Club, were given the opportunity of accepting US Dollar Notes issued by the Central Bank of Nigeria under the guarantee of the Federal Republic of Nigeria, in full satisfaction of the eligible outstanding obligations from Nigerian importers. The proposal covered only uninsured debts that were owed in foreign currencies, and the creditors were required to signify their acceptance of the offer of the promissory notes in full satisfaction of the debts. Those of them who had created a charge, pledge, or assignment by way of security interest over the debts in favour of banks, were required to ensure that the financing banks also signified their acceptance of the terms of the offer. In such a case, the financing banks were treated as the beneficiaries of the Notes and new Notes were subsequently issued in their favour. The creditors made their claims by providing as much information as possible about the debts. In order to provide a basis for verification, the Central Bank directed all Nigerian importers to also submit, through their local banks, details of such outstanding debts which had been approved for foreign exchange cover and were awaiting foreign exchange allocation. The local banks were in addition requested to validate the Debtors' Returns before forwarding them to the Central Bank.

7.72 To ensure justice and fair play in treatment, the foreign creditors insisted on a neutral and reputable international body to carry out the verification exercise. The Central Bank agreed and appointed the Chase Manhattan Bank, N.A., London as the Reconciliation Bank to assist, administratively, in the collection, processing and reconciliation of relevant information that was provided by both the creditors and the Nigerian eligible debtors. The creditors were required to submit their certificates direct to the Reconciliation Bank while the Debtors' Returns were submitted to the Central Bank for onward transmission to the Reconciliation Bank. In order to ensure that spurious claims were not approved for issuance of promissory notes, objective verification criteria were developed which were universally applied during the verification

process. The criteria which were known as the “Matching Fields” were communicated to all the parties i.e. to both the creditors and the debtors. The reconciliation reports generated by the Chase Manhattan Bank provided a basis for comparison between creditors’ certificates and debtors’ returns. Each claim must correspond in its entirety with the relevant certificate that was completed and submitted by the creditor to the Reconciliation Bank.

7.73 Originally, the reconciliation exercise was designed to be concluded within one year. But as the exercise progressed, many creditors who considered the deadline, for submission of claims as unrealistic, requested for an extension of time to enable them file their claims. Based on their requests, the deadline was extended several times so as to capture as many of the outstanding debts as possible. Thus instead of one year, the exercise lasted for over four years, finally terminating on March 18, 1988 when the last set of promissory notes was issued.

7.74 The finalisation of the exercise was sequel to a meeting that was held with the creditors on January 14, 1988 in London. It was also decided that items that were unmatched since April, 1984 or rejected during the exercise would not be approved for issue of promissory notes or be subject of further reconciliation by the Central Bank. It was, however, emphasized that creditors’ original rights against Nigerian importers were not extinguished by the decision. Consequently, creditors whose claims were not covered with promissory notes, as at the date of last Note issue, were made to apply for a refund of the Naira deposits of the principal amounts which the importers deposited with their local banks. During the reconciliation exercise, a total claim of USD9.8 billion was filed by the creditors. Of this amount, claims valued USD2.34 billion being insured, were subsequently rescheduled in accordance with the Paris Club Agreement of December, 1986 leaving a balance of USD7.4 billion representing uninsured short-term trade debts for issuance of promissory notes. When the exercise was finalised on March 18, 1988 claims valued at USD3.9 billion were covered with promissory notes, while claims valued at USD3.6 billion were rejected for various reasons, e.g. unmatched status, no Naira cover, Societe Generale de Surveillance (SGS) Query, etc.

7.75 The reconciliation exercise expected to be concluded within one year, was still in progress when the first instalment of principal repayment was due in October 1986. This, coupled with the liquidity problem at the time, made the country to default on the repayment of both the principal amount and the interest payments that were due in January and April, 1987. Besides, it was observed that the quantum of the arrears was initially grossly under-estimated and, therefore, the projection made for repayment was unrealistic. The original estimate of the arrears was approximately USD5 billion; but during the exercise, it was observed that the uninsured claims amounted to over USD7.4 billion, that is, excluding the USD2.4 billion insured claims which were processed for interest payments only and which were to be rescheduled under the Paris Club Agreement.

Other Refinancing Agreements

7.76 Arising from the above, the Central Bank proposed new refinancing terms which included the capitalization of the interest and the replacement of the first set of promissory notes, with a new set, embodying the capitalised interest. The proposal was exhaustively discussed between the Central Bank, the Trustee and the independent Financial Adviser who represented the interests of the Noteholders. Following the discussions, an agreement was reached to hold a meeting in Wembley, Middlesex, England to seek the approval of the Noteholders to reschedule the payments as proposed by the Central Bank. The Wembley meeting which was held on January 14, 1988 passed an Extra-Ordinary Resolution approving the reorganisation of the repayment terms as proposed by the Central Bank. The terms of the agreements included among others that:

- a) refinancing Notices be issued to cover incorporated debts, that is, principal;
- b) payable Debt Notices be issued to cover payable debts, that is, interest;
- c) restructuring Notices be issued to cover medium and long term components of the banks' debts;

- d) interest be based on London Interbank Offered Rate (LIBOR)
plus a margin of 1.25 per cent;
- e) the Club provide new money amounting to US\$320 million; and
- 0 repayment be made over a period of six years beginning in April 1990 and terminating in March 1996.

7.77 Under the terms of the agreements, the debt service obligations of the country amounted to US\$1.345 billion per annum. In the face of dwindling foreign exchange receipts, and the failure of the banks to provide new money as stipulated in the agreements, Nigeria defaulted. As a result of this situation the country approached the Club for more concessionary terms and new agreements, known as the Refinancing and Restructuring Amendment Agreements, were signed on 22nd March, 1989. They became effective on 7th June, 1989 and operational on 14th July, 1989. The highlights of the agreement are as follows:

- a) Payable debt amounting to \$500 million to be repaid between 1989 and 1991;
- b) 5% down payment of payable debt to be made upon signature of the agreement;
- c) Refinanced Letters of Credit amounting to \$2.440 billion to be repaid between 1992 and 2003; and
- d) Medium and long term debt amounting to \$2.8 billion to be repaid between 1992 and 2008.

7.78 The payable debt became interest bearing in the event of default, while the margins of interest rates on Refinancing and Restructuring debts were placed at 13/16% and 7/8% above LIBOR respectively. The agreements also contained a menu of options designed to provide further debt relief. The options included the conversion of payable debt into interest bearing Naira denominated securities with a coupon rate of 13.25% and maturity of 18 months; the conversion of other bank debts into a Nigerian Investment Bond with 10 years' grace and a repayment

period of 110 years and interest rate at 6% flat. The agreements also made provision for the amendment of the Debt Conversion Guidelines so as to make London Club Debt eligible under the programme. The agreements reduced the debt service obligations from US\$1.345 billion to US\$711 million per annum. However, the cashflow situation of the country could not absorb such a high debt service rate as provided for under the 1989 amendment agreements.

7.79 Consequently, Nigeria once more approached the banks in March 1990 with a request for the entire debt to be restructured. The proposal was designed to achieve an effective debt service reduction by converting all commercial banks' debts into 30-year bonds with a grace period of 10 years and at an interest rate of 3% per annum. The creditors banks made a counter proposal which contained a menu of options viz:

- a) buyback;
- b) issuance of Par Bonds with principal and interest collateralised;
and
- c) traditional rescheduling.

7.80 Following these proposals both sides entered into intensive and protracted negotiations which lasted for one year and on March 1, 1991 an agreement in principle was reached. The highlights included:

- a) conversion of the debts into a single currency denomination i.e., US dollar;
- b) buyback;
- c) issuance of 30-year Par Bond with principal amount fully collateralised with US Treasury Zero coupon or equivalent US obligations and interest amount for one year also collateralised;
- d) fixed interest rate of 6.25% per annum on the Par Bonds;

- e) traditional rescheduling with interest rate of LIBOR plus 13/1.6% and repayment period of 20 years (to years grace period and 10 years repayment period);
- f) banks who elected for the traditional option were required to provide new money of up to 10% of the amount so committed;
- g) interest on the new money to be LIBOR plus 1% per annum.

7.81 The implementation of the agreement ran into a hitch when Nigeria offered to collateralise the Par Bonds with the Resolution Funding Corporation Zero coupons Bonds (REFCORP BONDS) instead of US Treasury Zero coupons. The argument was that the agreement provided for an alternative which would be equivalent to a US Treasury obligation. Nigeria argued that REFCORP Bonds were equivalent to US Treasury Zero coupons. The banks rejected the collateral which led to a stalemate. Consequently, both sides went back to the negotiation table resulting in a revision of some of the terms of the agreement. The highlights of the revision included:

- a) Principal amount to be collateralised with US Treasury Zero Coupon Bonds;
- b) Interest rate was fixed at 5.1/2% per annum for the first three years and at 6.25% per annum thereafter; and
- c) banks who elected for the traditional rescheduling were required to provide 20% of the amount so committed to the option.

7.82 The agreement was successfully closed on January 21, 1992 and Nigeria bought back 62% of the debt amid issued collateralised Par Bonds for the remaining 38%. The cost of closing the deal amounted to US\$2.158 billion. Thus the country was able to achieve a debt and debt service reduction through the Brady type deal.

Debt Rescheduling with Paris Club

7.83 The Paris Club Debts were handled in the following manner:

1986 Agreement

7.84 Nigeria had the first rescheduling/refinancing agreement with Paris Club in December 1986. The agreement covered debt service obligations which fell into the following categories:

- a) commercial credits guaranteed or insured by the governments of the participating creditor countries or their appropriate institutions, having an original maturity of more than one year. pursuant to a contract or other financial arrangement concluded before October 1, 1985 for public sector debts or September 30, 1986 for private sector debts;
- b) loans from governments or appropriate institutions of the participating creditor countries, having an original maturity of more than one year, pursuant to an agreement concluded before October 1, 1985 in respect of public sector debts or arrears as at September 30, 1986 for private sector debts; and
- c) arrears as at September 30, 1986 on maturities under letters of credit or commercial credits having an original maturity of one year or less, guaranteed or insured by the governments or appropriate agencies of the participating countries, and not covered above. The highlights of the terms of the agreement are as follows:
 - i) Repayment Period: Debts under category (a) were to be repaid between November 15, 1992 and May 15, 1997. Those under category (b) were to be repaid between January 1, 1990 and July 1, 1994 while debts under category (c) were to be repaid between January 1, 1988 and July 1, 1990;
 - ii) Interest Rate: Interest rate was determined bilaterally between the governments or appropriate agencies of the participating creditor countries and Nigeria. The agreement provided that interest should be based on the appropriate market rates.

- iii) Bilateral Agreements: Nigeria was expected to enter into a bilateral agreement with each member of the participating countries. The country was obliged to provide the Chairman of the Club with the details of the agreement reached with each of the creditor countries.
- iv) De-minimis Clause: The Agreed Minute further provided that all debts not exceeding SDR1 million should be repaid on the original due dates and that arrears outstanding on such debts were to be paid not later than September 30, 1987.
- v) Comparability of Treatment: Nigeria was required to secure from other external creditors terms comparable to those that were set forth in the Agreed Minutes and also to avoid inequity between different categories of creditors. Consequently, the country was obliged not to accord to any other creditor repayment terms more favourable than those accorded to the participating creditor countries.
- vi) Special Account to be Opened with the Bank of England: The Agreed Minute mandated the country to open special interest bearing account with the Bank of England and to deposit in it SDR40 million each month which was designed to be used in implementing the agreement. No drawing from the special account was to be made for any other payment.
- vii) Effective Date of the Agreement: The provisions of the agreement became effective immediately the stand-by arrangement was approved in principle by the Executive Board of the IMF on December 12, 1986 and continued to apply as long as an arrangement with the Fund remained in the upper credit tranche.

7.85 The package was based on traditional rescheduling terms which did not provide any significant concession to the country. The cashflow position could not sustain the debt service obligations as provided in the

agreement and consequently, Nigeria defaulted and had to approach the club to reschedule some of the arrears and maturities falling due between January 1, 1989 and April 30, 1990.

1989 Agreement

7.86 The second Paris Club Agreement was signed on 3rd March, 1989. Essentially, the 1989 Agreement provided that:

- a) rescheduling of 60% of arrears of short term trade debts due on December 31, 1988 amounting to \$169.86 million to be repaid between January 31, 1990 and July 31, 1992 while the remaining 40% amounting to \$26.44 million to be repaid on January 31, 1990;
- b) rescheduling of 100% of Post September, 1986 maturities amounting to \$110.03 million to be repaid between June 30, 1990 and December 31, 1994; and
- c) rescheduling of 100% of maturities falling due (principal and interest) under the 1986 agreement between January 1, 1989 and April 30, 1990 to be repaid between February 28, 1995 and August 31, 1999.

7.87 Other highlights of the agreement included:

- a) that all bilateral agreements must be concluded before September 30, 1989;
- b) that interest rates on the consolidated debts to be determined on the basis of appropriate market rate;
- c) that an amount not less than SDR45 million (i.e. \$55 million) to be deposited every month in a special account with the Bank of England between April 30, 1989 and April 30, 1990 in order to facilitate the repayment of the debts under the agreement;

- d) arrears not covered by the agreement to be paid not later than September 30, 1989;
- e) all debts not exceeding SDR1 million to be repaid on the original due dates. Arrears outstanding on such debts to be paid not later than September 30, 1989; and
- 1) a de-minimis provision as in 1986 Agreement.

1991 Agreement

7.88 Nigerian debts were rescheduled on terms applicable to medium income, heavily indebted countries of the lower category. Congo, Morocco, Honduras & El-Salvador had earlier been accorded the same treatment by the Paris Club. Debts totalling \$3.2 billion were rescheduled as follows:

- a) \$1.8 billion representing 100% Principal and Interest on non previously rescheduled debts due for payment between 1st May, 1990 and 31st March, 1992 were rescheduled for 15 years including 8 years grace period;
- b) \$1.4 billion representing 100% Principal and Interest of debts rescheduled in 1986 maturing between 1st January, 1991 and 31st March, 1992 further rescheduled for 8 years including 4 years grace period; and
- c) Overseas Development Assistance (ODA) Loans not previously rescheduled to be rescheduled for 20 years including 10 years grace period.
- d) Voluntary Debt Conversion: For the first time, debt conversion option was introduced on a voluntary basis. In the case of commercial credits, 10% of the amount outstanding as at 31st December, 1990 subject to a maximum of \$20 million could be converted for debt for nature, aid, equity, and local currency. In the case of ODA loans, 100% of amount outstanding as at 31st December, 1990 could be so converted.

- c) Interest Rate: The interest rate on the amount rescheduled will be based on appropriate market rate.
- 1) Timetable for Payment of Arrears: Arrears as at 30th September, 1990 to be paid latest 28th February, 1991; Arrears as at 31st December, 1990 to be paid latest 31st May, 1991; Bilateral Agreements to be concluded by 31st August, 1991; and Reconciliations to be concluded latest 31st May, 1991 otherwise progress made to be communicated to the Paris Club Secretariat.
- g) Bank of England No. 3 Account: SDR80 million to be paid into the account between February, 1991 and March, 1992.
- h) De-minimis Clause: All debts not exceeding SDR1.5 million to be paid in cash
- i) Comparability of Treatment: Same as in 1986 and 1989 agreements. -

Debt Buy-back Operations

7.89 The agreement, in April, 1984, with foreign suppliers whose bills were outstanding as at 31st December, 1983 led the country to issue promissory notes denominated in U.S. dollars. However, as a result of cash flow problem, the obligations under the notes could not be met. Consequently upon that default, the terms were re-negotiated and it was further agreed, among other things, to remove the restriction on transfer of these notes, thereby making them freely transferable. This gave them a status in the secondary market for securities and so they were traded freely in the market at a substantial discount. Since the notes were unconditional and unsecured obligations of the Central Bank of Nigeria and were unconditionally and irrevocably guaranteed by the Federal Government of Nigeria, it was thought wise that the country should enter the market and discretely buy back as much as could be bought, to take advantage of the high discount available to reduce the debt burden to the nation. Accordingly, in March, 1988, the Central Bank of Nigeria began to test the market and as the Note buy-back operation progressed, the country commenced discussions with the

London Club of commercial bank creditors on further restructuring of the US\$5.6 billion being owed to these Commercial Banks. The banks, seeing the exit opportunity that the secondary note market presented to note holders, wanted to be eligible for a similar treatment. A new agreement containing a menu of options including a buy-back option was, therefore, signed in December, 1991.

7.90 Many banks were looking for a way of reducing their exposure to third world countries. The secondary market presented an opportunity for them to use the buy-back option to sell tranches of their debt at significant discounts. Nigeria seized the opportunity to buy-back some of these debts at discounted values, even before the deal was sealed in January, 1992.

7.91 From the exercise, a total of US\$1.091 billion in Notes were purchased by the CBN at a cost of US\$354.5 million, representing an average of 32.5% of face value (i.e. 32.5 cents to US\$1) - or a discount of 67.5% (i.e. 67.5 cents for every US\$1). This represents almost 25% of Notes originally issued by the CBN in 1988. The purchased Notes were cancelled in August 1992, thus saving Nigeria US\$87 million per year in debt service. Interest on Notes earned over the operation was US\$108.79 million. Between 1988 and 1993, a total of US\$2.93 billion of bank debt was purchased by the CBN at a cost of US\$999 million representing an average of 34% of face value (i.e. 34 cents US\$1) or 6% less than the buy-back price of 40 cents of the debt in the London Club Financing Arrangement, concluded in January, 1992. This enabled the CBN to make a margin of some US\$175 million in the operation in addition to a US\$32 million foreign exchange gain. Interest on bank debt earned during the period was US\$347 million. The total bank debt purchased represented 63% of the outstanding bank debt owed to the London Club.

7.92 In 1991, the Central Bank commenced the purchase of government debt also on a similar basis, buying mainly non-Paris Club debts which Nigeria had already started repaying. A total of US\$269 million of Hungarian and Czechoslovakian debt was purchased at a cost of US\$123.74 million in 1991. In 1992, the Central Bank started buying Paris Club debt as well. Consequently a tranche of US Eximbank and

Netherlands NCM debt totalling US\$18.6 million was bought at Nigerian Par Bond price levels. Also the Export Credit Guarantee Department (ECGD) of the United Kingdom - Nigeria's largest creditor - indicated their willingness to sell large tranches of their exposure at a purchase price equated to Promissory Note levels.

7.93 The purchase totalled US\$7.3 million, with further purchases inhibited by Nigeria's shortage of foreign exchange rather than ECGD's unwillingness to sell. Another batch of purchases involved a total of US\$32.5 million of Norwegian and Swedish government debt priced at Nigeria Par Bonds. In the first half of 1993 before the operation came to a close, US\$95.7 million of post-cut-off date Federal Ministry of Finance Notes issued to Fougere, and 83.3% guaranteed by COFACE, came on the market and were purchased at a discount of over 60% (net of January, 1993 payment which was in arrears).

7.94 Funding for the operations came primarily from the general reserves of the country and from the interest earned on debt already purchased and through re-purchase agreements with the NNPC. The latter involved NNPC buying the debt instruments with an agreement that the CBN would repurchase them later, when its cash flow permitted, albeit, at the same price the NNPC had bought it. Thus the NNPC was effectively lending money to the Central Bank at an interest rate equal to (lie return on the notes.

7.95 Of the total debt bought back, the government debt was cancelled immediately, the Promissory Notes were cancelled at Chase Manhattan Bank, New York (the Fiscal Agent) after due verification in August, 1992 while all the Central Bank debt was transferred for buy-back under the 1992 London Club Agreement. The proceeds of this later buy-back amounting to US\$1.2 billion flowed back into the reserves of the Central Bank of Nigeria. All financial benefits derived from the debt buy-back operation were credited to the account of the Federal Sub-Treasurer with the CBN. The entire debt buy-back operation was conceived out of a desire to capture for Nigeria the opportunities that arose as a result of closely related international debt market developments in the late 1980s. The operations were given a boost by the increased revenues received during the Gulf War. Nigeria has

benefited from earning substantial market discounts, a reduced debt service burden, and the reduction of the external debt stock by US\$5 billion.

7.96 These benefits could even have been more if the Central Bank was not directly involved in the buy-back operation. It should be possible for the purchase to be undertaken by a relatively small non Wall Street firm at a considerably lower cost to the country. The pace of the securities in the recovery market is extremely sensitive to direct intervention by Government or its agencies.

Debt Conversion

7.97 In July 1988, Nigeria introduced the Debt Conversion Programme (DCP). The main objectives were to reduce the external debt stock and lighten the debt service burden, encourage capital inflows, including repatriation of flight capital, and assist the recapitalisation of the private sector investment and the generation of employment opportunities. The programme involved the exchange of eligible foreign debt at a discount for local currency which is then invested in the equity of a local company. Alternatively, the local currency proceeds may be invested in either the loan stock or preferred stock of a company, or given as cash gift or grant to some local charitable organisations. Initially, promissory notes which are the products of the refinancing of the uninsured trade arrears were the only debt instruments that were converted by the Debt Conversion Committee (DCC). Thus, promissory notes became a viable source of capital inflow and a good source of recapitalisation of some private sector investments in the Country.

7.98 The eligible debts for conversion as at now are:

- a) Central Bank of Nigeria (CBN) dollar denominated promissory notes issued under the CBN Circular of 18th April, 1984;
- b) promissory notes issued by the Federal Ministry of Finance;
- c) par bonds issued under the loan restructuring arrangements with the London Club Group of Creditors; and

d) official debts owed to the Paris Club.

7.99 The Debt Conversion Committee was established with the Governor of the Central Bank as Chairman and some Ministers, and the Secretary to the Government of the Federation as members. Conversion is done usually through monthly auctions organised by the DCC Secretariat, but in exceptional circumstances, the Committee can allow conversion outside the auction system. In such cases, the discounts to be offered by the redeemors are determined by the weighted average of discounts offered by successful redeemors at the most recent auction. The Programme gives priority to investment in export-oriented or import substituting industries, especially where the production process is labour-intensive and is based on at least 70 per cent local raw materials. Investments that will lead to development of new products, new machineries and commercialisation of Nigeria's mineral resources are also within the priority areas.

7.100 Under the guidelines, redeemors pay transactions commission of 2.5 per cent of the discounted value of redeemed debts in foreign currency, except where the conversion is for the purpose of making a cash gift/grant, an option of paying the Naira equivalent is given to the redeemer. As at December, 1993, total transactions commission paid stood at \$10.12 million while another N9.17 million was paid in respect of conversion for gift/grant. Since the inception of the Programme in August, 1988, a total of 267 applications valued at \$4.9 billion had been received. Out of these, a total of 229 applications amounting to \$2.35 billion had been granted approval in principle by the Committee. The Committee has also conducted 44 auction sessions where debts worth \$604.37 million have been redeemed. Also, it has allowed some redeemors to redeem debts worth \$195.68 million out of the auction system. The total face value of debts cancelled under the Programme so far amounted to \$800.04 million at an average discount of 46.97 per cent.

7.101 A total sum of \$230.52 million in new money was invested by foreigners through the Debt Conversion Programme since it took off. The investment was in the form of equity, loan stocks and preference

shares of the beneficiary companies. Out of the total of \$800.04 million cancelled since inception, Nigerian redemptors have accounted for \$268.45 million or 33.55%. Also, the sum of \$131.19 million or N597463 million representing total foreign resources granted through the Programme has accrued to the unrequited transfers account of the balance of payments since the inception of the Programme. The redemption proceeds were invested in 128 projects in export oriented and import substituting industries including 10 non-profit making organisations which have benefited from the N4.3 billion so far disbursed under the Programme.

- 7.102 One of the constraints that have affected the operation of the Programme is the non-availability of eligible debts for conversion. Although four categories of Nigerians debts qualified for conversion, only one category, that is the promissory notes issued by the Central Bank, are readily available in the secondary market and this has affected the volume of transactions on the Programme. Apart from the non-availability of the instruments, the prices of the available one i.e. the promissory notes, is always on the increase. This has reduced the percentage of the market discount to be appropriated to the economy and a disincentive to investors to opt for debt conversion programme as a financing option.
- 7.103 The disparity noticed between the official exchange rate and the free market rate in 1991 and 1993 has grossly affected the operation of the Programme. The wider the gap, the less likely it is for conversion to take place. Towards the end of 1993, it became impossible for any conversion to take place; such that conversion at par (zero discount) would give only an effective rate of conversion close to the then free market rate. Thus, no genuine investor was interested in the debt conversion programme as a financing avenue. This largely accounted for there being no auctions since September, 1993.
- 7.104 As at January 1, 1993 the debt covered with promissory notes had been reduced from US\$4.8 billion to US\$3.22 billion while the London Club debt was reduced from US\$5.8 billion to US\$2.1 billion after the restructuring exercise. Of the US\$2.1 billion London Club debt, the sum of US\$2.05 billion was fully collateralised, meaning in effect, that

the US\$2.05 billion debt has been pre-paid. Unfortunately, the country has not been so successful with the management of its official debt, which was first rescheduled and twice again thereafter in March 1989 and January 1991.

7.105 It should be noted that the Paris Club rescheduling had provided only very temporary cashflow relief and had, in no way, resulted in the reduction of the net present value of the debt. The reason has been that the package was always structured to apply only to current maturities falling due within a consolidation period of about 15 months and not the entire debt stock and the capitalisation of the interest thereon. Consequently, instead of reducing, it tended to increase the amount of rescheduling the debt stock. Thus, the Paris Club debt has remained a major source of concern and urgently needs to be adequately and effectively addressed. The remaining official debt, which is largely multilateral and cannot be rescheduled, has largely been paid as and when due although with some occasional delays when foreign exchange was not available.

Problems of External Debt Management

7.106 In the light of this experience, the Bank had identified a number of problems that need to be adequately addressed if the nation is to have an efficient debt management system. The first arises from the nature of the relief package given by Paris Club which has the capability of increasing instead of reducing the stock of debt. Nigeria has been unable to secure concessional rescheduling terms such as those given under the Toronto, Trinidad, Poland/Egypt and Benin/Nicaragua terms which are designed to provide the beneficiary debtor countries with debt and debt service reduction. This has been due to Nigeria's failure to articulate an acceptable medium term restructuring programme and to exercise optimum prudence in the management of her resources.

7.107 The second problem which is related to the first is the attitude of some Paris Club members who are not forthcoming in providing the country with debt information, but who freely make such information available to the Paris Club secretariat. Such a practice largely accounts for unreconciled debt figures between Nigeria and her creditors. This also gives rise to significant differences between Nigeria's data and those of the Paris Club as well as those of the World Bank. Even more disquieting is the fact that the figures published

by the Central Bank are often widely different from those of the Ministry of Finance. It may be recalled that the services of a firm of financial consultants, S.G. Warburg Inc., was engaged to assist the country in preparing for Paris Club meetings, liaising with creditor countries in order to up-date the debt statistics, and ensuring that the country obtained favourable terms while negotiating bilateral agreements. The wide margin existing between the figure of the arrears given by Paris Club and those indicated from Nigeria's records and between the records kept by the Central Bank and by the Ministry of Finance could have been resolved if all the parties were equally diligent in the performance of their duties.

7.108 Negotiations for bilateral agreements often involve long delays. The Nigerian authorities complain of the unco-operative attitude of some creditor countries who are not forthcoming for negotiations until towards the end of the consolidation period. Although the Paris Club Agreed Minute stipulates comparability of treatment, some creditor countries are more prompt than others in processing their claims and some do not even submit their demand notes at all. Consequently, only bills that are presented are processed and settled. This leads to a situation where some countries are paid and some are not, resulting in what appears to be unequal treatment.

7.109 Thirdly, there is the problem at home of adequate data gathering, storage and retrieval. The authorities are unable to keep track of, and maintain accurate records on, loan disbursements and repayments. Although this problem is being addressed by the introduction of computerised system of operations in the Debt Management Department of the CBN, the Federal Ministry of Finance has been unable to keep pace with the CBN in this regard.

7.110 Fourthly, the World Bank has argued that Nigeria does not have adequate capacity by way of infrastructure and skilled manpower to handle disbursement and utilisation after the loans have been negotiated. Because of the additional commitment fees involved, this has invariably increased her debt service burden. The deficiencies are traceable to several factors: inadequate, insufficient counterpart funding, bureaucratic delays and instability in movement of Government functionaries arising from frequent changes in government and more importantly, in policies. But for the relative stability in the Central Bank, the problems arising from persistent instability would have been deplorable.

7.111 Fifthly, the frequency of Nigeria's default in payments after an agreement has been reached erodes the credibility of the creditors for Nigeria's domestic economic management. Nigeria defaulted in 1988 and 1989 on agreements reached with the Paris Club, and in 1986, 1987, 1988 and in 1989 on agreements with the London Club. These defaults suggest that the estimation of resources by the Nigerian authorities is grossly out of gear or that the management is extremely inefficient or that the authorities cannot be taken at their word. The recurrent divergence in the figures of the arrears by the Ministry of Finance and the Central Bank only serves to erode further whatever sympathy is to be expected of the creditors.

7.112 In addition to the above, the large and prevalent macro-economic imbalances do not present a conducive environment for effective management of the country's debt. The management of the domestic economy has a bearing on the effectiveness of servicing the external debt. For example, government budgetary deficit tends to cause distortions in the pricing system, and continued depreciation of the Naira exchange rate. The accumulation of large external and internal, debt compounds the problems of debt service as the pressure of the external debt service generates pressure on budget deficit and vice versa.

7.113 The external debt overhang poses a formidable problem for Nigeria. The Paris Club debt constitutes the most problematic issue to be adequately addressed. A precondition for renegotiation with the Paris Club is that Nigeria must put in place an arrangement with the International Monetary Fund (IMF) and the World Bank (WB). We appreciate that as a first step, it is important Nigeria cooperates actively with these bodies to successfully conclude Nigeria's current effort to adopt a Medium Term Economic Programme (MTEP). When in place, MTEP would qualify the country to seek concessionary rescheduling terms, especially the Trinidad terms with substantial debt stock and debt service reduction. The rewards take the form of lengthening of consolidation periods ranging from 2 to 3 years, whereas the usual Club's arrangement is for a 15 months consolidation period. With the adoption of MTEP and Enhanced Structural Adjustment Support Facility (ESASF) Nigeria should then ask the Paris Club for substantial debt reduction and highly concessionary rescheduling terms similar to the Trinidad terms. Under those terms, a beneficiary debtor country could achieve among other things, a one-third reduction of its debt stock, rather

than merely rescheduling maturities falling due during consolidation period; long maturity period of 25 years and fixed interest rate.

7.114 Nigeria has been classified as one of the severely indebted low income countries by the World Bank, although for the purpose of debt strategies it has been treated as a middle income country. To qualify for classification as a heavily indebted low income country, Nigeria will have to meet the conditions stated above and also show more prudent management of her domestic economy. She cannot gain that status by merely appealing to the G.7 countries.

7.71 15 We also believe that the time has also come for the government to review the agreement with its foreign debt Consultants. They should be made to do their work, but simultaneously local consulting firms should be attached to them to understudy their techniques and their methodology.

7.116 It would also be important to fully computerize the Debt Management Departments of the Federal Ministry of Finance and the Central Bank of Nigeria. In this regard, we have been informed that the Central Bank has recently installed the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) in its Debt Management Department. The system was chosen because it is compatible with the one that has already been installed in the Federal Ministry of Finance and it would, therefore, be easy for both organs of government to exchange information and thereby eliminate the unacceptable practice of issuing conflicting data on the debt position. For the system to generate the fullest possible benefit, however, the Central batik would require the full co-operation of the Ministry.

7.117 Although some of the problems highlighted above are outside the country's control as it would not be easy to make some creditors change their attitude, it is advisable that efforts should be made to be in regular touch with them so that observed differences can be resolved speedily.

7.118 Perhaps, we may have to emphasize that there is no primrose path to getting out of the debt problem. Nigeria has to strain every nerve to adopt and implement the medium term economic programme with greater commitment than ever before. The Paris Club often rewards debtor country governments having such a strong commitment.

7.119 Recommendations

- i) Government should spare no efforts to successfully conclude arrangements to adopt a Medium Term Economic Programme (MTEP).
- ii) Thereafter, Government should make an effort to have Nigeria reclassified by the Paris Club as one of the severely indebted low income countries.
- iii) We recognise that the capacity of the economy to source external loans depends in part on the nature of the project being financed by the loan and its potential to generate resources for the amortization of the loan. Therefore:
 - a) For projects in the economic sector, there should be a positive internal rate of return; borrowing for projects in the area of social services or infrastructure should be sought on IDA terms only. However, all projects should be subjected to detailed comparative cost/benefit tests.
 - b) Application of high cost external loans to non-productive, non-social uses should be avoided.
 - c) External loan requirements for private as well as public sector projects that are of a commercial and quick-yielding nature should be sourced from the international capital market while concessionary financing should be secured for social services and infrastructural projects.
- iv) The role of the Financial consultants to Government, S. G. Warburg Inc. needs to be re-examined. Adequate arrangements should be put in place to (develop local expertise in this field of financial engineering by immediately attaching a suitable local firm to understudy the foreign consultants.

- v) Efforts should be made to integrate debt management into the overall macro-economic policy framework of the country so as to enhance effective planning. At each stage Government must be able to reconcile the timing and the level of its borrowing with its capacity to service the debt.
- vi) The Federal Government in particular, should itself strive to use frugally, the hard-earned foreign exchange for the financing of the productive base of the economy. It should avoid the waste currently associated with the application of foreign exchange earnings to ventures of questionable integrity. The budget should include provisions for debt service.
- vii) Strengthen the Debt Management Department of the Central Bank of Nigeria and of the Federal Ministry of Finance with high quality staff. At the moment it is most regrettable to observe that the latter does not have such staff.

SECTION IV

THE OPERATION OF DEDICATION AND OTHER SPECIAL ACCOUNTS

7.120 Dedication accounts refer to resources dedicated or hypothecated from general or specific revenues to specific expenditure groups or items. They form part of the general resources and are fully reflected in the revenue budget. Similarly, the expenditure groups or items are reflected in the revenue budget. For example, receipts from toll gate fees or fuel taxes may be hypothecated, in full or in part, to the maintenance of highways, or the receipts from fuel taxes may be hypothecated to the improvement of the environment of the oil producing areas. The form of dedication is illustrated in the allocation of a percentage of the Federation Account given to Oil Producing Areas Development Commission (OMPADEC) for the rehabilitation of the oil producing areas.

7.121 To a government, there are arguably two basic, but broad merits in setting up special funds. First, they guarantee the effective funding of

projects of the highest priority and with critical impact on the technological and industrial development of the country. Where the payments are to be made in foreign currency and these accounts are maintained in foreign currency, it becomes much easier to procure the offshore inputs of the project and to pay the contractors involved in these projects. Secondly, the creation and judicious use of such special funds, not directly utilised on projects, could provide an effective means of sterilizing unanticipated revenues and the careful and gradual injection of such funds into the economy in such a manner as to avoid inflation through the control of money supply.

7.122 There are other types of dedication accounts in the Nigerian fiscal operations of which neither the resources nor the expenditure items are reflected in the Government budget:

7.123 **Central Bank Dedication Account:** A quantity of crude oil was dedicated to the prosecution of certain “priority” projects. The proceeds of the sale of the crude were not shown in the revenue side nor were the expenditures reflected in the expenditure side of the budget. The budget contains information on the quantity of crude dedicated, but not the revenue therefrom nor time expected disbursements from this account. The account was kept outside of the consolidated revenue account so that apart from a few members of the Government, no one else has any information on the size of the account or of the size and manner of the disbursements. It represented, in reality, a second but undisclosed budget operated only by the President and the Governor of the Central Bank.

The origin of this type of account goes back to September 1988 when the President approved a proposal to hypothecate 65,000 barrels of crude oil per day for certain priority projects, particularly the Ajaokuta Steel and Itakpe Iron Mining projects and the completion of the Shiroro Hydroelectric project. The quantity was increased to 105,000 bpd in October 1989 to finance such NNPC projects as the LNG and the commitment to the Joint Venture Partners of the NNPC. The quantity was further increased to 150,000 bpd early in 1994.

- 7.125 The funds are kept with the Bank for International Settlement, Basle. From Tables 7.5 and 7.6 it can be seen that total receipts and payments in respect of the dedication account from inception in September, 1988 to 30th June, 1994 were US\$6.195 billion and US\$6.109 billion respectively, leaving a balance of US\$85.943 million as at the end of the period.
- 7.126 Apart from the Dedication Account into which these proceeds from hypothecated crude oil sales are to be placed, there are other special accounts that arose subsequently and were operated in the same manner.
- 7.127 **NNPC Sales of Mining Rights Account:** The NNPC Sale of Mining Rights Account was opened in October 1989 with proceeds of sale of 20% mining rights in the NNPC/Shell Joint Venture - (10% to Shell, 5% to Agip and 5% to ELF). The total amount realized from the sale was US\$2.06 billion. Out of this the sum of US\$1.5 billion was transferred to the CBN for utilisation in accordance with the Government's directives. The remaining US\$560 million was retained by the Nigeria National Petroleum Corporation (NNPC). The funds transferred to the Bank were invested in fixed deposits with the Bank for International Settlements, Basic. Payments to contractors handling priority projects totalled about US\$359 million in 1990 and US\$395 million in 1991. Payments in 1992 to the tune of US\$937 million were effected on priority projects as well as in settlement of the country's indebtedness to the London Club group of creditors. Like the Dedication Account, the payments are made on the authority of the Head of State and Commander-in-Chief. The balance of this account as at 30th June, 1994 was US\$1.663 million.
- 7.128 **Stabilisation Account:** A Stabilisation Account was created in October 1990 to receive revenue from crude oil sales in excess of the budgeted provision during the Gulf War. The aim was to effectively separate it from the Federation Account and to sterilise it pending instructions for further utilisation. Between October, 1990 and June, 1994 funds totalling US\$4.398 billion were

TABLE 7.5 SUMMARY OF RECEIPTS INTO DEDICATION AND SPECIAL ACCOUNTS

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TABLE 7.6 – SUMMARY OF RECEIPTS AND DISBURSEMENTS (DEDICATION
AND SPECIAL ACCOUNTS)

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transferred to the Bank to manage. The funds are held with the Bank for International Settlements, Basle in Switzerland. Funds were periodically bought by the Central Bank of Nigeria who credited the Naira equivalent to the Federal Government's Stabilisation Account. As the funds were being managed, the bulk of the money was progressively applied to settle obligations outstanding to contractors handling priority projects and in financing the debt buy-back operation.

- 7.129 After the conclusion of the London Club deal in January, 1992 another sum of US\$1.21 billion representing the proceeds of debt held by the CBN was received back into the Account. The money represented a flow-back of funds earlier paid out for the debt reduction operation. In effect, the disbursement from the Account for debt buy back was merely an advance to be retired when the proceeds of the debt were recovered. There was, therefore, no net disbursement on account of debt buy back. The balance on the US Dollar account as at 30th June, 1994 was US\$117.360 million while that on the stabilisation account held in Naira was Nil. No payment was made out of this account since the end of the Babangida administration
- 7.130 **The Signature Bonus Account:** The NNPC had entered into some exploration contracts and made some up-front payments. Proceeds in respect of Signature Bonus amounting to US\$100 million were received and applied in the settlement of some project bills. A total sum of US\$99 million has so far been paid out of this, leaving a balance of US\$1.069 million (inclusive of interest earned) as at 30th June, 1994.
- 7.131 **GHQ Special Fund Account:** The GHQ Special Fund Account was opened at the Central Bank on 5th March, 1986 for the purpose of providing naira cover for military related projects approved by the Vice President of the country. The account was opened with the sum of N50.0 million transferred from NNPC Special Account, while subsequent credits to the account were from transfers from the Accountant-General of the Federation's office as well as a portion of the operating surplus paid to

Government by the Central Bank.

7.132 A great deal of the funds from that account was spent on civilian related projects, a situation that gained prominence from 1989 onwards. Among such civilian projects are:

- a) special payment to the Niger State Government for wheat production and for the Kontagora Water Supply project;
- b) refurbishing of the Nigerian High Commission office in London, and purchase of vehicles in connection with the President's visit to the UK; and
- c) payment to construction companies including Julius Berger, Dantata & Sawoe as well as the financing of certain projects at Abuja.

7.133 Disbursements from the account rose from N132.5 million in 1987 to N334.7 million in 1989. It, thereafter, rose significantly from 1990 onwards. For instance, the amount disbursed each year from 1990 to December, 1993 stood at N1.975 billion, N3.166 billion, N506 billion, N4.554 billion respectively and in the half year January-June, 1994 N0.889 billion.

Candidate List of Priority Projects

7.134 Originally created for projects classified as priority by the President, the Account was used to finance other projects that entered the candidate list due to pressure from Ministers and other interests. There was no documentation on the initial selection of projects, but it was known that the President was concerned about the delay in completing the Ajaokuta and Itakpe Iron and Steel projects and the Shiroro Hydroelectric Scheme. So much had been spent already on these projects that the President concluded that they warranted the extra expenditure to take them to the point of commissioning. In the original letter seeking approval for the creation of the Account in 1988, the Governor had recommended that the funds be applied to some military expenditures, external debt buy-back and the build up of external reserves.

7.135 The extension of the scope and widening of the application of the funds began in 1989 with the inclusion of several building projects and complexes in Abuja including the Airport, the dualisation of the road from the Airport to town, the National Assembly, Conference Centre, etc. Similarly, the Aluminum Smelter project in Ikot Abasi, the completion of the JSGI Power Station and road projects in Gboko-Yandev, Abuja-Kaduna-Kano and water projects in Gusau and Kafin Zaki Dam were included in the list. There is no evidence as to how and on what criteria these, rather than other projects, were selected.

7.136 In due course, pressures mounted on the President to utilise these funds for an amorphous assortment of expenditures which can hardly be classified as priority. These included expenses by diplomatic missions abroad, official travels of the President and his wife and even the welfare needs of the President's staff.

7.137 A broad classification of the disbursements is shown in Table 7.7. The aggregate disbursements to the various projects over the period 1938 to June, 1994 are also shown in Table 7.8. As the funds swelled from the inclusion of oilier sources of revenue - sale of mining rights, stabilisation account, signature bonus, and GHQ account - the care with which the expenditure items and classes were selected declined so much that the funds were applied to such items as medical treatment abroad of favoured patients, donations to institutions like the Bar Association, procurement of ceremonial uniforms, tours of athletes for the Commonwealth handball competition, contribution to the Government of Liberia, purchase of TV sets for the Presidency, a documentary film on Nigeria, production of a book on the President, etc. The diversity of the classes of expenditures made from these accounts violates the original intention of creating the accounts mainly for "priority" projects. For it is difficult to justify the inclusion of such projects in the list of priority items for expenditure. Nor were the Accounts utilised for the other purposes - debt buy back (except for an advance payment made for debt buy back, which was refunded later) and the build-up of reserves - as approved initially by the President.

TABLE 7.7 – DISBURSEMENTS FROM DEDICATION ACCOUNTS BY
CATEGORY OF EXPENDITURE

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TABLE 7.8 – BREAKDOWN BY EXPENDITURE OF PROJECTS

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THE OPERATION OF THE ACCOUNTS

7.139 The accounts were opened on the instruction of the President who was expected to issue the directive that should lay down the way and manner the accounts were to be operated. The Panel was unable to trace any document in which the President directed the manner in which the account was to be operated.

7.140 The disbursements from, and the method of operating these accounts fall into three categories:

7.141 **Security and Defence Expenditures:** These were expenditures requested, and approved, for the security agencies for their covert operations and for equipment. These requests were usually channelled by the Director-General, National Intelligence Agency or the National Security Adviser to the President or occasionally to the Governor. In the latter case, the Governor might authorise the disbursement and simultaneously send a memorandum to the President for his approval. In other cases, the approval was handed down to the Governor by the President. Occasionally, the National Security Adviser or Director-General, National Intelligence Agency, had gone directly to the Director, Foreign Operations but such direct interventions were referred to the Governor. In either case, the Governor then instructed the Director, Foreign Operations, directly, to pay and he also indicated the account to be debited.

7.142 On the part of the Director and his immediate Manager in charge of Operations, once they were satisfied that the authorisation was genuine, the payment was made. In each case, the Bank did not demand nor did it obtain any documentary evidence of the services or equipment being paid for, because the documents were regarded as classified.

7.143 **Contractors:** From time to time, certificates of performance by contractors engaged in contracts and projects in the candidate list of priority projects under the Dedication and Special Accounts

were lodged with the Central Bank by the appropriate Ministry. In no case was the original contract document or copy thereof lodged with the Bank. The desk officer in the office of the Director of Foreign Operations tabulated the certificates received on behalf of each contractor and each project, updated the computer records and forwarded these to the Governor as a matter of routine. It had not been possible for the Bank to check the requests for payment against the total commitment on the contract to guard against double payment or inaccurate claims. At intervals, the Governor reviewed the material and either authorised payments to contractors in amounts specified and simultaneously addressed the President for covering approval or first obtained the approval before authorising payments. Practically, in each case, the initiative was taken by the Governor.

7.144 **Presidential Fleet & Other Payments:** Instructions for payments for maintenance or build up of the Presidential Fleet of aircraft always came from the President. But with regard to payment for other requirements or services unconnected with the fleet, the Governor might first approve, in case of urgency, and subsequently obtain the President's covering approval.

7.145 What stands out is that the Governor played a vital role in the management of the Dedication and other Special Accounts not only as fund manager and banker; but also as an initiator of the timing of payments and, in a very substantial manner, the beneficiaries of these payments. It is, significant that apart from the few occasions of recoverable advances from the Accounts for Debt Buy-Back operations, the Governor had not once sought approval to utilise these resources for the build up of external reserves. That lapse is all the more inexplicable in the light of the secular deterioration in the external reserves position which, as at the time of this Report, offers less than five weeks' import cover.

7.146 The Central Bank claimed that as a banker to the Government it only dealt with instructions in respect of payments from the Dedication Accounts. It did not get involved in the physical receipt of goods or physical assessment of projects executed. Whenever an instruction was given by the Governor to effect payment, the Bank officials carrying out the instruction

presumed that the President or the relevant Government agency had processed all the documents in respect of the claim and had found the claim to be justified, before authorising the payment. Hence as a banker, the Central Bank proceeded to make the payment rather than undertake to verify the authenticity of any claim. In effect, so long as the signatures were confirmed to be genuine, the Central Bank had no business but to effect payment. It was only with respect to payment to contractors that performance certificates accompanied requests for payment.

7.147 From the foregoing, it is clear that the instructions relating to the operation of these accounts ran between the President and the Governor and between the Governor and the Director, Foreign Operations. The Panel was informed that each time the Governor received an authority from the President to effect a payment, a Minute was sent to the Director, Foreign Operations, through the Deputy Governor, International Operations. The dedication accounts were not operated whenever the Governor happened to be away. The Deputy Governor, International Operations and the Director, Foreign Operations, had no discretion with regard to the operation of the dedication accounts. They acted only on the authority of the Governor.

APPRAISAL OF THE OPERATION OF THE ACCOUNTS

7.148 **Scope of expenditure:** The Panel observed that the use of the Dedication Account had been stretched far beyond its original scope. Further, the utilisation of the stabilisation account had completely undermined its fiscal objectives. The list of projects to be serviced from the Dedication and other Special Accounts which had been referred to earlier, did indeed contain some projects of importance to the rest of the economy. However, there were many large projects of doubtful viability and many more of clearly misplaced priority. In addition to these, the Dedication and Special Accounts had become a parallel budget for the Presidency. The decision as to what expenditure items to be financed out of these dedicated accounts was made by the President alone, depending on the pressures brought to bear on him by the sponsors of the items. For example, the accounts had been utilised to defray an assortment of expenses that could not in any way be described as priority such as:

	(\$m)
Documentary Film on Nigeria	2.92
Purchase of TV/Video for the Presidency	18.30
Ceremonial Uniform for the Army	3.85
Staff Welfare at Dodan Barracks/Aso Rock	23.98
Travels of the First Lady abroad	.99
President's Travels abroad	8.95
Medical (Clinic at Aso Rock)	27.25
Gifts: Liberia	1.00
Gifts: Ghana	.50
Nigerian Embassy: London	18.12
Nigerian Embassy: Riyadh	14.99
Nigerian Embassy: Teheran	2.76
Nigerian Embassy: Niamey	3.80
Nigerian Embassy: Pakistan	3.80
Nigerian Embassy: Israel	13.07
TV Equipment for ABU	17.90
Ministry of Defence	323.35
Security	59.72
Defence Attaches	25.49
GHQ	1.04

7.149 Neither the Dedication Account nor the Stabilisation Account was applied for the purpose it was originally designed to serve. Thus, the Dedication Account was used for many non-priority projects and the Stabilisation Account was not, in practice, used to sterilise revenues in excess of projected earnings. Instead, after a short delay, the monies in the accounts were spent virtually as fast as they accumulated. As can be seen from the figures presented, by June 1994, almost all the money in the Dedication and Special Accounts had been spent.

7.150 **Transparency:** In addition, even at the Federal Government level, the operation of such accounts was not subject to the normal budgetary processes, and therefore lacked transparency. By limiting the authorisation process for its operation to the approval of the President or Head of State, which was communicated directly amid only to the CBN Governor, it created considerable room for abuse of procedures, abuse of application and reduced accountability.

7.151 **Parallel Foreign Exchange Budget:** Each financial year the Federal Ministry of Finance announced the budget. The approved budget for the Federation showed the expected receipts in foreign exchange and the expected disbursements. The receipts into the Dedication and other Special Accounts were not reflected in these figures. There had been considerable criticism of the establishment and operation of Dedication and Special accounts in Nigeria. The most strident criticisms had been made by the World Bank and the IMF. They knew of the existence of these accounts, the sums held therein and the disbursements therefrom. They were hot, therefore, well disposed to assist Nigeria to plead with her foreign creditors for concessionary terms on the external debt service. The main point of domestic criticism was that these resources could have been applied to back up the FEM operations and second, that the balances kept in these accounts were not included in the Federation Account, a practice which violated the fundamental precepts of the federal fiscal relations in Nigeria. By excluding these incomes from the Federation Account, the respective shares of the State and Local Governments had been more or less confiscated by the Federal Government, thereby unilaterally violating the revenue allocation formula.

7.152 **Anomalies:** Some anomalies had been observed in the method of operation of these accounts:

- a) Several payments indicated in the Reconciliation Statements had not been backed-up by the President's approval. On the other hand, there were some approvals for which no equivalent payments had been listed;
- b) in many cases, there had been very long delays between the time payments were effected to relevant contractors/firms/suppliers and the time of request for or receipt of, ex-post Presidential approval;
- c) in a number of cases, there were significant variations between the amounts approved for payment and the actual disbursements made, without any further explanation from the documents supplied;
- d) in a large number of cases, there were no indications, in the letters written to the Head of State seeking approval to make

payments or seeking ex-post approval, as to which dedication account was to be charged - either Dedication, Sale of Mining Rights, Signature Bonus, or Stabilisation Accounts. In such cases, it would be impossible to ascertain, on the basis of the information available, whether or not the approvals were in respect of any of these special accounts. And yet it was the Governor who instructed as to which particular account was to be debited; and

- e) the Central Bank was never able to establish that payments on behalf of the Ministry of Defence and the National intelligence Agency were based on genuine and well established contracts or transactions. This was because the relevant documents were never made available to the Bank, as such documents were regarded as classified items.

7.153 Significance for the Macroeconomy: The funds accruing to these accounts had been applied mainly to payments for services of contractors, and for the purchase of military equipment and services. The gross takings on these accounts from their inception in 1988 to June 1994 totalled \$12.4billion. These had been held totally outside the country's external reserves. Indeed, if the funds had been counted as part of the external reserves and had been held as such, the impact on the exchange rate in time years under review would have been so significant that the Naira would have been stronger in 1994, in relation to the dollar, than it was in 1985 when it stood at Ni to \$i.004. It should be evident, therefore, that the burden of external debt to the Paris and London Clubs and the pressure on the exchange rate would have been substantially mitigated if not completely eliminated. It is this fact that calls to question the wisdom and prudence not in the creation of these accounts but in its disbursements.

7.154 Recommendation

The Dedication Account and other Special Accounts be discontinued in the following manner:

- i) all further disbursements from these accounts be immediately stopped;

- ii) the balance in the existing Dedication and other Special Accounts should immediately be taken into the external reserves of the Central Bank;
- iii) receipts from sales of dedicated crude oil be paid into that account up to the end of the 1994 fiscal year;
- iv) thereafter, with effect from January, 1995, there should be no further dedication of crude oil. But if for any reason there is to be a dedication account, there should be a total and full disclosure of both the expected revenue and the item/s of expenditure in the Budget; and
- v) the GHQ Special Account should be transferred to the normal Budget of the Government.

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