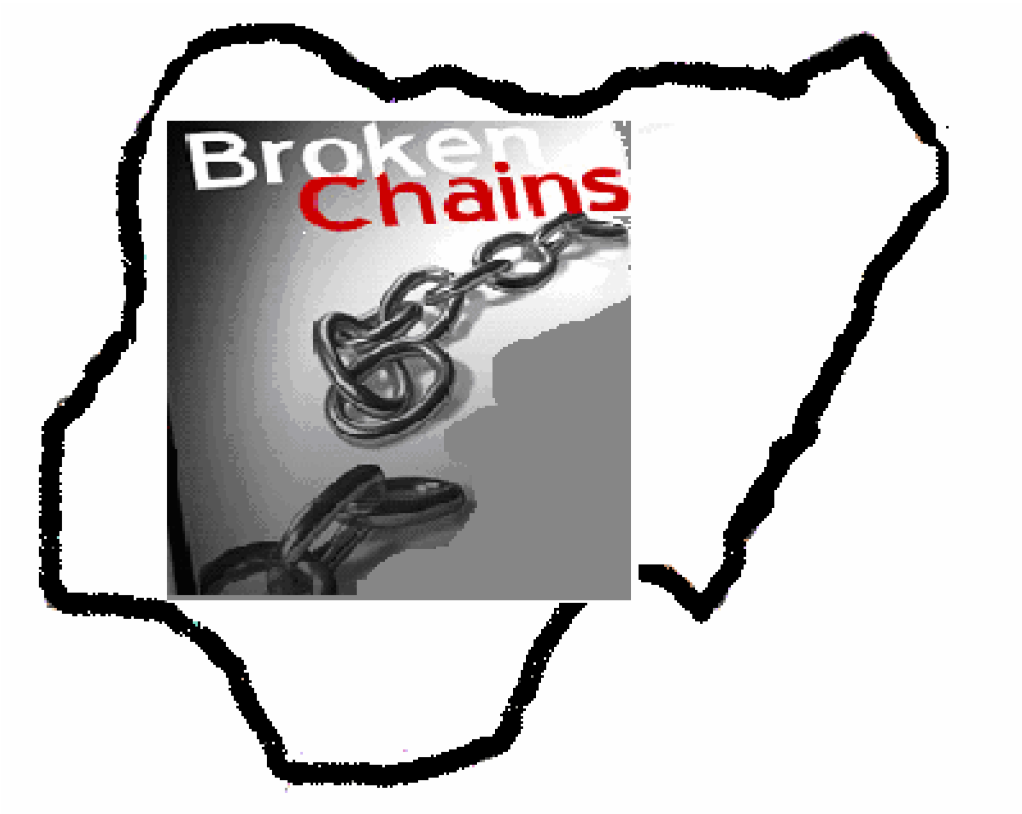
DEBT MANAGEMENT OFFICE

NIGERIA’S DEBT RELIEF DEAL WITH THE PARIS CLUB



The fetters of debt burden are broken only by debt cancellation.
Nigeria's chance is now!!

Many Nigerian children learn under a tree; Debt cancellation could change all that.

Background

Nigeria's first loan from the Paris Club of Creditor Nations was a US$13.1 million loan taken from the Italian government in 1964 for the building of the Niger Dam. From that time till the end of the decade, Nigeria's borrowing from foreign lenders was generally insignificant.

However the oil boom of 1971-1981 introduced the era of big borrowing in Nigeria. Loans were acquired by various tiers of government as Nigeria embarked on major development and reconstruction projects in the wake of the civil war. The borrowing continued well into the civilian era, as the Federal Government embarked on the guaranteeing of many unviable loans taken by private banks, state governments and parastatals.

In 1982, when oil prices crashed, Nigeria was unable to pay off the loans it borrowed. Interest payments spiked, penalties rose, the crisis had begun. This pattern continued well into the military regimes of 1985-1993 and 1993-1998, when Nigeria stopped paying its debts to the Paris Club altogether, after the Paris Club refused to substantially reduce Nigeria's debt.

With the return to civilian rule in 1999, Nigeria embarked on a relentless campaign for debt relief. Nigeria's debt, which stood at US$36 billion in December 2004 was unsustainable, President Obasanjo campaigned. *Nigeria spends more on interest payments than it does health care and education. Given this debt level, Nigeria cannot achieve the Millennium Development Goals.*

This debt relief effort yielded fruit on June 29, 2005, when the Paris Club and Nigeria agreed on an US$18 billion debt relief package.

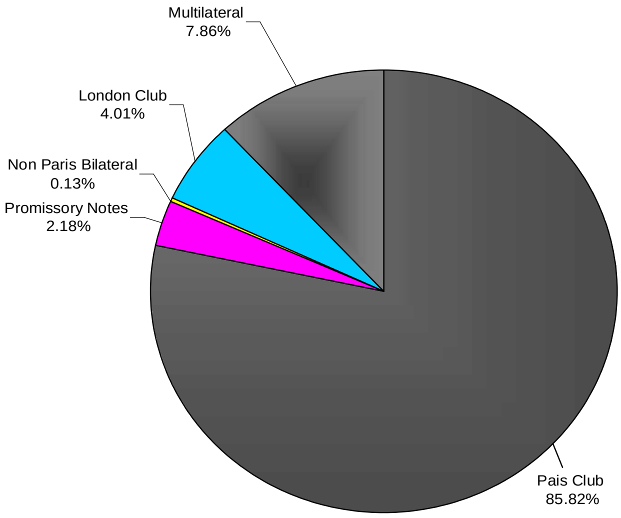
Nigeria's External Debt

How much does Nigeria owe?

- As at December 31, 2004 Nigeria owed a total of USUS$35.994 billion.
- At the official exchange rate of ₦134 to US$1.00, this is equal to ₦ 4.82 trillion.
- If shared among Nigerian's 130 million people, each person will owe ₦ 37, 101. 51 to the outside world.
- But Nigeria's Gross Domestic Product (GDP) Per Capita is ₦ 3,379.50, meaning that on average, each person in Nigeria is only able to earn ₦ 3,379.50 in one year.
- That means every Nigerian who in the very unlikely event manages to save say half of his total annual income (₦ 1, 689.75); will need about twenty-two years to save enough money to pay off all our debt.
- And to achieve this, this Nigerian must survive on ₦ 5.00 a day.

Who does Nigeria owe?

External Debt Outstanding by Creditor Category
As At December 31, 2004



Clearly, the largest proportion of Nigeria's debt is owed to the Paris Club.

What is the Paris Club?

- The Paris Club is an informal group of official money lenders formed in 1956 with its Secretariat in Paris.

- It was created to find coordinated and lasting solutions to the payment difficulties experienced by countries that owed its member countries.

- It is a voluntary gathering of creditor countries willing to treat in a coordinated way, the debt due to them by developing countries.

What is the Source of Nigeria's Paris Club Debts?

- These are loans insured through Export Credit Agencies of creditor governments or their appropriate institutions, extended to the Federal Government of Nigeria (FGN), the States and other public entities and which are covered by the guarantee of the Federal Government of Nigeria.

- The Paris Club debts also include commercial credits or trade arrears incurred by private entities which have been verified by the Federal Government of Nigeria.

- The drastic reduction in foreign exchange earnings in the 1980s made it extremely difficult for Nigeria to meet its external payment obligations, resulting in massive build up of arrears.

- The foreign creditors reacted by suspending new lines of credit, thus compounding the economic problems facing the country. Nigeria then decided to approach the Paris Club for an agreement on paying at a later date.

How Many Previous Agreements has Nigeria Reached with the Paris Club and why did these Arrangements not Resolve the Debt Problems?

- Nigeria has rescheduled its debts on four different occasions: 1986, 1989, 1991 and 2000.

- The intended effects of rescheduling include extending the period of repayment, and improving the means with which payments are made. In effect it means postponing the evil day.

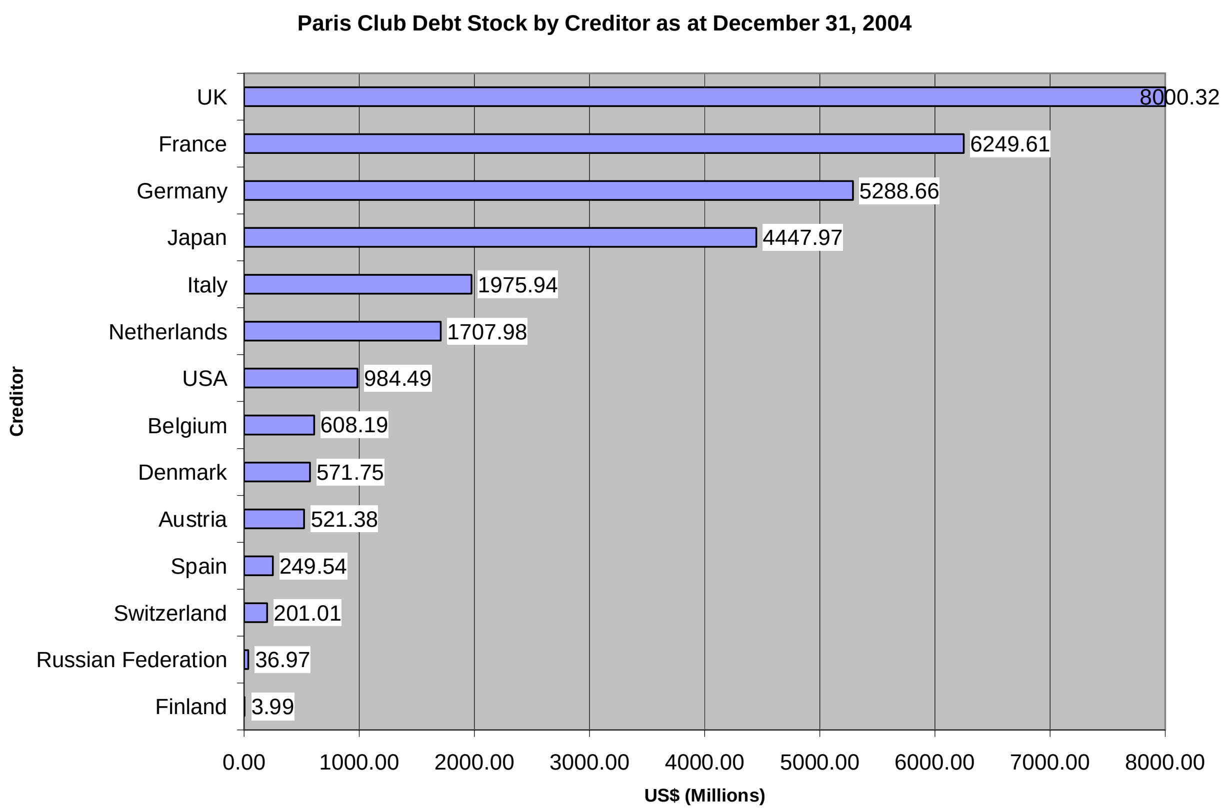
- However, despite these rescheduling agreements, Nigeria's Paris Club debt still continued to increase because of the country's inability to fully pay what was due each year.

Which countries are Paris Club members and how much does Nigeria owe each of them?

- Nigeria's debt outstanding to each of the Paris Club creditor countries as at December 31, 2004 is displayed in the picture below.

- Nigeria owes the highest amounts to the United Kingdom, France, Germany and Japan.

- But Nigeria needs the consent of even the smallest creditors like Spain and Finland to be able to secure debt relief



Nigeria's Quest for Debt Relief

Is Nigeria's Debt Burden so Heavy that Debt Relief Should be Given a High Priority?

- Nigeria's debt to GDP is about 58%, almost double the recommended level of 30%. Debt to total government revenue amounts to 412%, and debt/export ratio stands at 152%.

- In the crudest of explanations, this means that the country would have to give up more than half of its gross output i.e. everything we produce, without making allowance for the cost of producing them, every year in order to pay off its debt.

- It also means that government's annual gross revenue would have to increase by four times to afford timely offsetting of the nation's indebtedness to the outside world.

- The Nigerian worker would have to export the equivalent of one and half times his current annual levels in order to liquidate the external charge on his foreign exchange revenues.

What did the Government do to prioritize the Quest for Debt Relief?

- Owing to Nigeria's huge debt burden, resources which could have been used to tackle poverty and support economic growth are diverted to servicing external debts. This drain on resources also constituted a major threat to the consolidation of the country's nascent democracy.

- Accordingly, the quest for debt relief was declared a priority of the Olusegun Obasanjo administration upon his assumption of office in May 1999.

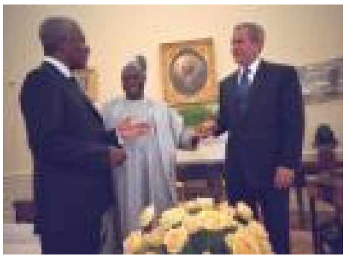
- To achieve this objective, a Debt Management Office (DMO) was established in October 2000 as the sole agency responsible for the management of the country's debt.

- Guided by its vision "to build a world-class DMO capable of making Nigeria's debt sustainable by 2006", and a mission "to transform Nigeria's debt portfolio into an asset for growth and development", the DMO audited the country's loan portfolio, updated, reconciled and computerised the debt data base to produce consistent, credible and reliable debt figures.

- With the concerted efforts of President Obasanjo, the Ministry of Finance, National Assembly, DMO, the Economic Management Team, NGOs and other stakeholders, the credible implementation of the country's National Economic Empowerment and Development Strategy (NEEDS), as well as the securing of an IDA only status for Nigeria, (a factor very supportive for debt relief), thus making Nigeria eligible to borrow on very soft and favourable terms, the creditors and multilateral financial institutions began to positively consider Nigeria for debt relief.

How did the International Community Respond to the Government's Quest for Debt Relief?

President Obasanjo's debt diplomacy finally paid off. In 2005 the campaign for debt relief reached a climax when Great Britain, acting as chair of the G8 (the eight most developed countries of the world), brought to the fore Third World, and particularly, African debt issues. The G-8 communiqué, in recognition of the progress made by Nigeria in the implementation of economic and governance reforms, agreed to support a sustainable debt treatment for the country within the framework of the Paris Club. At their meeting on Wednesday June 29, the Paris Club creditors announced the decision in principle, to grant a debt relief package amounting to about US$18 billion out of the US$30.84 billion outstanding as at December 31, 2004.



The Issues

How Will Nigeria's Debt Relief Offer by the Paris Club Work?

The offer consists of three parts:

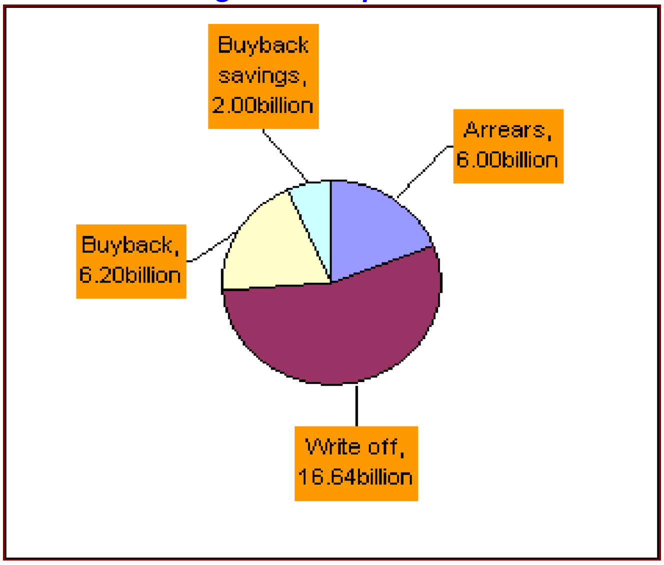
- Nigeria is required to settle arrears owed to the Paris Club. Arrears are amounts of principal, interest and late interest that have fallen due, but have not been paid. It is a standard requirement of the Paris Club for a debtor to clear its arrears prior to commencement of any debt relief negotiation. It should be noted that Nigeria's case is exceptional in the sense that the debt relief offer was made even before the settlement of the arrears.

- Once the arrears have been paid, there would be a reduction of the debt stock in favour of Nigeria on Naples Terms. This simply means that they will write off up to 67% of the total debt stock. The name "Naples Terms" comes from the first time it was used in Naples, Italy in 1994.

- What remains of Nigeria' debt stock after the cancellation on Naples Terms will then qualify for a "buy back" at an appropriate discount rate. This means Nigeria will pay less than the face value to liquidate the debt, thus making substantial 'buy back savings'

- In total Nigeria is expected to achieve about 60% cancellation of its Paris Club total debt stock based on December 2004 figures.

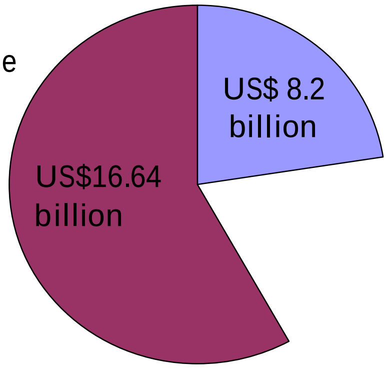
What does this mean for Nigeria in practical terms?

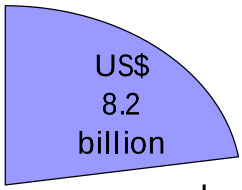


- About US$6billion, which is in arrears, would be paid upfront, by October 2005.

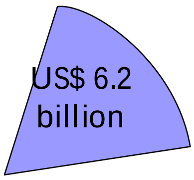
- Nigeria's total indebtedness to the Paris Club amounting to US$30.84 billion will be reduced to USUS$24.84 billion.

- This outstanding US$24.84 billion will be eligible for relief treatment under the Naples Terms which allows a write off of up to US$16.64 billion.





- The balance of about US$8.2 billion after this cancellation will qualify for a buyback at a market-related discount, expected to save Nigeria a further US$2.0 billion, leaving a balance of about US$6.2 billion.



- Nigeria will pay this US$6.2 billion in order to completely exit its Paris Club debt.

- In total therefore it is expected that the amount of debt cancellation Nigeria will get from this treatment will be about US$18 billion.

Any Policy Requirements?

- Usually, to reach a deal with the Paris Club, a country is required to have a formal agreement with the IMF.

- Nigeria does not have an IMF program, but has signed up to a new framework with the IMF known as a Policy Support Instrument (PSI).

- This is essentially an arrangement for IMF officials to endorse NEEDS, Nigeria's home-grown locally driven economic reform program.

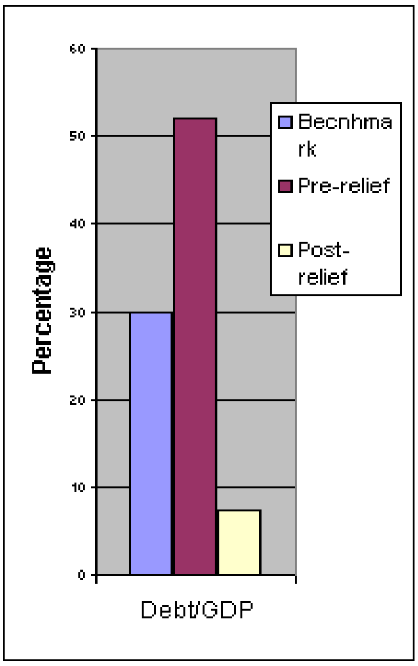
- The IMF already endorses NEEDS on a quarterly basis. The PSI only formalizes this endorsement arrangement. Therefore no new policy requirement other than NEEDS is to be made of Nigeria. This unique arrangement benefits Nigeria more than any known previous Paris Club relief deal.

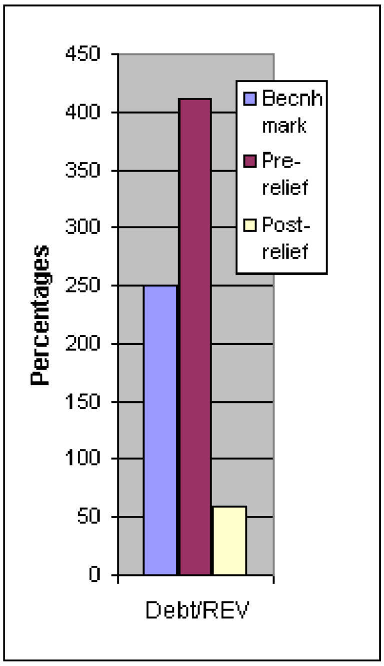
What Is The Timeframe of the Deal?

- Arrears are expected to be paid by October 2005, after the signing of the PSI.
- Nigeria will have another meeting with the Paris Club to conclude details of the agreement.
- Between October 2005 and March 2006, the debt write off will occur, and the buy back processed, thereby ensuring that Nigeria no longer owes the Paris Club any money.

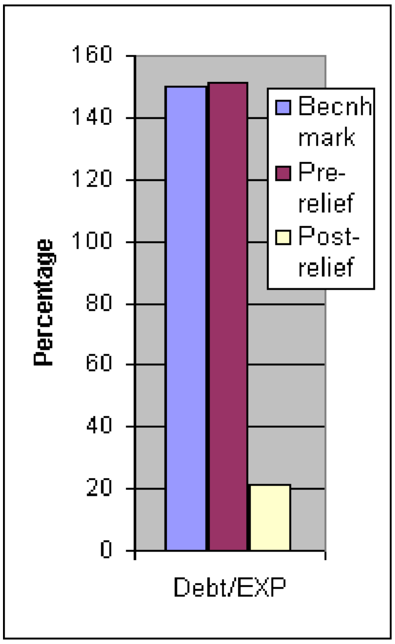
Will Nigeria be Debt Free after the Relief?

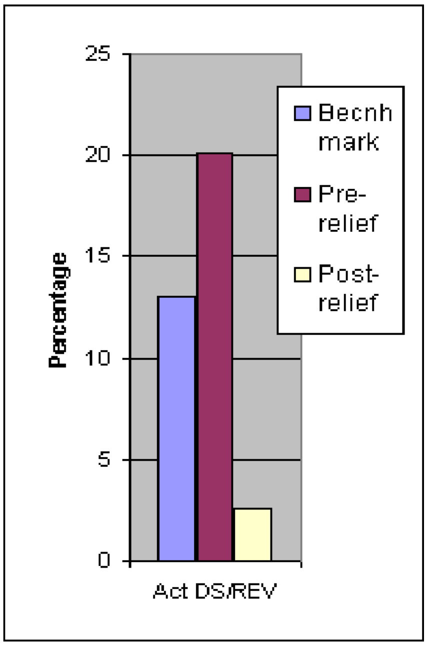
- No. Nigeria still has external debt outstanding of about US$5 billion owed to Multilateral Financial Institutions, Promissory Notes Holders, London Club Creditors and Non-Paris Club Bilateral Creditors. Over the years, Nigeria has continued to meet its obligations to these group of creditors as at when due.
- However, Nigeria's external debt will now become sustainable. In other words, Nigeria will be able to maintain a level of external indebtedness, benefit from investing the borrowed funds, and service the debts without adversely affecting the nation's growth and development.





- As illustrated in the graphs above and below respectively, dramatic improvements in the debt ratios are expected to occur after debt relief. A high ratio is indicative of a high burden of debt and vice versa: Debt as a percentage of Gross Domestic Product (Debt/GDP) is expected to fall from pre-relief level of 52% to about 7%. Debt as a percentage of Government revenue (Debt/REV) will also fall from 412% to just 58%, and debt as a percentage of export (Debt/Exp) will fall from 152% to a mere 21.5%.



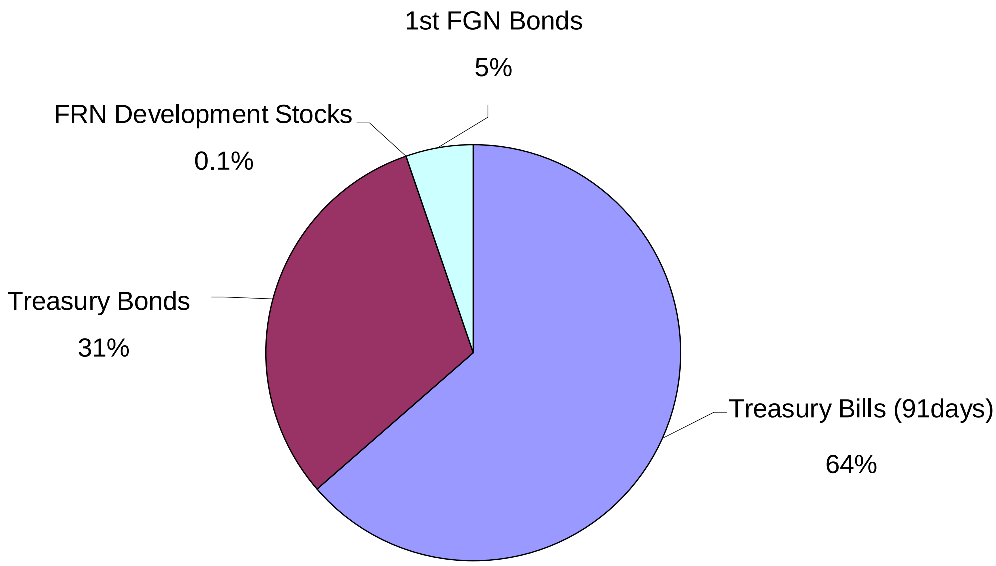


- Actual commitment of resources in terms of debt service as a percentage of Government revenue (Act DS/REV), and export will also fall: Nigeria will need only about 1% of its GDP, less than 3% of government revenue, and just about 3% of its export earnings to service external debt.

Will there still be Need for Debt Management after Debt Relief?

- Yes. In addition to the need for new external loans which will need to be professionally and prudently managed, it is pertinent to note that Nigeria has a huge securitized domestic debt portfolio, amounting to about ₦1. 36 trillion as at end of December 2004.

- The composition of Nigeria's domestic debt shows an unhealthy dominance by short term instruments, with the banking sector as the major holders of government securities.



- The DMO has since 2003 embarked on the restructuring of the securitized debt portfolio with the objective of lengthening the maturity of the instruments and deepening the government bond market.

- In 2003, the First FGN Bond (ranging from 3 to 10 year tenors) was floated after 17 years of its absence from the market. Six-month and 1-year Treasury Bills are now issued regularly to replace 91-day Treasury Bills.

- A regular monthly issuance of 2 to 3year FGN Bond commenced in July 2005.

- There is also the local contractors debt estimated at over ₦650 billion which is being verified in order to initiate appropriate solutions.

What Are The Benefits of the Debt Relief?

- Current debt relief will reduce Nigeria's external debt stock and debt service obligations, thus lifting the heavy debt burden off the economy.

- The debt write-off of about US$18 billion, when eventually actualised, would constitute a direct saving on debt service payments. Nigeria has in the last five years been spending an average of US$ 1billion out of about US$2.1 billion falling due annually in Paris Club debt service.

- This huge amount would immediately be made available to fund critical priority sectors such as health, basic education, water, power, road networks and other infrastructure to stimulate the economy.

- The saving from debt relief is imperative for the implementation of NEEDS, and the attainment of the Millennium Development Goals (MDGs).

- By making resources available for critical infrastructural needs, the relief will encourage private-sector-driven job creation to boost economy-wide employment.

- The exceptional circumstance of the debt relief de-classifies Nigeria as a "bad and doubtful debt" country. It is therefore a testimonial to an improving socio-political and investment environment, which will increase foreign direct investment (FDI) to expand the industrial base and create wealth.

- Export Credit Guarantee Agencies will be confident to restore insurance cover for exports of goods and services, as well as investment capital to the Nigerian private sector. This will improve the competitiveness of private enterprises.

How will the Government Deliver the Benefits to the People?

- One of the issues that instigates negative reactions to debt relief is the fear that the government may not deliver on promises to channel savings to the target sectors for the realization of dividends. References are made of illegal capital flight by past political leaderships and the mismanagement of previous oil revenue windfalls. Without prejudice to the basic foundations that inform this opinion – the long years of mismanagement of both borrowed and domestic sourced funds by past governments, which had created pessimism among citizens - one can not ignore the present administration's commitment to probity and accountability in public finances.

- In the past two years, the Federal Government has made impressive progress in improving public expenditure management. As part of the economic reform program and plans to increase government's transparency and accountability in the use of public resources, a number of measures have already been put in place including a *Due Process* mechanism for transparent and consultative budget process, the *SERVICOM Charter*, which outlines performance matrices for ministries and government services and improved *Access to Information* by the publication of Federal allocations to all tiers of government.

- The *Fiscal Responsibility Bill* is already with the National Assembly and a big push is being made to enact this and other related legislation. An *Economic Reform and Governance Project* has been agreed with the

World Bank, through which the government is investing US$56m over five years in reforms to the federal government's budget, financial management and procurement policies and processes. These reforms demonstrate the government's commitment to reform, responsibility and ultimately poverty reduction.

- Prior to securing the Paris Club commitment for debt relief, the government had established a framework for a Virtual Poverty Fund, now formally called the Oversight for Poverty Expenditure on NEEDS (OPEN), for tracking debt service savings as well as instituting a programme of substantial reforms of budget systems at the federal and state levels. The fund is a mechanism for enhanced funding, tracking and monitoring of budget lines in key sectors aimed at meeting the MDGs and reducing poverty. OPEN will potentially monitor the use to which the savings on debt servicing following debt relief will be put, as well as any future increase in Development Assistance from the rich nations into Nigeria.

What Measures Will Be Put in Place to Prevent a Repeat of Past Mistakes?

- The Fiscal Responsibility Bill has been designed to lock in the gains of the economic reform and prevent a relapse to the past. The Law will commit all tiers of government to a set of rules for efficient economic management in terms of standardized planning, as well as control and monitoring of public borrowing and expenditure.

- Efforts are on to enhance and strengthen existing guidelines on public borrowing in line with relevant provisions of the DMO Act.

- The government has set up a Virtual Poverty Fund, which is a framework for monitoring and tracking expenditure related to meeting the Millennium Development Goals (MDGs) as provided in the budget: poverty alleviation, health, education and infrastructure development. This monitoring will involve representatives from the civil society, the media and the organized private sector.

What are the Choices and Consequences before Us?

- The first option is to repudiate: Nigeria refuses to pay any more debt service to its creditors. This very simple option was tried in the 1980s and 1990s with grave consequences. It will work if and only if Nigeria were an island, producing all that it requires, by its own indigenous technology, and needs nothing whatsoever from the international community.

- The second option is to reject the Paris Club offer, continue with traditional rescheduling, postpone the evil day, pay only about a third of accrued debt service, and leave the rest to accumulate, recapitalize and further increase the nation's debt stock. The consequences here are easily predictable – heavier debt burden on the economy, and no chance at all of attaining the MDGs.

- The third option is to accept the debt relief offer, enjoy about US$18 billion debt cancellation, pay off about US$12 billion, and free the economy from the chains of debt burden.

The choice is yours!!!

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