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TRENDS IN NIGERIA'S BALANCE OF PAYMENTS (1980-1994)*

by

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This paper examines trends in Nigeria's balance of payments. Factors which have contributed to the continuous weakness of Nigeria's balance of payments include the poor performance of non-oil exports, fluctuations in crude oil prices, payments for the provision of international services, e.g., shipping, insurance, tourism, the low level of income from direct Nigerian investments abroad and high debt service payments. More fundamental problems underlie these factors: a hostile international environment; a deterioration in terms of trade; a huge external debt servicing; slippages in fiscal and monetary policies and inappropriate exchange and interest rate policies. The failure of policy reforms to redress the adverse impacts of all these problems adequately indicates that Nigeria's balance of payments will continue to experience persistent pressure and show widening deficits from 1995 to 1998. Projections to 1998 reveal that the problem will remain large and non-oil export receipts will remain low. A reversal of the projected trend is possible if a programme of economic transformation is undertaken. This should be based on raising the level of domestic productivity, reducing domestic absorption (expenditure) through reduction in fiscal deficits and the adoption of sustainable and realistic interest and exchange rates, under a largely liberalized economic environment.

This paper periscopes developments in Nigeria's balance of payments from 1980-1994. It also looks into the future by projecting developments in Nigeria's balance of payments up to the year 1998. The paper is divided into five sections. Section One reviews some balance of payments concepts as well as the framework within which external sector policies were conducted. Section Two reviews the trends in Nigeria's balance of payments while Section Three discusses the factors influencing the trends. Section Four contains balance of payments projections up to 1998 and measures to ensure the viability of the balance of payments. Section Five concludes the paper.

I. CONCEPTUAL/POLICY FRAMEWORK

Definition of the Balance of Payments.

The balance of payments is a statistical statement summarising, for a specific time

* *The views expressed in the paper are personal and so do not reflect those of the Central Bank of Nigeria.*

frame, economic transactions between residents of an economy and the rest of the world. Specifically, the balance of payments records the import and export of goods, services and income, and transfers as well as changes in a country's liabilities to and claims (assets) on the rest of the world or non-residents. Thus, the balance of payments is a flow, not a stock, concept and involves more than payments. In other words, certain transactions which may not have been paid for in cash and kind are also recorded such as, gifts in cash and kind, deferment of debt service payment due as well as unremitted profits, among others.

The balance of payments is broadly structured into the current and capital accounts. The current account records transactions in goods, services and income as well as unrequited transfers while the capital account (excluding reserve movements) refers to changes in financial assets and liabilities. Specifically, the capital account records transactions in direct and portfolio investment, external loan drawings and amortisation, changes in short-term capital including the net change in Commercial and Merchant Banks' assets and liabilities as well as errors and omissions. It also records reserve movements which refer to transactions relating to Central Bank's holdings of Gold, Special Drawing Rights (SDRs), Foreign Exchange and Use of Fund Credit.

For analytical purposes, however, the standard components of the balance of payments which constitute "building blocks" are arranged in some systematic fashion called balances in order to aid policy formulation and evaluation. The commonly used balances are the current account balance, capital account balance and overall balance. The current account balance refers to the balance on goods, services, income and current transfers, and constitutes an integral part of the national accounts. The capital account balance represents the net change in financial claims on or liabilities to the rest of the world. The overall balance as construed in Nigeria's balance of payments, is the sum of the balances on current and capital accounts but excluding the exceptional financing items.

Exceptional financing items themselves refer to those transactions that finance balance of payments needs or simply put, they are transactions undertaken to bridge gaps in the balance of payments. Specifically, the accumulation of arrears, debt forgiveness in respect of payments falling due in the current period, drawings on balance of payments support loans, rescheduling/refinancing of payments falling due in the accounting period constitute credit entries under exceptional financing. However, certain entries are also debited such as the repayments of arrears.

As a result of the importance of crude petroleum in the economy, Nigeria's balance of payments is divided into oil and non-oil sectors. The oil sector is the most significant component of the economy and the largest foreign exchange earner. The oil sector refers to oil producing and prospecting companies while the non-oil sector refers to the rest of the economy. This dichotomy is important not only because of the dominance of oil in Nigeria's economic life but also as a result of the special nature and dynamics of oil operations. The oil companies, by the very nature of their operations export crude oil, but are not required to repatriate the proceeds of their sales like the rest of the economy. The impact of their operations, in terms of foreign exchange remittances, is felt in the form of payment of petroleum profit tax (PPT), rent, royalty and other charges related to ecological degradation. The foreign oil companies, by the very nature of their equity participation, are allowed to appropriate a defined share of the country's real resources which they can dispose off on their own terms and conditions. Furthermore, their operations are highly capital intensive. For these and a host of other reasons, the foreign oil companies in particular are generally regarded as economic "enclaves" characterised by their peculiar modes of operations and privileges. Thus by the very nature of oil company operations, the value of the country's resources exported may not necessarily synchronise with foreign exchange inflow into the economy. On balance therefore, if oil sector balance of payments was constructed, it would invariably show a huge current account surplus as has been the case in Nigeria.

Policy Framework

While the foregoing section focussed on the methodological and conceptual under-pinnings of the balance of payments, the present one briefly reviews the policy framework in which balance of payments policy is normally conducted. The important thing to note about the balance of payments is that it is linked with the other sectors of the economy-monetary, fiscal and real-in a general equilibrium sense. This implies that developments in the external sector affect other sectors and vice versa. These relationships can be better appreciated through the examination of certain identities. These identities are very useful in identifying and understanding the factors that influence the developments or trends in the balance of payments. In particular, they help to identify areas of weakness in policy formulation and implementation. In this connection, we shall briefly examine the relationship between the external sector and the public finance sector on the one hand and the monetary sector on the other. The relationship with the fiscal operation can be summarised as:

$$Sp + Sg - Ip - Ig = CAB = - Sf \quad \text{................(1)}$$

$$(Sp - Ip) + (Sg - Ig) = -Sf = CAB \quad \text{.........................(2)}$$

where

Ip = private sector investment

Ig = investment by government sector

Sp = private sector savings

Sg = savings by government sector

CAB = current account balance

Sf = net foreign savings or inflow of saving from non- residents minus outflow of saving from residents.

This relationship focuses on the impact of the private and public sector transactions on the current account. Specifically, equations (1) and (2) imply that the current account balance can only improve if savings of both the public and private sectors increase. Also, reduction in expenditure by both sectors will strengthen the current account. Thus, on a long term basis, the relationship underscores the need for increased and complementary efforts by both the public and private sectors to ensure balance of payments viability through the generation of more savings.

The monetary sector is linked with the external through the following identity:-

$\Lambda M1 = \Lambda Cp + \Lambda Cg + \Lambda NFA + \Lambda OA\,(Net) - \Lambda QM$

Hence; $\Lambda NFA = \Lambda M1 - \Lambda Cp - \Lambda Cg - \Lambda OA\,(Net) + \Lambda QM$

OR $\Lambda NFA = \Lambda M1 + \Lambda QM - \Lambda Cp - \Lambda Cg - \Lambda OA\,(Net)$

Where $\Lambda M1$ = change in currency outside banks plus demand deposits

ΛCp = change in credit to private sector

ΛCg = change in credit to government

ΛOA (Net) = change in other assets (net)

ΛQM = change in Quasi - Money

It should be observed that the sum of $\Lambda M1$ and ΛQM represents the total liquidity in the economy. The term ΛNFA represents the change in the net foreign assets of the banking system. If the change in net indebtedness of the private sector is added to the change in banking system's net foreign assets we have net foreign investment position (NFI) which is broadly equal to the change in the current account balance. The above identity implies that given an optimum or desired level of liquidity in the system ($\Lambda M1 + \Lambda QM$), an increase in net foreign assets or investment position, that is, an improvement in the balance of payment is only possible if the change in credit to the economy is reduced to a sustainable level, that is, a level consistent with the change in the desired or optimum level of liquidity in the system.

Balance of payments management policies

The concept of management of the balance of payments is also usually couched in terms of expenditure-changing and expenditure-switching policies. Expenditure-changing policies refer to fiscal policy (conducted by changing government expenditure and/or taxes) and monetary policy (which refers to changes in money supply which in turn affect interest rates). Expenditure-switching policies refer to devaluation (depreciation) and revaluation (appreciation). The aim of expenditure reducing policies is to reduce domestic expenditure on consumption and investment (absorption) and thereby release goods for exports while leaving aggregate output unchanged.

The aim of expenditure-switching policies is to switch domestic demand from imported to home-made goods. The extent to which the switching is achieved depends on elasticities of supply and demand for tradeables. If the depreciation of the nominal exchange rate is matched by increases in wages, absorption and inflation, the real exchange rate would not depreciate and so the balance of payments would not improve. Consequently, there is need to increase output to improve the balance of payments. However, expenditure-reducing policies have costs in terms of loss of output, investment and employment. The loss will be minimized if resources can be easily moved to the tradeable goods sectors. Alternatively, bridging external loans may be contracted to sustain an acceptable level of investment and output.

Conditions for Balance of Payments Viability

For a proper understanding of the trend in Nigeria's balance of payments, it is necessary to discuss briefly the concept of viability of the balance of payments. In this context, the current account is largely focused on for obvious reasons. First, in most countries, it is the largest components of the balance of payments. Second, it represents, the current flow of real resources between residents and non-residents. The net balance merely represents financial claims on or liabilities to the rest of the world. A negative balance implies the use of other countries' resources far in excess of what it has provided while a positive balance implies the acquisition of or claims on other countries' resources.

In short, countries with current account surplus positions provide real resources to non-residents and acquire financial claim while countries having deficits acquire real resources either at the expense of increase in liabilities to the non-residents or the use of its own external assets. However, the acquisition of liabilities can be temporarily offset by use of 'own' resources such as external reserves. In a situation of persistent or a fundamental disequilibrium, external reserves could be depleted to a dangerously low level which might compel the authorities to take corrective measures. Invariably, however, such measures are delayed by borrowing from abroad or by simply delaying payments for imports or for servicing external debt obligations when they fall due. Commonsense suggests that external obligations cannot continue to accumulate indefinitely without compromising a country's credit worthiness or inviting hostile reaction from creditors. The analysis so far should not suggest that the running of current account deficit in the balance of payments is inconsistent with or violates the concept of viability of the balance of payments. Indeed, some countries have recorded current account deficits in their balance of payments in a number of years. However, such deficits may have been financed in a manner that does not constrain the achievement of other macro-economic objectives such as inflation, employment etc. A viable balance of payments may, therefore, be defined as a current account position which shows persistent surpluses at levels that would not elicit retaliatory trade restrictions from trading partners or where deficits can be financed on a sustainable basis by net capital movements on terms and conditions which are compatible with the attainment of reasonable economic growth and development, macro-economic stability as well as with enhancement of capacity to service the external debt.

II. TRENDS IN NIGERIA'S BALANCE OF PAYMENTS

In this section we shall examine the observed trends in Nigeria's balance of payment since 1980. The analysis will focus primarily on the current account, capital account, overall balance and its financing. However, developments in external debt, exchange rate, and reserve movements are also discussed.

Current Account

The current account, for most part of the period under consideration, remained under pressure. Except in a limited number of years (1980, 1984 and 1990), current account deficits were recorded in the other years. The current account deficits of both the oil and non-oil sectors, averaged 2.3 per cent of GDP. However, a breakdown shows that while the non-oil sector deficit averaged 18.2 per cent of GDP, the oil sector recorded an average surplus of 17.2 per cent. The aberrations in 1980 and 1990 reflected the sharp increases in oil prices which were the aftermath of wars in the Middle-East. The surpluses recorded in 1984 and 1985 resulted from the sharp reduction in imports prompted by the new stance of stringent exchange and trade control imposed by a new Administration. The pressure on the current account reflected largely, the poor performance of non-oil exports, the fluctuation in crude-oil exports, the chronic deficit of the services account and the low level of unrequited transfers from abroad. Non-oil exports averaged $393.2 million during the period. Their share in total exports remains pathetically low at about 2.6 per cent in 1994, unchanged from that in 1980. Fluctuations in crude-oil exports often led to wide swings in the current account. This was the case in 1980 and 1990 as well as in 1986. The first two years were characterised by sharp increases in international oil prices while the year 1986 witnessed a severe down-turn. The services account remained in persistent deficit as a result of low levels of receipts and huge payments in respect of international services as well as unsustainably high level of external debt falling due especially in recent years. The low level of receipts is attributable to the fact that the transportation of Nigeria's merchandise trade and passengers are performed largely by non-resident carriers. Also more Nigerians travel abroad than foreigners visit Nigeria. Thus, the net position on non-factor services is not in Nigeria's favour. Worse still, as a result of the absence of Nigerian direct investment companies abroad, receipts in respect of factor services are abysmally low. The chronic deficit of the services account becomes more particularly worrisome when it is realised that in some countries, the above-average performance of the services account often swings the current account into a surplus position.

Capital Account.

The capital account excluding financing items, like the current account, remained very weak throughout the period under review. The deficit averaged $798.3 million or 2.0 per cent of GDP. The weakness of the capital account arose from the low level of long-term capital inflow in the form of direct investment and drawings on project-tied loans. In contrast, capital outflow in the form of loan repayments and short-term capital movements have been substantial. An example will suffice. Net transfers on long-term debt defined as disbursements less amortization averaged $3198.8 million between 1980 and 1994. If, however, interest payments and direct investment inflow were added, net transfers abroad would rise to $4450.4 million. This trend is particularly disturbing and immerserizing for a resource-starved country like Nigeria which is in dire need of ameliorating capital inflow. Another disturbing feature of the capital account is the low level of portfolio investment. Portfolio investment consists of transactions in bonds, debentures, notes as well as non-direct investor equity, preferred shares or stocks, mutual funds and investment trusts. It also includes transactions in money market instruments such as Treasury Bills etc. The reasons for this poor trend is not far-fetched. Trading in such instruments demands sophisticated, open and internationalised money and capital markets with relative ease of investment and divestment. Shares of Nigerian companies, for example, are not quoted in international stock exchanges. Under such circumstances, the ability of the foreign investor to take the risk of investing in the Nigerian capital and money market instruments is severely constrained. Furthermore, the unconducive domestic environment discourages foreign direct and portfolio investments.

Overall Balance

Reflecting the persistent deficits of the current and capital accounts, the overall balance as defined earlier to exclude exceptional financing items, also remained in substantial deficit throughout the period under review. The deficit averaged $3085.4 million annually or 25.4 per cent of GDP. However, overall surpluses were recorded in 1980 and 1990 largely as a result of the buoyant current account position following the up-swing in crude oil prices.

Financing the Overall Balance

Following the sharp rise in oil prices in 1980 to early 1981 and in 1990, the overall balance of payments was in substantial surpluses. This paved the way for replenishing the dwindling stock of external reserves. Thus, the reserves declined from $10,001.1 million in 1980 to $3,807.2 million in 1981. Indeed, total foreign exchange inflow in 1980 was about $25,979.3 million. Reserves at the end of 1980 could cover 7.2 months of imports. In 1990 reserves rose to $3,883.6 million enough to finance 6.3 months of import. For the rest of the period in which the overall balance was in substantial deficits, the financing was through a combination of measures. These included the utilization of external reserves, balance of payments support loans and most importantly, the deferment of external debt obligations. External reserves utilization accelerated in 1982 and 1983 such that they could finance only one month of imports. The stock of external reserves rose marginally in 1984 and 1985 following severe compression of imports but even then, could cover less that three months of imports. Reserves fell again in 1986 but then could finance 2.0 months of imports. This seemingly impressive development arose from the sharp decline in imports following the sharp depreciation of the naira exchange rate at the introduction of the Structural Adjustment Programme (SAP) as well as the problems encountered by importers in utilizing the import licenses issued to them during the year. In 1992, following the CBN undertaking to meet the needs of all foreign exchange users who could provide naira cover, and the need to meet obligations arising from zero-coupon debt buy-back scheme, external reserves declined sharply to $712.0 million enough to cover only 1.2 months of imports. While reserves had in a number of years been run down to cover deficits, there were some occasions when reserves accumulation had occurred even when the balance of payments had been weak. This apparent contradiction can only be reconciled by reference to the other financing items especially the rescheduling and deferment of external debt obligations and the drawings on balance of payments support loans.

Following the accumulation of trade arrears in the early 1980s, the rescheduling and refinancing of arrears began in earnest in 1986 with the rescheduling of some part of trade arrears first with the London Club and later with the Paris Club. These efforts were supported by two balance of payments support loans from the World Bank in 1986 and 1989. These loans amounted to $450 million and $454 million respectively. In recent years however, following the inability of the authorities to conclude a Medium-Term Economic Programme with Nigeria's creditors, restructuring of external debt has proved particularly difficult especially with the Paris Club. In the absence of progress with the restructuring of Paris Club debt and the low level of foreign exchange inflow, the authorities resorted to the deferment of due external debt obligations. Consequently, arrears of debt service payment have continued to mount and stood at $5,865.0 million at the end of 1994.

While the foregoing reviews developments in Nigeria's balance of payments in analytic and perspective terms, the rest of this section considers developments in specific areas such as reserve movements, exchange rate and external debt.

Reserve Movement.

Reserves are important component of the balance of payments account basically as financing item. Arising from the windfall from the improved price of crude oil in the international market in the early 1980s, the country's external reserve position witnessed drastic build-up reaching $10.0 billion in 1980. However, this level could not be sustained owing to the crash in the price of oil in 1982 and increased importation resulting in the continued depletion of the external reserve. Thus, the country's external reserve position averaged $1.7 billion in 1982-1987. The level further dropped to a low of $0.6 billion in

1988 before improving in 1988-1994 averaging $2.0 billion. Using the reserve/import ratio as a measure of reserve adequacy in the country revealed that, the level of reserve could sustain 5.5 months of total import commitments in 1980, 1.7 months in 1981-1985 and only 3.6 months in 1986-1994. The internationally accepted level of reserve of any country should be that which can successfully finance a minimum of four months import bills.

Naira Exchange Rate

The principal objective of exchange rate policy during the early years of 1980s was to check inflationary pressures. This was achieved by maintaining an overvalued exchange rate so as to encourage importation. Consequently, the naira exchange rate was maintained well below the equilibrium level. The official rate averaged $1 = ₦0.7057 between 1980 - 1985 compared with the PPP rate of $1= ₦3.4716. Attempts to adjust the rate in the context of a crawling peg during the subsequent period of foreign exchange scarcity was half-hearted and so could not push the exchange rate to its equilibrium. In 1986, a market-driven exchange rate policy was therefore put in place to reflect the dictates of a viable balance of payments policy. The objectives were, to liberalize the foreign exchange market so as to achieve realistic naira exchange rate that would allocate resources more efficiently and specifically encourage non-oil exports and capital inflow. The institutional arrangement for achieving those objectives came to be known as the Foreign Exchange Market (FEM).

The introduction of the liberalized exchange rate system resulted in a sharp depreciation of the naira exchange rate from an average of $1 = ₦0.7057 in 1980 - 1985 to $1 = ₦5.9251 between 1986 and 1991. Compared with the PPP rate of $1 = ₦10.1328, the official naira exchange rate remained overvalued. However, a bold attempt was made on March 5, 1992 to reduce the spread between the official rate and the parallel rate by sharply devaluing the official rate from $1 = ₦10.6 to $1 = ₦18.00 thus reducing the premium to about 8.9 per cent from 84.9 the previous day.

However since April, 1993, the official rate had been largely pegged at $1 = ₦22 compared with PPP rate of $1 = ₦39.4458. Although the parallel rate was also below the equilibrium rate, it tended to track the PPP rate more closely than did the official rate at least from 1980 - 1993 (see chart). In 1994 however, the parallel rate indicated an undervaluation with respect to the equilibrium rate. The position in 1994 therefore required an appreciation of the parallel rate and depreciation of the official rate to bring those rates in line with the equilibrium rate.

The degree of misalignment of the naira exchange rate as reflected in the spread between the official and the parallel rates which averaged 62.2 per cent between 1980 - 1982 rose sharply to 263.5 per cent between 1983 - 1985 reflecting the strict exchange control measures in place during that period. With the introduction of the liberalized foreign exchange market in 1986, the spread declined progressively reaching a trough of 17.2 per cent in 1992 following the devaluation of the official rate. Since 1993, however, the spread has been increasing and stood at 173.9 per cent in 1994 as a result of the pegging of the official rate as well as the depreciation of the parallel rate.

An analysis of the competitiveness of the country's exports as reflected in the movements of the real effective exchange rate indicate an overwhelming improvement. However, the question as to whether the country benefited in that regard is not pursued further in this paper. Suffice it to note however, that while the Real Effective Exchange Rate (REER) appreciated by 87.2 per cent between 1980 - 1984 indicating an apparent loss of competitiveness, it depreciated by 89.3 per cent between 1985 and 1992 but appreciated again, by 9.0 per cent in 1993. The loss in competitiveness was substantial in 1994 with the REER increasing by 83.5 per cent from the level in the previous year.

External Debt.

In the 1980s, the economy witnessed the continued resort to external borrowing for the financing of domestic production in the wake of declining foreign exchange earnings occasioned by glut in the international oil market. Payments arrears arising from the inability of the authorities to provide foreign exchange for imports accumulated. Thus, the country's stock of external debt which stood at \$3.9 billion in 1981, rose sharply to an average of \$12.3 billion in 1981-1985, before skyrocketing to \$25.6 billion in 1986. The debt stock rose further to \$30.7 billion in 1988 but declined slightly to 29.4 billion in 1994. The structure of total external debt outstanding revealed that while the relative share of the Paris Club group of creditors increased from 30.3 per cent in 1983 to 63.2 per cent in 1993, that of the London Club declined from 35.3 per cent in 1983 to 7.2 per cent in 1993 due to the restructuring of this class of debt. In general, the quantum of debt owed the Paris Club of creditors and the other groups of creditors is worrisome. This precarious position is put in its proper perspective if we consider the ratio of debt outstanding to the Gross Domestic Product (GDP) in addition to the relatively high level of debt service payments accommodated by the dwindling external earnings. The external debt outstanding to GDP ratio was 3.7 per cent in 1980 but averaged 55.7 per cent in 1981-1990, before increasing further to 82.9 per cent in 1991-1994. However, the ratio of actual debt service to total foreign exchange inflow averaged 15.4 per cent between 1980-85 and 20.8 per cent between 1980 and 1994. Since 1980 government has fixed the ratio at not more than 30 per cent.

Although the ratio of actual debt service payment to exports of goods and non-factor services was 14.6 per cent compared with the budgetary provision of 30 per cent in force since 1986. Even then, the level of resources devoted to servicing external debt is considered high. The situation becomes more worrisome if debt service payments due are considered. The ratio of debt service payments due to exports of goods and non-factor services averaged 60.5 per cent from 1986-1994.

III. FACTORS AFFECTING NIGERIA'S BALANCE OF PAYMENTS

It is clear from the previous section that the factors which have contributed to the weakness of Nigeria's balance of payments include, the poor performance of non-oil exports, the fluctuations in crude oil prices, lack of meaningful participation by Nigerians in the provision of international services related to shipping, insurance and tourism as well as the low level of income from direct investment abroad by Nigerians. Others include the low level of loan disbursement leading to net transfer of resources abroad and the high debt service payments. However, these factors are symptomatic of more fundamental problems. The problems are examined in the remaining part of this section. They include the hostile international environment, deterioration in the terms of trade, huge external debt overhang, slippages in fiscal and monetary policies and the pursuit of inappropriate exchange and interest rate policies.

(a) Hostile International Economic Environment

For many years now, Nigeria has had to operate in an increasingly hostile international economic environment in which it has no control. With import prices rising and export prices falling generally, the terms of trade deteriorated from 180 per cent in 1980 to 80.2 in 1994 (1985 = 100). This is not difficult to understand. While import prices in industrial countries (Nigeria's major trading partners) rose to reflect the general increase in prices in those countries, the prices of Nigeria's exports declined reflecting the low income elasticities of her exports and increased level of protectionism in advanced countries. The index of Nigeria's agricultural products declined by an annual average of 7 per cent between 1980-94 while oil prices barely rose above the level a decade ago.

(b) External Debt Burden

The very high debt service burden facing Nigeria is also a serious problem confronting Nigeria's balance of payments. In 1994, scheduled debt service payments amounted to $4,008 million excluding arrears and absorbed 42.0 per cent of exports. If stock of arrears were added, debt service payments due in 1994 would rise to $9,873 million or 104 per cent of export of goods and non-factor services. A ratio of 17.9 per cent in respect of actual debt service to exports also remains worrisome given the need to service the domestic economy. The setting aside of a large part of foreign exchange receipts to debt servicing has meant that less has been made available for servicing the productive sectors of the economy. The use of a large proportion of current resources to finance past consumption is particularly strenuous for the balance of payments and ultimately destabilising.. The high debt service burden facing Nigeria is accounted for by the following:-

(i) Depreciation of Major International Currencies

The depreciation of the dollar in which most of Nigeria's external debts are serviced vis-a-vis the currencies in which the debts are denominated has put additional stress on the balance of payments, by escalating the dollar cost of servicing the debt. Since 1986, the US dollar has depreciated consistently although concerted efforts have been mounted by the Group of Seven (G-7) Central Banks to support the dollar.

(ii) Capitalisation of Arrears

The capitalisation of interest payments as they fall due helped to raise Nigeria's debt burden. This process results in the drawing up of new loans profile whose terms are often more stringent. It is instructive to note that Nigeria's external debt burden was exacerbated by the conversion of private into public debts at the point where the authorities undertook to provide the foreign exchange cover for trade arrears. About two-thirds of the rise in external debt from $13 billion in 1986 to $30.6 billion in 1992 was due to the assumption of such non-guaranteed debt by government. Thus, the increase in external debt was not necessarily due to acquisition of new loans.

(iii) Lack of Progress in Restructuring Nigeria's Debt on Long-term Basis.

Attempts at restructuring Nigeria's debt on long-term basis have been rebuffed by international creditors on the excuse that Nigeria has not been able to present a credible Medium-term Economic Programme to the IMF. In the meantime, arrears continued to accumulate with adverse consequences for the country's credit worthiness abroad.

(c) Lack of Adequate Strategy for Managing Oil Shocks

Over the years, Nigeria has been subjected to severe oil shocks. However, there has been no concerted effort to manage such shocks in any meaningful manner. The need to manage these shocks becomes more compelling when it is noted that over 90 per cent of foreign exchange receipts and over 80 per cent of government revenue come from oil exports, and that a change in oil price has more than proportionate effect on foreign exchange receipts. It has been estimated that a one dollar movement in oil price implies a change of $650 million in gross export receipts. A viable oil management strategy therefore should be able to stabilize the flow of foreign exchange between periods of positive and adverse shocks. This will allow the flow of external resources at a pace that will ensure desired levels of output and investment as well as viable balance of payments.

(d) Misalignment of the Naira Exchange Rate

The parallel market premium remains uncomfortably high reflecting the rigidity of the naira exchange rate in the official market. The premium is currently 263.6 per cent. Surely, such misalignment is destabilizing to the market and has encouraged speculation and capital flight. While the official rate has been fixed at around \$1.00 = ₦22 for many months, the parallel rate has been depreciating and currently stands at \$1.00 = ₦80.00. The pegging of the official rate at ridiculously low level is particularly distortioning and implies that foreign exchange is not rationally priced or used. The depreciation of the naira exchange rate was accounted for by decline in foreign exchange inflow to service the economy in the face of mounting aggregate demand. It will be recalled that in 1980 while total foreign exchange available to service the economy amounted to \$25,793.5 million, total liquidity in the economy (M_2) was ₦14,397.4 million. This implied a ratio of \$1 to ₦0.56. However, at the end of 1994, foreign exchange available to service the economy declined to \$4,372.5 million while broad money (M_2) rose to ₦267,759.8 million implying a ratio of one US dollar to ₦62.24 . This, in a simple way, underscores the dilemma of the naira exchange rate generally and the inappropriateness of the policy to fix the official rate of the naira at the current level of \$1 = ₦22. It also calls into question a policy that seeks to provide credit at below market interest rates.

(e) Slippages in Monetary and Fiscal Policies Implementation

In section one, the relationship between the external sector and monetary policy on the one hand and fiscal policy on the other, was examined. It was noted that government expenditure far in excess of savings was destabilising to the current account. Similarly, credit expansion far in excess of desired or optimum liquidity level also weakened the balance of payments. Although data on private sector savings and investment are not readily available, indications are that slippages in fiscal operations represented by the budget deficit has been relatively high. More worrisome however, has been the avid desire to finance the deficit by borrowing from the Central Bank. Thus, the fiscal deficit to GDP ratio has remained unacceptably high reaching 12 per cent of GDP in 1994 compared with 3.9 per cent in 1985 and 4.0 per cent in 1980. Equally disturbing was the deviation of the observed level of credit to the economy from target. Observed growth in credit to the economy averaged 33.4 per cent between 1986-1994 compared with an average target of 10.5 per cent. In the same vein, the growth rate of money supply (M_2) was 34.5 per cent exceeding the growth target by 10.1 percentage points. Given these fiscal and monetary out-turns, the current account weakened considerably.

IV. BALANCE OF PAYMENTS PROJECTIONS AND MEASURES TO ENSURE THE VIABILITY OF THE BALANCE OF PAYMENTS

In the recent past, government had taken a number of measures aimed supposedly at revamping the economy. These included the pegging of exchange and interest rates. However, in retrospect, these measures appeared to have been counter-productive as the assumptions on which they were based were not correct. While serious efforts have been made especially in the 1995 budget to redress some of the shortcomings of past policies within the context of what government euphemistically called 'guided deregulation" - the reintroduction of the autonomous market for foreign exchange, the abolition of the Exchange Control Act of 1962, the scrapping of the Enterprises Promotion Decree, 1989, among others - some areas fundamental to the efficient functioning of the system also needed urgent attention.

Projections of Nigeria's balance of payments up to 1998, however, presents a disturbing picture of persistent pressure. The current account deficit as a proportion of GDP is expected to average 5.2 per cent. Given the weakness of the capital account, the overall balance is also expected to be in deficit if current policies continue. Despite the deferment of debt service payments which cannot be expected to continue under present circumstances, residual financing gaps are expected to emerge and average $1672.0 million annually from 1995-1998.

The following measures aimed at strengthening the balance of payments in the medium to long-term were informed by the fact that the major problems of the economy remain the unrealistic level of the exchange rate, the low level of non-oil export receipts, the unsustainable debt service burden and the non-convergence of monetary and fiscal policies:

(a) Unification of the Official and Autonomous Exchange Rates

The unification of the official and free market rates will reduce the distortionary effect of such divergence and encourage non-oil exports. This should be done as quickly as possible. Thereafter, the unified rates should be allowed to reflect market fundamentals such as liquidity in the system, domestic rate of inflation vis-a-vis that of Nigeria's major trading partners.

(b) Resolution of the External Debt Problem

This implies restructuring the external debt so as to reduce the debt service payments to a level that will release resources for domestic use in the productive sectors of the economy. To achieve this objective, the need to conclude a Medium-term Economic Restructuring Programme with the IMF becomes very compelling.

(c) Harmonization of Monetary and Fiscal Policies

This implies first and foremost, that the fiscal deficit should be brought down to an acceptable level. If this is achieved, the need for accommodating monetary expansion will be limited. Besides, the reduction in inflationary pressure will enhance macro-economic stability and provide an enabling environment for productive investment. In addition, interest rates should be unpegged. This will promote effective mobilization of savings.

(d) Proposals to increase non-oil exports

The implementation of proposals to enhance non-oil exports should be vigorously pursued especially with respect to Liquified Natural Gas Projects and the Export Processing Zone. The on-shore manufacturing concessions in the 1995 Budget should be commenced without further delay while off-shore processing arrangements should be explored. In addition, the export of manufactures should be vigorously pursued, especially to the West African sub-region. Manufactures would benefit from a successful off-shore arrangement.

V. CONCLUDING REMARKS

Nigeria's balance of payments has been under persistent pressure since 1982 when the second oil shock and the debt burden became seriously pronounced. Attempts geared towards managing the balance of payments, involving restrictive exchange and trade control practices, failed to achieve the objectives of policy. The liberalisation of exchange controls and the institution of a market-based exchange rate mechanism with the commencement of the Structural Adjustment Programme (SAP) temporarily stabilised international payments. However, slippages in policy, in particular, the reflation of the economy in 1988, intensified pressure on the external sector. Non-oil exports that initially rose at the inception of SAP declined in 1989 and have remained low and depressed ever since.

The disproportionate size of oil exports vis-a-vis non-oil exports, the excruciating debt burden, the unfavourable domestic and international economic environments have constrained the achievement of balanced and sustained economic growth that could foster balance of payments viability.

Although economic policies in place assure some balance of payments stability when well implemented, projections up to 1998 indicate that the debt problem would remain large, non-oil export receipts would remain low and even decline while the overall balance of payments position reveals widening deficits from 1995 to 1998. Thus, the residual financing gap is expected to increase rapidly from 1995 to 1998. The dismal picture of the external sector even with current policies elicits the need to adopt economic policies that would ensure macro-economic balance, institute a culture of policy stability, enhance non-oil exports, and develop adequate debt servicing capacity through the enhancement of domestic productivity which would eventually result in increased export potentials and receipts. While the future appears not very encouraging on the basis of current policy stance, a reversal of the projected trend is possible with the adoption of a programme of economic transformation based on the need to raise the level of domestic productivity, reducing domestic absorption (expenditure) through reduction in fiscal deficits without necessarily compressing imports and the adoption of sustainable and realistic interest and exchange rates under a largely liberalised economic environment.

TABLE 1
BALANCE OF PAYMENTS-ANALYTICAL STATEMENT
($ MILLION)

Category	1986	1987	1988	1989	1990	1991	1992	1993	1994 1/
A. CURRENT ACCOUNT	- 2433.2	-1021 9	-214 6	-1255 1	2407 4	-1269 2	-294.0	-884 0	-2219 7
Merchandise....................	2459 9	3492.0	2541 1	4177 8	8723.1	4508 6	4682.4	3268 5	2881 3
Export (F.O.B) ...	6371 8	7590.2	6931 7	7870 9	13671 2	12264 4	11886 1	9924 4	9425 4
Oil	5977 4	7052 2	6319 0	7469 8	13265 6	11792 4	11641 7	9696 6	9181 0
Non-Oil... .	394 4	538 0	612 8	401 1	405.5	472.0	244 4	227 8	244 4
Imports... . .	-3911 9	-4098 1	-4390 6	-3693 1	-4948.0	-7755.8	-7203 7	-6655 9	-6544 1
Oil	-652.8	-792 5	-845 1	-634 3	-755 6	-784.3	-1130.8	-1865 9	-1935 0
Non-Oil	-3259.1	-3305 6	-3545 5	-3058 8	-4192 5	-6971.5	-6072 9	-4790 0	-4609 1
Services and Income.............	-4721.4	-4489 8	-2841 3	-5587 8	-6765 4	-6513 7	-5709 4	-4959 6	-5601 4
Investment income (credit)	70 5	46 0	41 5	152.1	211 3	210.8	157 5	56 8	48 8
Interest on reserves..	70 5	46 0	41.5	152.1	211.3	210 8	157 5	56 8	48 8
Others......	0 0	0 0	0 0	0 0	0 0	0.0	0 0	0 0	0 0
Investment income (debit)......	-3064 9	-2877 4	-2122 8	-3572.0	-4301 5	-3890.2	-3841.7	-3354 1	-3001 3
Interest on Loans (scheduled)	-2092.8	-2149 2	-2050 5	-2447.0	-2814 5	-2444.0	-2413.0	-2010.8	-1661 0
Others	-972 1	-728 2	-72 4	-1125.0	-1487 0	-1452 2	-1428 7	-1343 3	-1340 3
Non-factor services	-637 1	-304 3	-684 8	-822 9	-651 6	-1347 6	-606 7	-381 9	-1502 8
Other services	-1089 9	-1354.2	-75 2	-1345.0	-2023 6	-1480 7	-1418 5	-1280 4	-1146 1
Unrequited transfers (net).........	-171.7	-24 1	85 6	154.9	449.7	735 8	733 0	807 1	500 4
B. CAPITAL ACCOUNT............	-765 4	-3037 8	-3999 0	-1730 6	-2969 0	-227.0	-5448 3	-895.4	349 3
Direct Investment.............	525 6	613 2	381 8	1884 2	583 0	697 9	836 1	1345.3	1969 1
Portfolio Investment............	108 3	1088 3	580 4	-219 8	-54 1	-60 0	2130 3	-17.1	-9 3
Other Capital Long term...........	-2913 1	-3569 9	-3501.7	-3289 3	-3552 0	-3096 0	-5639 7	-1731.6	-1894.9
Official of which . . .	-2601.6	-3522 2	-3476 2	-3271 6	-3557 6	-3096 0	-5639 7	-1731.6	1894.9
Amortisation (scheduled) . .	-3216 0	-3781.0	-3874.0	-3441 0	-4021 0	-3332 0	-6065 0	-2163 9	-2346.5
Disbursement.	614 4	258 8	397.8	169.4	463 4	236 0	425 3	432 3	451 6
Other official	0 0	0.0	0.0	0 0	0.0	0.0	0 0	0 0	0 0
Private (net)	-311 6	-47.7	-25.5	-17.7	5.6	0 0	0 0	0 0	0 0
Other capital short-term (net).......	1513.9	-1169 4	-1459 5	-105 7	54 1	2231.0	-2775.1	-492 0	284.3
C. NET ERRORS AND OMISSIONS.	-548.4	-306 6	-307.1	-136 3	-155 2	-98 0	-120 6	-113.7	-77 0
OVERALL BALANCE.........	-3747 0	-4366.2	-4520 7	-3122 0	-716 9	-1594 3	-5862 9	-1893.1	-1947 5
FINANCING..................	3747 0	4366 2	4520.7	3122.0	716 9	1594 3	5862 9	1893.1	1947 5
a. Exceptional Financing..........	3186.8	4406 0	4010.9	4306 9	3018 3	2195 5	2088 8	2510 6	2276 2
(i) Promissory notes (arrears)	0 0	0.0	0.0	0 0	0 0	0 0	0 0	0 0	0 0
(ii) Deferred/Resch debt services	2936.8	4206 0	3910 5	3852.3	3018.3	2195 5	2088 8	2510 6	2276 2
(iii) Others...	250 0	200 0	100 4	454 6	0.0	0 0	0 0	0 0	0 0
b. Reserves 2/................	560.2	-39 8	509 8	-1184 9	-2301 4	-601 2	3774.1	-617 5	-328 7

1. Provisional
2. Minus (-) sign indicates increase in reserves
Plus (+) sign indicates decrease in reserves.

Memorandum items:.........................

Category	1986	1987	1988	1989	1990	1991	1992	1993	1994 1/
Average Exchange Rate (₦/$)	1 4000	4 0000	4 5000	7 3652	8.0378	9 9095	17.2985	22 0468	21.8861
End-of-Period Exchange Rate (₦/$)	3 3166	4 1916	5 3530	7 6500	9 0001	9.8662	19.6609	21 8861	21 8861
Current Account Balance as % of G D.P	-4.7	-3.8	-0 7	-4 1	7 4	-3 9	- 09	-2 4	-5 4
External Reserves - Stock (US $ million)	1086.7	1111.8	614 5	1758 3	3885.5	4486 7	712.6	1330 1	1658 8
External Reserves - Stock (₦ million)	3604 2	4660.1	3289 5	13451 1	34970 0	44266 7	14010 2	29109 8	36304 9
Number of Months of Import Equivalent	2 9	2.8	1.5	5 0	6 3	6.5	1.1	2 2	2 7
Debt Service as % of Exports of Goods and Non-Factors Services	79 5	75 9	81 5	73.5	46.4	43.9	65.4	37 7	40 9

TABLE 2

PROJECTION OF NIGERIA'S BALANCE OF PAYMENTS (1995-1998)

		PROJECTION			
CATEGORY	1994 1/	1995	1996	1997	1998
A. CURRENT ACCOUNT	-2219.7	-1775	-2426	-3637	-4395
Merchandise.........	2881.3	2676	1944	1100	137
Export (F.O.B)	9425.4	9767	9788	9758	9754
Oil..................................	9181.0	9527	9553	9527	9527
Non-oil......................	244.4	240	236	232	227
Imports......................	-6544.1	-7091	-7844	-8658	-9617
Oil......................	-1935.0	-2265	-2660	-3101	-3627
Non-oil....................	-4609.1	-4826	-5184	-5557	-5990
Services and Income...........	-5585	-4951	-4870	-5237	-5031
Investment income (credit......	48.8	125	140	153	163
Non-factor Services......	24	24	24	23	23
Interest on reserves...........	48.8	101	116	130	140
Others........................	0.0	0	0	0	0
Invesment income (debit)........	-5634	-5076	-5010	-5390	-5194
Oil	-1340.3	-1612	-1653	-1677	-1677
Non-oil.....	-4294	-3464	-3357	-3713	-3517
Interest on Loans (Due)	-1661.0	-1755	-1528	-1800	-1610
Direct Investment.....	16	16	16	16	16
Non-factor Services....	-1502.8	-630	-668	-761	-755
Other services......	-1146.1	-1095	-1177	-1168	-1168
Unrequited transfers (Net).....	500.4	500	500	500	500
B. CAPITAL (EXCLUDING D AND E..	349.3	-1097	-1976	-1097	-1097
Direct Invesment	1969.1	1086	1086	1086	1086
Portfolio Invesment...	-9.3	-256	-256	-256	-256
Other capital long term...	-1894.9	-2211	-3090	-2211	-2211
Official (of which)......	-1894.9	-1642	-2055	-1925	-1233
Amortisation (Due)	-2346.5	-2644	-3090	-3010	-2328
Disbursement	451.6	1002	1035	1085	1095
Other Official.........	0.0	0	0	0	0
Private (Net)..............	0.0	0	0	0	0
Other capital short term (Net)...	284.3	284.3	284.3	284.3	284.3
C. NET ERRORS AND OMISSIONS...	-113.9	0	0	0	0
OVERALL BALANCE = Total (A and B and C)...	-1984.4	-2872	-4402	-4734	-5491
D. FINANCING.............	-329	-507	-230	-230	-230
(I) World Bank	0	0	0	0	0
(ii) A.D.B.	0	0	0	0	0
(iii) Other Creditors	0	0	0	0	0
(iv) Drawings under ESAF 3/	0	0	0	0	0
(v) RESERVE MOVEMENTS 4/	-329	-507	-230	-230	-230
(vi) Promisory Notes (arrears)	0	0	0	0	0
FINANCING GAP	-2313	-3379	-4632	-4964	-5721
DEFERRED DEBT SERVICE	2313	2985	2619	2810	3200
RESIDUAL FINANCING GAP		-394	-2013	-2154	-2521

MEMORANDUM ITEMS....					
EXCHANGE RATE (N/$) (AVERAGES)	21.8861	22.0000	22.0000	22.0000	22.0000
CURRENT ACCOUNT BALANCE AS % OF G.D.P.	-5.4	-4.9	-4.7	-5.4	-5.7
EXTERNAL RESERVES (STOCK) $ MILLION	1659	2166	2396	2626	2858
NUMBER OF MONTHS OF IMPORT EQUIVALENT	2.7	3.6	3.7	3.6	3.6
DEBT SERVICE DUE AS % OF EXPORT OF GOODS AND NON - FACTOR SERVICES	40.9	44.0	47.1	49.2	53.2
EXTERNAL DEBT STOCK ($Billion)	29.4	30.9	32.2	33.6	35.3
EXCHANGE RATE (N/$) END-PERIOD	21.8861	22.0000	22.0000	22.0000	22.0000
EXTERNAL DEBT STOCK (N Billion)	643	680	708	739	777
EXTERNAL DEBT STOCK AS % OF GDP	75.0	192.0	145.0	109.0	86.0
SCHEDULED DEBT SERVICE (EXCL ARREARS) $M	4008	4339	4619	4810	5200
STOCK OF ARREARS ($ MILLION) ESTIMATED	5865	5865	5865	5865	5865
CRUDE OIL PRODUCTION (MBD)	2.01	2.04	2.04	2.04	2.04
LOCAL CONSUMPTION (MBD)	0.27	0.30	0.30	0.30	0.30
EXPORT (MBD)	1.74	1.74	1.74	1.74	1.74
OIL PRICE ($ PER BARREL)	15	15	15	15	15

1/ PROVISIONAL

2/ PROJECTION

3/ DRAWINGS UNDER THE ESAF ARE ASSUMED TO BE NIL UNDER THE REFERENCE SCENARIO

4. Minus Sign (-) indicates increase in reserves

Plus Sign (+) indicates decrease in reserves.

5. Assumes debt service payment of $2,000 million in 1995 - 1998

TABLE 3
COMPOSITION OF NIGERIA'S EXTERNAL DEBT STOCK

CATEGORY	1993	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
MULTILATERAL	884	1097	1317	1887	2985	2838	3171	3842	3650	4518	3695	4402
PARIS CLUB	5390	5811	7833	10228	12569	14400	15871	17171	17793	16434	18161	18334
LONDON CLUB	6263	4996	3560	6088	5860	5960	5680	5861	5988	2120	2056	2058
PROMISSORY NOTES	3702	4125	4255	4498	4850	4810	4553	4550	4479	3246	3160	3178
OTHERS	1526	1318	1939	2873	2032	2685	2311	1675	1454	1226.1	1647	1456
TOTAL	17765	17347	18904	25574	28296	30693	31586	33099	33364	27544	28719	29428

MEMORANDUM ITEMS:

SHARE IN TOTAL DEBT (%)

MULTILATERAL	5.0	6.3	7.0	7.4	10.5	9.2	10.0	11.6	10.9	16.4	12.9	14.9
PARIS CLUB	30.3	33.5	41.4	40.0	44.5	46.9	50.2	51.9	53.3	59.7	63.2	62.3
LONDON CLUB	35.3	28.8	18.8	23.8	20.7	19.4	18.0	17.7	17.9	7.7	7.2	7.0

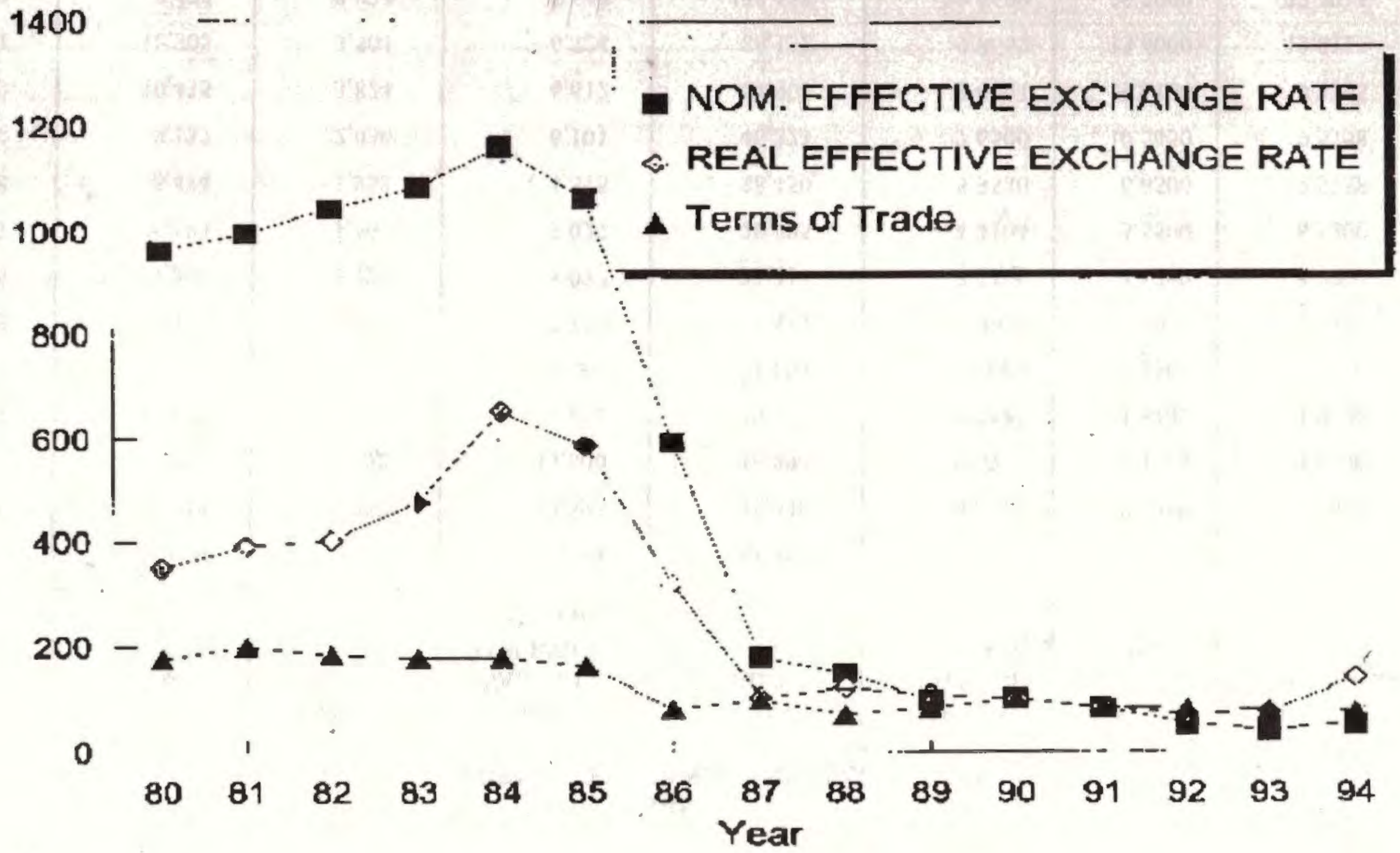
TABLE 4
COMPARATIVE EXCHANGE RATE ANALYSIS

YEAR	PURCHASING POWER PARITY RATE	OFFICIAL EXCHANGE RATE	PARALLEL MARKET RATE	NOMINAL EFFECTIVE EXCHANGE RATE	REAL EFFECTIVE EXCHANGE RATE	TERMS OF TRADE	C/A BALANCE AS % OF GDP
1980	2.5515	0.5464	0.9009	963.8	348.5	174.8	4.6
1981	2.5120	0.6100	0.9259	996.8	390.6	197.9	-7.9
1982	2.9564	0.6729	1.1364	1042.6	401.2	183.0	-9.4
1983	3.0322	0.7241	1.8182	1083.0	473.7	177.3	-5.5
1984	3.8045	0.7649	3.2500	1160.6	652.6	179.1	0.1
1985	5.9076	0.8938	3.7900	1063.8	584.8	162.1	3.1
1986	6.0343	2.0206	4.1700	593.6	319.3	80.6	-4.7
1987	6.2532	4.0179	5.5500	178.7	102.3	97.1	-3.7
1988	6.6808	4.5367	6.0500	146.8	121.1	69.4	-0.7
1989	10.1377	7.3916	10.5450	97.9	107.6	82.6	-4.1
1990	15.7418	8.0378	9.6100	100.0	100.0	100.0	7.4
1991	15.9491	9.9095	13.4000	82.5	84.3	84.6	-3.9
1992	24.4772	17.2984	20.3000	53.3	69.9	82.0	-0.9
1993	37.4991	22.0468	36.2000	41.4	76.2	80.1	-2.4
1994	56.3610	21.8861	59.9540	55.0	139.8	77.9	-5.4

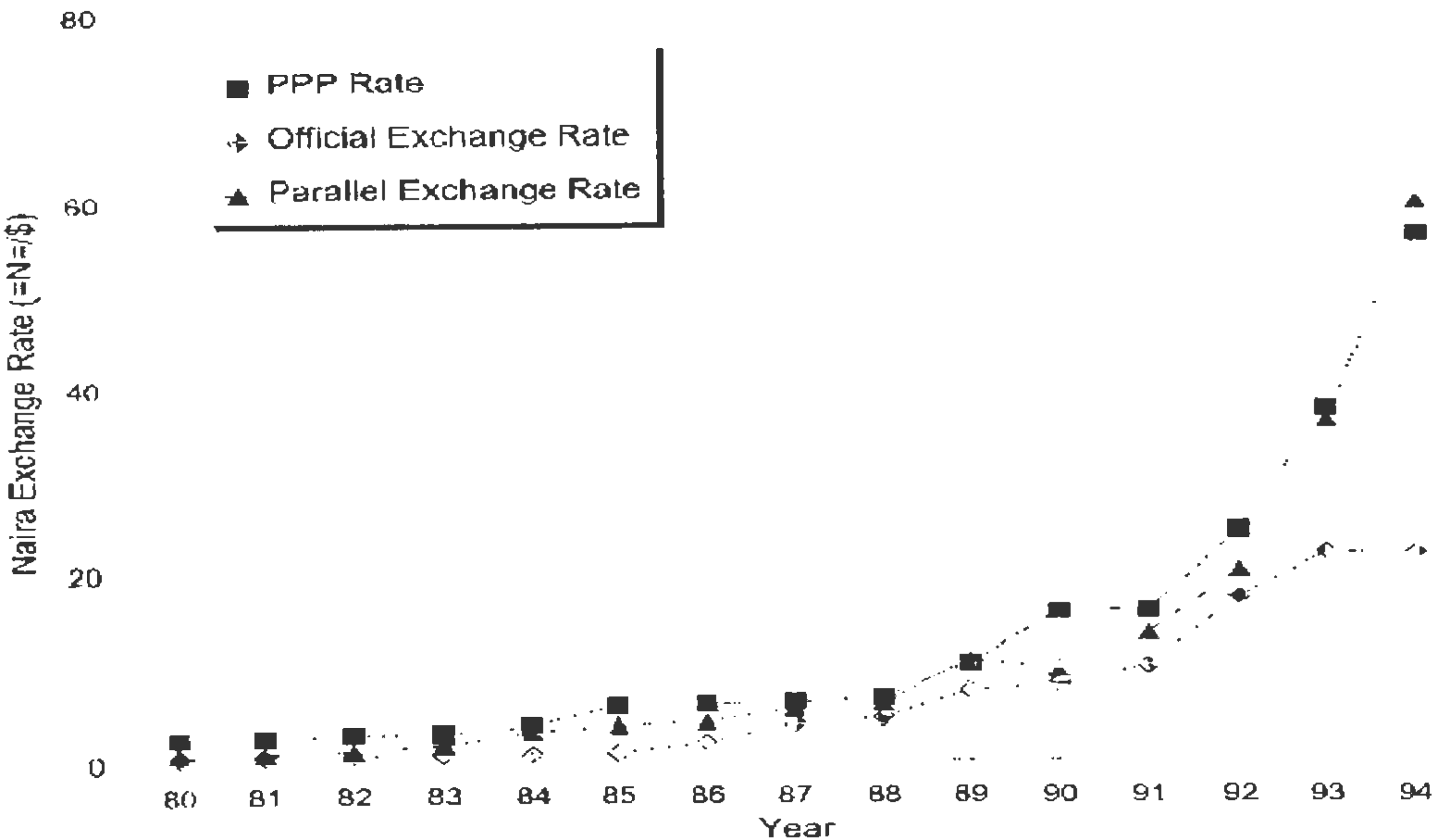
TABLE 5
FOREIGN EXCHANGE ADEQUACY

YEAR	FOREIGN EXCHANGE INFLOW ($'M)	DEBT SERVICE	AMOUNT AVAILABLE TO SERVICE ECONOMY	TOTAL LIQUIDITY (M2)	OFFICIAL EXCHANGE RATE	PARALLEL MARKET RATE	IMPLICIT EXCHANGE
1980	25,979	186	27,794	14,397	0.5444	0.9009	0.5600
1981	21,449	857	20,592	15,548	0.6369	0.9259	0.7600
1982	14,951	1,152	13,800	16,894	0.6702	1.1364	1.2200
1983	11,679	1,846	9,834	19,369	0.7485	1.8182	1.9700
1984	12,121	3,455	8,666	21,601	0.8082	3.2500	2.4900
1985	12,310	4,180	8,130	23,819	0.9996	3.7900	2.9300
1986	7,204	2,127	5,077	24,216	3.1166	4.1700	4.7700
1987	6,593	1,567	5,027	29,995	4.4104	5.5500	8.5200
1988	6,474	1,953	4,515	38,450	5.3530	6.0500	7.5758
1989	8,137	2,036	6,101	46,223	7.6500	10.5450	9.5758
1990	10,435	3,824	6,612	64,903	9.0001	9.6100	9.8165
1991	10,305	3,501	6,724	86,152	9.8662	13.4000	12.8123
1992	8,476	2,833	5,643	128,518	19.6609	20.3000	22.7735
1993	7,511	1,664	5,847	196,318	21.8861	36.2000	33.5976
1994	6,067	1,694	4,373	267,759	21.8861	59.9540	61.2372

INDEX OF NAIRA EXCHANGE RATE



Naira Exchange Rate Per Dollar



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