



## **NIGERIA'S PROGRESS UNDER THE PARIS CLUB DEAL FOR DEBT RELIEF**

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### **Summary**

- In October 2005, Nigeria concluded the terms for eliminating all of her Paris Club debt by April 2006.
- The benefits of the deal are already becoming apparent. At the end of January 2006, Nigeria received her first international credit rating. Fitch Ratings granted a BB- status on Nigeria's long-term debt. This was better than expected and is on a par with ratings for Turkey and Brazil. The rating should give Nigerian firms much better access to foreign direct investment.
- The financial benefits are striking. The Debt Management Office estimates that Nigeria will save nearly \$43 billion in debt service costs over the next 15 years by eliminating Paris Club debts. This money has been committed to funding poverty eradication and will be tracked carefully through the Virtual Poverty Fund.
- After the deal was negotiated in October, the process of implementation began. In December 2005, the National Assembly passed the Supplementary Appropriations Bill introduced by President Obasanjo. This granted the funds necessary for Nigeria to fulfil her payment obligations under the deal, consisting of arrears of \$6.4 billion and a buy-back of \$6 billion.
- Once the Bill was passed the way was open for signing bilateral agreements between Nigeria and each of her creditors. The bilateral agreements allow creditors to receive their share of the arrears payment in exchange for cancellation of 33% of Nigeria's outstanding debt to them. To date, 10 out of the 15 agreements have been signed.
- The next step is that through the Policy Support Instrument, IMF staff will report on Nigeria's macroeconomic progress in March. A satisfactory review will be taken by creditors as the green light to finalise debt cancellation and for Nigeria to buy back all the remaining debt at a discount.

## **Introduction**

Nigeria concluded the terms for eliminating her Paris Club debt back in October 2005. This paper sets out the progress that has been made to date along the path to implementation, and also takes a look at the future for debt sustainability in Nigeria.

The timetable for implementation of the debt reduction envisaged a two stage programme:

- First, Nigeria would pay off \$6.4 billion of arrears and creditors would cancel the first 33% of the remaining debt stock outstanding (some \$24 billion after payment of arrears).
- Second, under Nigeria's two-year Policy Support Instrument (PSI) with the IMF, a first review of Nigeria's economic performance up to the end of 2005 would be prepared by IMF staff in the spring of 2006. On the basis of IMF endorsement, creditors would finalise the debt relief package by cancelling the second portion of 34% of the \$24 billion debt stock outstanding after payment of the arrears. Finally, Nigeria would buy back the remaining amount at the agreed discount.

At the end of this two-stage process, 60% (\$18 billion) of Nigeria's total Paris Club debt will have been cancelled, with Nigeria paying outstanding arrears of \$6.4 billion, and buying back the balance (\$6 billion). Nigeria will then be free of the entirety of her Paris Club debt, which accounted for 86% of her total external debt before the deal was negotiated.

In order to put the timetable into practice, several steps needed to be taken. First, approval was required from Nigeria's National Assembly for the appropriation of public funds to pay creditors the arrears and finance the buy-back. Second, arising from the Paris Club agreement, the signing of bilateral agreements between Nigeria and each creditor country that is party to the deal.

## **National Assembly Approval**

National Assembly approval of funding for Nigeria to pay the agreed \$12.4 billion to the Paris Club creditors was not a foregone conclusion. Earlier in the year, in March 2005, some members of the National Assembly had passed a resolution calling for the government to repudiate her debts to her rich western creditors altogether.

After the Paris Club deal was negotiated, some members of the National Assembly, along with sections of the press and NGOs, asked whether paying \$6.4 billion in arrears to rich countries was a good use of the oil windfall revenues. In addition to these concerns, there

were questions over whether the correct constitutional procedures were being followed in appropriating the money.

President Obasanjo submitted a Supplementary Appropriation Bill to the National Assembly soon after the Paris Club deal was struck. The passage of the bill attracted some controversy with claims that the money had already been paid over to creditors before National Assembly approval had been granted. Appearing before the Senate in mid-November, Finance Minister, Dr Okonjo-Iweala, made it known that the \$6.4 billion initial payment to the Paris Club had not been made ahead of National Assembly approval. She explained that the money had been transferred to an escrow account at the Bank for International Settlements in preparation, but the money still belonged to Nigeria and would not be released until the appropriation was officially sanctioned.

Final approval for the exceptional Supplementary Appropriation Bill was granted by the House of Representatives in the middle of December, clearing the way for the transfer of arrears payments to creditors once the bilateral agreements were signed.

### **Bilateral Agreements**

After final National Assembly approval was obtained, the first bilateral signing with eight creditors - Belgium, Finland, France, Germany, Italy, Switzerland, the United Kingdom, and United States - took place on 17<sup>th</sup> December in Abuja. Once these agreements were signed, funds due to those creditors for payment of arrears could be released from the escrow account held at the Bank for International Settlements. Simultaneously nearly \$6 billion was written off by creditors – that is, 33% of the remaining debts outstanding to those creditors.

Two weeks later, bilateral agreements were signed in Brasilia with Brazil and the Netherlands, allowing for around \$830 million more to be written off. This leaves five agreements outstanding, including those with Austria and Denmark. These remaining creditors will only receive their arrears payments once the bilateral agreements are signed.

### **IMF Review Under the Policy Support Instrument**

Nigeria's circumstances led the IMF to adopt an entirely new monitoring arrangement, one that now applies to countries that are implementing home grown macroeconomic policies.

Just prior to negotiations with the Paris Club, the IMF Executive Board approved a two-year Policy Support Instrument for Nigeria. This was a pre-requisite for a deal with the Paris Club, which normally

requires a debtor to have had an IMF programme in place for at least three years.

IMF staff will provide creditors with a review of Nigeria's performance up to December, 2005 against macroeconomic indicators and poverty reduction measures under the National Economic Empowerment and Development Strategy (NEEDS). This report will be submitted at the end of March 2006. A satisfactory review will act as a green light for the final stage of the debt relief package – write off of 34% of the debt stock which was outstanding when the deal was negotiated, together with buy-back of the remainder of the Paris Club debt.

### **Challenges to the Deal**

Coinciding with the passage of the Supplementary Appropriation Bill through Nigeria's National Assembly, western NGOs launched an attack on the debt relief deal and called for creditors to release Nigeria from the burden of paying arrears, and buying back the balance of the debt. Jubilee Debt Campaign UK and USA, supported by a group of US congressmen and women, called for the UK, US and others to commit to returning Nigeria's payments.

In criticising the deal, NGOs and their supporters underestimated a) the limited room for manoeuvre open to Nigeria; and b) the scale of President Obasanjo's achievement. While it may be true that creditors will receive more from Nigeria in one year than the sum the Gleneagles Summit of the G8 promised Africa over the next ten years, it is also the case that Nigeria will be clearing \$30bn of debt. By the spring of 2006, the Nigerian government will have achieved economic independence from creditors. Just as vital to the revival of the Nigerian economy is the saving of almost \$43bn in debt payments due over the next 15 years.

Nigeria's democratic government has placed the highest value on clearing the Paris Club debts to rid Nigeria's people, and future generations, from the weight of financial obligations to the west. With oil windfall revenues much increased owing to the rising cost of oil throughout last year this was Nigeria's best chance of escaping from a spiral of indebtedness. As the Finance Minister has also pointed out, the future is full of uncertainties, which include the trajectory of interest rates, exchange rates and foreign exchange revenues. Movements in any or all of these variables could have escalated the burden of debt in the future.

Nigeria is not alone in taking the view that it is wise to pay off debts when you can. This is exactly what Brazil, Argentina and Russia have decided to do by paying back their debts to the IMF and in Brazil's case, buying back all that it owes to the Paris Club. The terms of Brazil's buy-back of Paris Club debt are not as generous as those

accorded to Nigeria – whose buy-back is at a discount to the face value of the debt. Indeed, the only concession the Paris Club made to Brazil was to allow her to pay back the debt early.

### **Use of Resources Freed up by Debt Relief**

Every year Nigeria has been paying \$1 billion in debt service payments to her Paris Club creditors, but because she has not been able to meet the total bill of about \$2 billion annually, arrears and penalties have been adding to the debt stock, compounding problems for the future. Now, both the annual payment and build-up of debt can stop.

Nigeria's Debt Management Office has estimated that, with higher debt service costs due in future years, Paris Club debt would have cost Nigeria \$43 billion up to 2021. Through this deal, the money can be diverted from paying creditors to investing in the economy and people of Nigeria. In an interview following the Paris Club meeting, Finance Minister Ngozi Okonjo-Iweala confirmed how the benefits of debt relief will feed through to the Nigerian people:

**“The money saved from external debt servicing will be ploughed into poverty reduction programmes, boosting agriculture, health care and education, to meet the UN MDGs.”**

Babatunde Osotimehin, chairman of the National Action Committee on Aids (NACA) said in a recent interview with the News Agency of Nigeria<sup>1</sup> that President Obasanjo had directed that 10% of the \$18 billion of debt relief granted by the Paris Club would be used to fight AIDS.

At the Nigeria National Debt Strategy and New Financing Analysis Workshop which began on 23<sup>rd</sup> January 2006 in Abuja, Dr Okonjo-Iweala reiterated that management of the funds made available through the Paris Club debt deal will be monitored by a tracking mechanism called the Virtual Poverty Fund. The Fund will take the form of an initiative named OPEN (Oversight of Public Expenditure on NEEDS) to monitor and track all MDG-related expenditure. This will come into effect in the 2006 Federal Government budget, and will apply to baseline MDG expenditure as well as any additional spending released by debt relief. This will be overseen by a committee called the Millennium Development Goals Committee, to be chaired by President Obasanjo.

Dr Okonjo-Iweala also pointed out that the present administration was taking other necessary measures to complement the landmark gains from the debt relief package, including strengthening budgetary

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<sup>1</sup> Reported in Angola Press, 17<sup>th</sup> January 2006, “Nigeria to spend 10% of debt relief on HIV/AIDS”.

processes and public expenditure management, continuing anti-corruption reforms, enforcing due process in public procurement and expenditure, and enacting the Fiscal Responsibility Act.

### **Future Borrowing and Debt Sustainability**

The Finance Minister has made clear that due to the limitations which domestic resources place on national development efforts, there is a need to seek supplementary external funding. She has also stressed, however, that in the past such external resource mobilization led to the creation of unsustainable debt burdens, largely due to inappropriate financing and use of funds.

The Minister stated at the opening of the current Workshop in Abuja, that borrowing will have to take place, but only on concessionary terms under a medium-to-long term debt sustainability programme for the country. She is quoted<sup>2</sup> as saying that:

**"my perspective on the issue is that whether new financing would create sustainability problems or not depend partly on the financing options governments adopt to pursue poverty reduction and wealth creation programmes and partly on the utilization of borrowed funds. In particular, the financing options that may be available consist of grants and concessional loans, especially now that Nigeria is an International Development Assistance (IDA)-only country. ... However, even concessional loans contracted to advance poverty reduction and wealth creation goals must have ceilings to avoid high and unsustainable debt levels."**

Director-General of the Debt Management Office (DMO), Dr Mansur Muhtar, also speaking at the workshop, gave a warning about domestic debt. He put the domestic debt stock of the country at N1.5 trillion, warning that Nigeria must avoid another debt trap. Dr Muhtar noted positive steps in the management of domestic debt, however, as the proportion of short-dated Treasury Bills has gradually declined since 2004 when the Central Bank and DMO initiated a programme to lengthen maturities. He stated<sup>3</sup> that:

**" A regular monthly issuance programme for restructuring the short-tenored instruments into longer-dated ones began in July 2005. The issuance programme for 2006 plans to extend the tenor of the FGN Bonds to 5 and 7 years. In particular, the domestic debt management programme ensures that budget deficits are no more funded with Treasury Bills but with long-dated bonds".**

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<sup>2</sup> Quoted in the Vanguard (Lagos), 24<sup>th</sup> January, 2006: "Nigeria to Borrow More Foreign Loans, Says Okonjo-Iweala"

<sup>3</sup> Quoted in The Daily Champion (Lagos), 24<sup>th</sup> January 2006: "Nigeria's Domestic Debt Hits N1.5 Trn"

By lengthening the maturity of her liabilities, Nigeria should be able to reduce the mismatch between liabilities and spending programmes, which tend to be longer term. This will help provide greater security in financial planning since the bigger the mismatch in terms between borrowing and spending projects, the greater the need to roll over funding, which carries the risk either that funds will not be available or only at higher rates of interest.

### **Improved Prospects for Foreign Direct Investment**

As well as reducing the annual debt service cost, Nigeria's economic team expected that reducing the debt burden would improve the country's credit-worthiness in the eyes of investors, thereby improving confidence and promoting private sector development in the country.

This expectation was borne out at the end of January 2006 when Nigeria received her first ever credit rating. This should be a significant boost to Nigeria's ability to access foreign direct investment. Fitch Ratings gave Nigeria a long-term credit rating of BB-, three notches below investment grade, putting her on a par with middle income countries such as Brazil and Turkey. The rating agency also projected a stable outlook for the country and assigned their positive rating decision directly to Nigeria's Paris Club deal and the government's commitment to ongoing economic and institutional reforms.

### **Conclusion**

President Obasanjo's team achieved an historic economic goal in October 2005 by concluding an agreement on debt relief with the Paris Club. The path to implementation has not been clear of difficulties, and the government has had to account to the Nigerian electorate for its negotiating stance. However, the Paris Club deal has already borne fruit with Nigeria attaining a positive international credit rating.

If the deal is concluded successfully, which depends on the IMF's review, the government faces the ongoing challenge of meeting development goals within a debt sustainability framework, but will have secured financial and economic independence for the people of Nigeria.