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Debt relief for Nigeria: all parties benefit

Nigeria's position has improved, in part thanks to the debt relief agreement of 2005 with the Paris Club. Nigeria repaid USD 12 billion of the USD 30 billion it owed the members of the Paris Club; its creditors wrote off the remaining USD 18 billion. It was a controversial arrangement, because a previous IMF study had shown that Nigeria was financially capable of paying off its debts. Indeed, its oil production made it the second biggest economy in sub-Saharan Africa. The fact that it nevertheless qualified for debt relief was due to its serious attempts at economic reform and the realisation that this agreement would give creditors their best option of retrieving part of the outstanding debt.

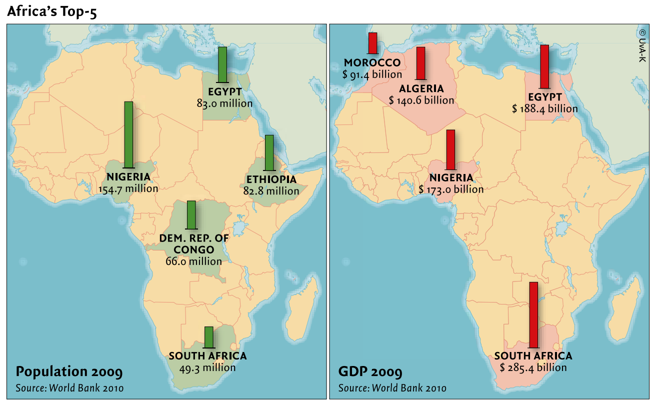
Introduction

The main questions dealt with in this joint evaluation[1] were: What led up to the agreement? To what extent did it impact on economic growth and poverty reduction in Nigeria? To what extent were these results sustainable? And is it true that debt relief contributes to economic growth, better public finance management and poverty reduction?

Situation in Nigeria

With 150 million inhabitants, Nigeria is Africa's largest country. It has a history of violence, military coups, corruption, human rights violations and conflicts of a political, ethnic, regional and religious nature. In 1999 – after 33 years of military rule – democratic elections were held. These were won by Olusegun Obasanjo, a former Nigerian army general and former president of Nigeria. Since 2010, Goodluck Jonathan has been president.

Africa's Top-5



In the mid-1970s, Nigeria was the fifth largest oil producer in the world. The early 1980s saw a sharp drop in oil revenue. The government did not however cut its spending; it managed to secure funds for gigantic development projects and to contract yet more loans. Its wealth is distributed very unevenly; around 67 per cent of the population lives below the poverty line of one dollar a day. Its strong dependence on oil and gas makes the Nigerian economy vulnerable. Moreover, the Niger Delta is plagued by conflicts, environmental problems and pipeline sabotage.

Debts

By 1980, Nigeria's foreign debts amounted to almost USD 9 billion. Repayment was not a government priority. Overdue payments, interest and fines made the debt even bigger. In 1986, the Paris Club and Nigeria concluded a debt agreement; in exchange, Nigeria accepted an IMF adjustment programme. It didn't help. New debt treatments followed. However, these only led to repayment being postponed, not to debt reduction.

By 2005, the total foreign debt had swelled to USD 34 billion, over USD 30 billion of which was owed to the 15 members of the Paris Club, an informal group of wealthy nations that jointly negotiates debt treatment with countries struggling to make repayments.

The debt relief agreement

In 2003, the Nigerian government launched an economic reform programme called the National Economic Empowerment Development Strategy (NEEDS). Nigerian ownership of policy plans was substantial.

In 2005, the IMF concluded that Nigeria did not have an unsustainable debt: since 2003, the country's economy was once again benefiting strongly from its oil exports. The World Bank, on the other hand, took the view that a debt of that size would prevent Nigeria from ever being able to attain the Millennium Development Goals.

At talks preceding the G8 summit in Gleneagles, Scotland, in June 2005, the G8 finance ministers decided to cancel the debt. Belgium, the Netherlands and other G8 creditors initially opposed this move. In the end, though, all the countries resigned themselves to the decision, which was already a fact. However, the Netherlands only agreed after a number of conditions had been met, such as IMF supervision of policy reforms and the earmarking of funds freed up by the debt cancellation for poverty reduction.

On 17 October 2005, the IMF approved an agreement with Nigeria. Three days later the debt relief agreement was signed by the Nigerian government and the Paris Club. The United Kingdom, the United States, the IMF and the World Bank were particularly influential in this process. Of the total debt of USD 30.4 billion, USD 18 billion was written off; Nigeria repaid USD 12.4 billion out of oil savings amassed during a period of high oil revenue. Its debt with the Paris Club was thus reduced to zero.

Conclusions

The evaluation report concludes that the decision to relieve Nigeria's debt was justified. As a result of the agreement and the attendant economic reforms, Nigeria's current economic position is much better than before the agreement. The creditor countries also benefited.

Outcome for Nigeria

The findings of this evaluation are more positive than is generally the case with studies of debt relief in other countries, one reason being that Nigeria's entire foreign debt disappeared at a single stroke. Moreover, Nigeria's ownership was substantial. President Obasanjo's strong wish to reach a debt agreement ensured broad political consensus in Nigeria for domestic economic reforms.

The main outcomes lie in the field of macroeconomic stability, economic growth, poverty reduction and policy.

The debt relief has improved the quality of policy. Nigeria had already been making serious efforts to introduce policy reforms in the period preceding the debt agreement. As of 2003, it saved some of its oil revenue for the first time, rather than immediately spending it. This had a beneficial effect on macroeconomic stability: inflation went down. Other major policy reforms were carried out, ranging from improved debt management to anti-corruption efforts, the reform of the civil service, privatisations and social investment. Between 2005 and 2007, IMF supervision helped to keep these reforms in place. Corruption was slightly reduced and investor confidence grew. Thanks to the agreement, Nigeria's foreign debt had shrunk to a mere USD 4 billion by 2009. In other words, debt sustainability increased.

Another outcome was that the debt service saved (amounting to USD 1 billion annually) was earmarked for poverty reduction in the form of a Virtual Poverty Fund (VPF). In practice only about half of this sum was actually spent. There was marked progress in the fields of education, health care and drinking water supplies; it was somewhat less marked in the fields of infrastructure, agriculture, microcredit and social security. Experience with the VPF also increased national planning, implementation, budgetary, monitoring and evaluation skills.

Debt relief gave a modest boost to annual economic growth averaging 6 - 7 per cent between 2004 and 2009. This was partly directly attributable to the agreement: the vanished debts, the annual savings of USD 1 billion and the policy reforms. Its indirect effects were also significant: greater macroeconomic stability, improved creditworthiness and increased foreign investment. The one-off repayment of USD 12 billion did not stall economic growth, because the money came from a special oil savings account.

Outcome for the creditor countries

The agreement also proved beneficial to creditors. They stood to gain strategically from increased stability in Nigeria, both politically (the international war on terrorism) and economically (largely oil supplies, but also trade and investment). In addition, Nigeria repaid a large sum that would otherwise probably not have been recouped, certainly not in the short term. Finally, the official aid figures shot up as a result of this debt relief, particularly in the case of the countries that were the biggest creditors. This brought them closer to the old international agreement of spending 0.7% of GNP on development aid.

Sustainability

The sustainability of the outcome of the agreement will vary per field in the medium term (3 to 5 years). A lasting improvement has been made to debt sustainability. Some policy reforms also appear to be lasting, like debt management and the fiscal rule on the deployment of extra high oil revenues. It is expected that the VPF will remain in place given the broad support it enjoys – including in Nigeria's individual states – even though its full impact is not yet clear.

Vigilance remains necessary, however. Sustainability stands or falls with national stability, which is threatened by civil conflicts, particularly unrest in the oil-producing Niger Delta. Corruption and crime are still a huge problem. Other causes for concern include the rapid increase of domestic debt, the great income disparity and the recent increase in government spending. The oil savings account is now almost empty.

In summary

- The intervention theory that debt relief fosters economic growth and reduces poverty appears to be valid. The agreement has influenced poverty in two ways: directly, through improved macroeconomic policy and VPF expenditure, and indirectly, through economic growth.
- Not all changes are expected to be lasting, but positive effects are nevertheless discernible; public finance management, including debt management, has improved, debt sustainability has increased and efforts to reduce poverty have been stepped up.
- According to the evaluators, parties were right to conclude the debt agreement because the benefits for Nigeria have proven substantial. Moreover, the agreement also served the interests of the creditors involved, being in line with their major priorities.

[1] The joint evaluation was organised and funded by the Policy and Operations Evaluation Department (IOB) of the Dutch Ministry of Foreign Affairs and the Special Evaluation Office of International Cooperation (SEO) of the Belgian Federal Public Service Foreign Affairs, Foreign Trade and Development Cooperation. The report was published as *Mutual interests – mutual benefits. Evaluation of the 2005 debt relief agreement between the Paris Club and Nigeria. Main report* (2011).