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Nigeria and the IMF

Press Release:
IMF Executive Board Completes the Fourth Review Under the Policy Support Instrument for Nigeria
October 15, 2007

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Nigeria: Authorities' Letter and Policy Statement

September 26, 2007

The following item is a Letter of Intent of the government of Nigeria, which describes the policies that Nigeria intends to implement in the context of its request for a policy support instrument from the IMF. The document, which is the property of Nigeria, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

FEDERAL MIISTRY OF FINANCE
Office of the Honourable Minister

FMF/HMF/30 September 26, 2007

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, DC 20431

Dear Mr. de Rato:

The attached Policy Statement describes economic and financial policies that the government of Nigeria has been pursuing and wants to continue to implement. The Policy Statement outlines our broad macroeconomic objectives and policies for the remainder of 2007 and for the medium term. These policies are based on our National Economic Empowerment and Development Strategy (NEEDS). We have no objection to the publication of the Policy Statement and the Staff Report for the Fourth Review under the Policy Support Instrument (PSI) which was submitted to the IMF Executive Board at the same time.

The Government of Nigeria believes that the policies set forth in the attached statement are adequate to achieve the objectives of our PSI program. Given our interests in macroeconomic stability, we stand ready to take additional measures as may be necessary to achieve needed objectives. We look forward to continuing to work in partnership with the Fund and the Bank in the implementation of our homegrown program and will naturally consult in advance should revisions be contemplated to the policies contained in the PSI.

/sgd/ /sgd/

Dr. Shamsuddeen Usman
Minister of Finance

Mr. Tunde Lemo
Deputy Governor, Central Bank of Nigeria

Policy Statement by the Government of Nigeria on the Nigerian Economic Reform Program After Completion of the Policy Support Instrument

September 2007

This policy statement by the Government reviews Nigeria's Policy Support Instrument (PSI) following the review of the fourth and final phase of the PSI by the IMF. It summarizes recent developments on the reforms, including progress with the existing structural assessment criteria and benchmarks, and short-term objectives going forward to complete ongoing work. It also outlines the medium-term policy agenda of the new Administration and emphasizes that the overall strength and direction of the program remain highly positive. The PSI framework has been vital to the acceleration of the reform agenda in Nigeria over the last 2 years, and this administration is considering a second programme involving external surveillance as a foundation for driving further change, and will confirm the details following the Article IV consultation in November.

OVERVIEW

1. **This Policy Statement by the Government follows the completion of the fourth, and final, stage of the Policy Support Instrument (PSI), following earlier Statements dated October 2005, March and December 2006 and May 2007. The Statement spells out the Government's economic reform program covering macroeconomic, structural and anti-corruption issues. The Fourth review mission took place during August 22-30, 2007.** Nigeria's reform program, which is being continued and developed further by the new Administration of President Yar'Adua, is based on the country's home-grown poverty reduction program, the National Economic Empowerment and Development Strategy (NEEDS and NEEDSII). It focuses on addressing the structural and institutional weaknesses of the economy, tackling corruption and overhauling the public expenditure management. This has been summarized in the Seven-Point Agenda of the new President, set out at the end of this statement, and is underpinned by a commitment to transparency, accountability, respect for due process and the rule of law.

2. **The broad goals of NEEDS, NEEDSII and the Seven-Point Agenda are poverty reduction, wealth creation and employment generation through the development of an enabling environment for growth.** This takes the form of fiscal discipline through an oil price-based fiscal rule, improved public expenditure management, better public procurement systems and better service delivery, combined with more efficient revenue collection, tax reforms and customs reforms. Progress in these areas will provide a stable macroeconomic environment, which should **enable the private sector to play its role as the engine of economic growth.** Similarly, the anti-corruption drive of the Economic and Financial Crimes Commission (EFCC), and the work of the Nigerian Extractive Industries Transparency Initiative (NEITI) in auditing the oil and gas industry are addressing lapses in governance and transparency within that sector. Furthermore, ongoing reforms in the public service will

deliver efficiency just as market liberalization and privatization of key public enterprises are helping to improve the public finances and quality of service.

3. **The reforms have continued to deliver significant results. Macroeconomic stability has resulted in growth, while other key indicators have also been positive.** In 2006, real GDP grew by a robust 6.03 percent in spite of a 4.51 percent decline in oil GDP due to disruptions to production in the Niger Delta. Non-oil GDP grew by 9.41 percent. This follows the overall growth rates of 6.5 percent and 6.6 percent recorded in 2005 and 2004 respectively. In all three years, the performance of the non-oil sector dominated real GDP growth; in 2004 and 2005, for example, non-oil GDP grew by 7.8 percent and 8.6, respectively. Growth is forecast to be 6.21 percent in 2007, once again driven by non-oil growth of 9.61 percent as against a further decline in oil GDP of 5.96 percent. This puts Nigeria on track to achieve the top end of her target band of 7-10% non-oil GDP growth this year.

4. **The performance of the fiscal sector continues to be robust. Nigeria has met her target on the non-oil primary balance for the Federal Government at the end of June 2007.** The consolidated fiscal surplus for 2006 was about 6 percent of GDP, following the surpluses of 11 percent and 10 percent of GDP recorded in 2005 and 2004 respectively. Estimated consolidated fiscal surplus for 2007 will be around 1% of GDP, due to the need to draw down from the excess crude account in the first half of the year to address production shortfalls. The balance on the excess crude oil account as of end-June 2007 stood at $9.64 billion and N238 billion (the latter reflecting the balance for the domestic crude oil component). The domestic account is some N373 billion lower than at end-2006 due to the withdrawals made to address revenue shortfall from production.

Foreign reserves as of end June 2007 stood at $42.62 billion (from $41.96 billion at end December 2006) as a result of continued prudent fiscal policy with support from monetary policy. Headline inflation has continued on a broadly declining path; at end June, the rate was 6.4 percent (year on year) compared to 8.5 percent at end December 2006. This June figure was up slightly from a low of 4.6 percent in May, due to the impact of petroleum price increases and the temporary rise in VAT, but fell again to 4.8% in July. The 12-month average inflation rate was 5.9 percent, reflecting mainly the effect of good harvest, as foodstuff constitutes about 64% percent of the CPI basket. **The reserve money target for end-June 2007 was met at N858.2bn, reflecting the effective use of Open Market Operations in the second quarter**, despite pre-election activities by the various political parties during the period. The Monetary Policy Rate (MPR), successfully introduced in December 2006, has proven effective in addressing the problem of interest rate volatility; preliminary data indicate that this has started to have a calming effect on the rates. The rate was lowered by 200 basis points at the June meeting of the MPC, reflecting price stability in the economy and the lower rates prevalent in the market. Finally, following the adoption of a Wholesale Dutch Auction System after the banking consolidation, the exchange rates on foreign exchange markets have converged since mid-2006. The nominal exchange rate has remained stable reflecting improved macroeconomic conditions. However, as price stability is the primary objective of monetary policy over the coming period, exchange rate policy will remain subordinate.

Following the exit from the Paris Club, Nigeria has also successfully exited its London Club debt by redeeming Par Bonds ($1.486 billion) and repurchasing its promissory Notes. It has also successfully repurchased about ⅓ of its Oil Warrants (not part of London Club debt stock). As of mid-June 2007, Nigeria's external debt stood at about 3% of GDP, most of this being multilateral debt. The Debt Management Office (DMO) is developing a debt management framework, which will guide future operations in the areas of borrowing, terms and conditions, repayment, etc. Two international rating agencies (Fitch and Standard & Poor's) have continued to support their BB- sovereign rating with a stable outlook.

5. **The 2007 budget was passed by the National Assembly and signed into law in December 2006, the first time this has happened in advance of the commencement of the new fiscal year.** The budget was based on an average price of $40 per barrel for Nigerian crude oil, following the price-based fiscal rule that has been in operation since 2004. In line with Government's commitment to ensure effective cash-management, production shortfalls have been addressed using revenue smoothing from the domestic excess crude account where necessary.

The strategy entails building on the gains of the last three years, continued adherence to the medium term expenditure framework (MTEF), prudence in public expenditure management and observance of due process in public procurement. The 2007-9 medium-term sector strategy (MTSS) process that drove the 2007 Budget process significantly deepened the planning stage of the budget, bringing greater coherence and engaging a wide range of stakeholders. Other aspects include the intensification of the fight against corruption, and a continuation of the privatization exercise, including deregulation of key sectors, extending the reforms to the rest of the public sector and strengthening of trade facilitation. With the attainment of macroeconomic stability, the new Government is now focusing translating these gains into meaningful improvements for ordinary Nigerians, through the removal of bottlenecks to private business, promoting real sector activities (including through a more vigorous implementation of the local content policy), human capital development, and improved service delivery.

Ongoing Macroeconomic Policies

6. **Short-term macroeconomic policy will revolve around the implementation of the 2007 budget**. The incoming Administration has conducted a complete review of the 2007 Appropriation, with a view to identifying funds available for the implementation of a number of key public service reforms, including implementation of the consolidated salary structure, ongoing right-sizing of Ministries and clearance of local contractor arrears. N170 billion of efficiency savings have been identified from within the existing Appropriation to fund these reforms. An additional N76 billion of revenue has also been identified, principally independent

non-oil revenues already received. In order to continue the prudent implementation of the 2007 budget within the programmed non-oil primary balance for the second half of the year, the Government commits to the following measures:

a. Government will continue to operate the Fiscal price based rule for oil, set at US$40 per barrel for the rest of 2007. Excess crude will continue to be saved; draw down of the account will take place only to compensate for revenue shortfall, to ensure funding remains at the target levels set out in the Budget. No additional sharing will take place in the remainder of 2007;
b. To ensure that no additional capital expenditure from the 2006 Appropriation is undertaken;
c. To ensure that spending from the 2007 Appropriation is ended on 31 December 2007, as is legally required;
d. To put on hold expenditure from the excess crude account on large infrastructure and other capital projects for the rest of 2007 while they are being reassessed;
e. Suspend duty waivers and tax exemptions to prevent further loss of government revenue in 2007; and
f. To ensure the collection of additional non-oil revenues, including fees already outstanding on a commitment basis for GSM licenses, in the second half of 2007. This will be part of medium-term programme to ensure greater efficiency in the collection of such revenues.

7. It is recognized that in order to enable the private sector to successfully play its role as the main driver of economic growth, infrastructure needs to be strengthened. As indicated above, expenditure from the excess crude account on Infrastructure projects has been put on hold while they are being reassessed. This is to ensure that future spending is conducted in such a way as to maximize value for money, ensure optimal project selection and to guarantee a legally sound basis for spending oil savings. Furthermore, a review is being undertaken to look at options for financing such projects, which explicitly avoid adding to Federal and State Government stocks of non-concessionary debt. This may include greater private sector participation, and alternative management structures, for such projects.

8. The oversight role of the Due Process Office has now been formally situated in the Bureau for Public Procurement (BPP), established following the passage of the 2007 Procurement Act. This will further safeguard value for money.

9. In order to ensure that the liquidity impact of Government spending is managed properly, interaction between the fiscal and monetary authorities have been successfully intensified to enable the Central Bank have up-to-date information on the domestic component of this spending so it can take timely action in the management of the liquidity impact of the extra spending. A Fiscal Liquidity Assessment Committee (FLAC) comprising of

representatives of the Ministry of Finance, Budget Office, CBN, OAGF, NNPC, and FIRS has been meeting weekly, to monitor expenditure developments and their liquidity implications. Similarly, provision has been made in the budget to fund the cost of liquidity mop-up. Combined with the new MPR, this will help to bring about a more effective control of the liquidity situation. Going forward, specific monetary policy elements of the macroeconomic framework include the following:

a. As at end-June, 2007, external reserve stood at US$42.7 billion, an increase of US$6.1 billion or 16.7 per cent over the level of US$36.6 billion at end-June 2006. The gross official reserves could cover 25 months of total imports of goods and services. Based on the WEO projections for 2007 oil prices (US$67.40), the stock of international reserves is expected to rise to $43.7 billion at end 2007.

b. With continued prudent fiscal policy and a proactive monetary policy, as shown in the first half of 2007, inflation is estimated to remain in single digits for the remainder of the year, following the 4.8 percent level achieved at end July. Related to this, broad money growth rate at end-June was 10.8 percent over December 2006. The increase in M2 was driven largely by foreign assets (net) of the banking system, which increased by 15.2 per cent as at end-June 2007, compared with 13.0 per cent in the preceding quarter. The narrow money (M1) increased by 2.9 per cent in June compared with 4.8 per cent in March 2007. Aggregate domestic credit (net) declined by 63.7 and 37.2 per cent in March and June 2007, respectively, due mainly to the decline in credit to government (net) by 50.6 per cent at end-June 2007. On the other hand, credit to the private sector rose by 17.1 and 24.8 per cent in March and June 2007, respectively. The improvement in credit to the private sector reflected the positive impact of banking consolidation and the moderation in the lending rate.

ONGOING REFORMS

10. **Structural reforms have been deepened**. Following the successful sale of the eight oil service companies ahead of schedule, further progress has been made in the power sector. Following the appointment of the National Commission on Privatization, concessioning of the Transmission Company of Nigeria is underway. Privatization of the Abuja Electricity Distribution Plc awaits a full review of the energy sector, currently underway.

11. **Several other key reforms have also delivered tangible benefits:**

a. Convergence under the Common External Tariff (CET) of the West African regional economic bloc, ECOWAS.

b. The reform of the Nigeria Customs Service (NCS) continues, including staff restructuring and retraining, and an increase of goods passing through the green channel. Clearance times are to be brought down substantially to 48 hours.

c. Computerization of the Budget Office and Office of the Accountant General of the Federation (OAGF), with a view to interconnecting their operations with those of the BPP and CBN, is ongoing under the Government Integrated Financial Management System (GIFMS) being developed with World Bank support.

d. Government is completing the process of paying contractor arrears. The program commenced in July 2006; contractors that were owed up to N100 million have been fully paid off, while bonds have been issued to cover the debt to contractors owed over N100million. N21 billion of cash payments remain in order to complete the clearance programme, and will be made by end-2007.

e. Similarly, a database of pensioners has been established and the clearing of arrears has been completed, with cash payment for all arrears. In July 2007, Nigeria successfully transferred to a fully funded, defined contributions pension system, which will guarantee long-term sustainability in the pensions sector, as well as deepening fund management capacity in the capital markets.

f. The resolution of the 14 banks that failed to meet the consolidation deadline is on course. To give effect to the revocation of the 14 bank licenses, the Nigerian Deposit Insurance Corporation (NDIC) had obtained final court orders on 10 banks and provisional court order on one, with 3 banks outstanding. The payment of private sector deposits in the failed banks as promised by the CBN had commenced fully under the Purchase and Assumption method, with the CBN issuing Promissory Notes to cover the gap between the assumed deposit liabilities and the assets of the failed banks picked by the banks assuming responsibility. Thus, out of a total of N65.81 billion private sector deposits assumed, N40.94 billion (62.2%) have been accessed by the respective private depositors.

g. The Civil Service reforms are continuing, with full disengagement of 35,600 staff who were not employed with correct qualifications for their job roles; payment of severance benefits and training for smooth transition to post–retirement life has been completed. Disengagement from Government Parastatals has removed an additional 32,240 workers, whose severance payments will be concluded by end of 2007.

h. A new salary structure has been introduced designed to motivate retained civil servants and attract good quality staff into the system.

i. 12 core Ministries have been restructured (State House, Finance, Solid Minerals, National Planning Commission, FCT Administration, Health, Education, Foreign Affairs, Commerce, Science and Technology, Transport, and Internal Affairs). The Government has reduced the number of Ministries by merging some of them, and the new organizational and management structures have been approved and were employed by the new administration on commencing office.

j. The reorganization of the CBN, NBS, NNPC, NIPOST, NISER and Center for Management Development (CMD) has been completed.
k. A Tax Policy Unit has been set up in the Ministry of Finance designed to help strengthen this aspect of the work of the fiscal authorities.
l. The National Bureau of Statistics (NBS) continues to be strengthened through its own internal reforms, with a view to repositioning it for more efficient delivery of macroeconomic statistics.

12. **Ongoing Transparency and anti–corruption efforts**

a. The auditors have been appointed for the 2005 NEITI audit and have made significant progress. Consultants have been appointed to handle the international competitive tender process to appoint auditors for the 2006 and 'Value for Money' audit. The NEITI Act has been successfully passed into law.
b. The publication of the revenue allocation to the 3 tiers of Government continues.
c. The EFCC has continued to make progress in its anti-corruption work in terms of arrest and prosecution of corrupt public officials, including former State Governors.

13. **The push to get relevant bills in the National Assembly passed has yielded success including**:

a. 2007 NEITI Act;
b. 2007 Public Procurement Act;
c. 2007 FIRS Act;
d. Four 2007 Tax Reform Acts;
e. 2007 CBN Act;
f. 2007 Statistics Act;
g. The Fiscal Responsibility Bill has been passed by the National Assembly and will be signed by the President once a consensus and legal agreement has been reached with the other tiers of government on managing oil revenues.

14. Government commits to completing all outstanding structural assessment criteria and benchmarks outstanding within the following time-frame:

a. Implementation of consolidated banking supervision by April 2008, with release of the approved framework to the banking industry before the Final IMF Board Meeting on PSI, mid-October 2007;
b. Completion of taxpayer enumeration and PIN by Q1 2008;
c. Completion of reforms of human resources in FIRS by Q1 2008;
d. Quarterly reporting of MDG expenditures under the Virtual Poverty Fund

before the Final IMF Board Meeting on PSI, mid-October 2007;

e. Customs will ensure that 50% of goods are cleared through the blue (large importer/exporter) and green (pre-cleared) channels by Q1 2008, subject to compliance by private sector operators;
f. Appointment of 2006 and 'Value for Money' auditors under NEITI by September and October 2007 respectively;
g. Publication of Procurement manual before the Final IMF Board Meeting on PSI, mid-October 2007;
h. Roll-out the IPPIS computerized payroll system to the remainder of Government by December 2008; and
i. Complete bid opening for concessioning of Transmission Company of Nigeria before the Final IMF Board Meeting on PSI, mid-October 2007.

MEDIUM-TERM POLICIES OF THE NEW ADMINISTRATION

15. **The major challenge continues to revolve around how to transmit the gains of the reforms to everyday benefits for ordinary Nigerians as a means of securing their continued support for the reforms.**

16. **Mr. President has set out his Seven-Point Policy Agenda, designed to address this fundamental issue and ensure that reforms are accelerated under the new Administration:**

a. **Power and Energy:** No nation has ever achieved rapid economic development without a dynamic energy sector. Thus, critical infrastructural reforms are to be carried out to ensure the development of efficient and adequate power supply.
b. **Food Security and Agriculture:** The Food Security and Agriculture Policy is linked with the need to address Millennium Development Goal (MDG) One – eradication of extreme poverty and hunger. The emphasis is on the development of modern technology and a financial framework for research, production and development of agricultural inputs, which will deliver a 5-10 fold increase in yield and production.
c. **Wealth Creation and Employment:** Nigeria has historically been a mono-resource dependent economy. The new focus is to improve on wealth creation and employment generation through diversified production in the non-oil sectors.
d. **Mass Transportation:** The goal is to modernize and industrialize Nigeria with the development of key modes of mass transportation including railways and inland waterways, for the movement of raw materials, goods, and people.
e. **Land Reforms:** The objective is to revolutionize land use policy by introducing a strong legal framework of land ownership, optimizing Nigeria's

growth through the lease of lands for commercialized farming and other large-scale businesses by the private sector.

f. **Security:** Security is considered as a necessary condition for the development of a modern economy. Productivity, wealth and economic growth thrive only in an environment of security of life and property.

g. **Qualitative and Functional Education:** Linked to the rapid socio-economic development of a nation is the issue of human capacity building. This policy will address the challenges of universal access, along with quality, funding and management of all tiers of education.

Critical to the 7-point agenda, there are two special interest issues:

a. **Niger-Delta:** The Niger-Delta crisis remains the primary focus marshaled not with physical policy or military security, but through honest and accurate dialogue between the communities and the Government for a people centered development; and

b. **Disadvantaged Groups:** Strategies under the seven point agenda will be used to inform and ensure the full participation and representation of all categories of special and disadvantaged groups.

17. **In line with the Seven-Point Agenda, a draft of the NEEDSII document has been circulated for final comments.** This second, home-grown poverty reduction strategy paper, further articulates the detailed policy aims of Government. It is expected that NEEDSII be finalized by December 2007. Corresponding SEEDSII programmes for State Governments are under development. The administration will focus on efforts, through engagement and technical support, to replicate Federal reforms in fiscal responsibility, debt management and public procurement at the State level. Under Nigeria's Federal constitution, this approach of transparent, constructive engagement is the only approach to achieving sustainable reform at sub-national level.

18. **Government continues to pursue its policy of deploying the savings arising from exiting the Paris Club debt** (about $1 billion per annum, of which $750 million is from the Federal Government) into MDG-related spending, and to achieve this Seven-Point Agenda. In the 2007 budget, a total of N110 billion was appropriated for this purpose.

19. **Monitoring of Government reforms will continue to be strengthened.** At the Federal level, an MDA benchmarking exercise will be undertaken in the final quarter of 2007, alongside the continued development of the OPEN framework for monitoring and evaluation of expenditure. The 2007 SEEDS benchmarking will also take place in the fourth quarter, 2007.

20. **The Government reiterates its commitment to seek only concessional financing in the period ahead** to help finance any gap in its investment program. A review has been initiated on bilateral loans for infrastructure development, so as to ensure that the optimal funding strategy is in place for such projects.

21. **The medium-term macroeconomic policy will continue to target macroeconomic stability and structural reforms. The Government commits to a framework that will be based on the following assumptions:**

a. Crude oil production is expected to continue to increase in the medium term, reaching about 2.70 Mb/d in 2009, and thereafter rise further in line with current Government plans to increase the production capacity. However, conservative production projections of 2.43Mb/d have been used for the 2008 Budget, to protect against ongoing production disruption. The oil price based fiscal rule will continue to underpin the budgeting process. Government will continue to operate the rule for oil set at moving-average of historical oil prices to protect against oil price volatility and smooth expenditure from 2008 and beyond.

b. The 2008 Budget will propose a slight reduction in Government Primary Expenditure. The framework proposed for the 2008 Budget by the Administration will deliver a consolidated non-oil primary balance for the Federal Government of N1,408 billion (15.5% of non-oil GDP), which will ensure ongoing stability in the macroeconomy.

c. The 2008 Budget, and future spending, will be fully articulated within a medium-term expenditure framework with 100% expenditure coverage, and underpinned by the medium-term sector strategy process to ensure increasing value for money in public expenditure;

d. Sharing and expenditure from oil savings will be underpinned by a consensus driven legal framework. A minimum balance will be retained to protect against oil price volatility. For additional funds, the Federal Government will make available to States and Local Governments a range of investment opportunities, including critical infrastructure projects and oil & gas investments on a commercial basis, as well as an off-shore savings fund; and

e. From 2009, Federal Government will seek to avoid deficit financing to fund her primary expenditure.