DEBT MANAGEMENT OFFICE

NIGERIA

EXTERNAL BORROWING GUIDELINES

2008 - 2012

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1. INTRODUCTION [1]

1. 1 Background

During the 1990s, the Nigerian economy recorded low growth rates averaging less than 3 percent per annum, low domestic investment, high unemployment and wide balance of payments deficits. Nigeria was in a situation of debt overhang, i.e. its debt stock exceeded its future repayment capacity. This situation discouraged investment in the Nigerian economy and created difficulties in accessing funds from the International Capital market, not only for the government but also for the private sector.

After about three decades of military rule, the civilian government which was elected in 1999 launched a home-grown development strategy, namely the National Economic Empowerment and Development Strategy (NEEDS). This was complemented by State (SEEDS) and Local Government (LEEDS) strategies. NEEDS aimed at value reorientation, poverty reduction, wealth creation and employment generation.

The economy responded positively to these policy reforms. The average annual real GDP growth rate was 6.5 percent between 2003 and 2007, reflecting the strong annual growth of the non-oil sector. The regime of fiscal prudence, tighter monetary policy and low deficit/GDP rates during this period resulted in single digit inflation.

Although the above achievements did not directly impact on the country's external debt sustainability, the reforms enabled Nigeria to resume dialogue with creditors on debt relief. Through high level diplomatic initiatives, the government garnered the support of the international community and was eventually able to get the Paris Club, Nigeria's leading creditor, to agree to a historic debt relief deal that allowed the country exit from all its Paris Club debt obligations between October 2004 and April 2005. This was followed by the exit from its London Club debt obligations in 2006.

Following its success with external debt, the government began the restructuring of the domestic debt portfolio, which was dominated by short term instruments. This has resulted in a portfolio with a substantial long-tenored component. Furthermore, it started working on recognising and settling contingent liabilities that emerged from unfunded pension arrears, local contractors' debts and privatized enterprises, through the issuance of sovereign bonds.

In order to avoid a relapse in to debt unsustainability, the following guidelines have been developed for the use of the Federal and State Governments, as well as their agencies. This version is an update on the guidelines issued in previous years.

The following guidelines complement the existing provisions as contained in The Constitution of the Federal Republic of Nigeria, The Debt Management Office (Establishment) Act, 2003, Act no 18, and the Fiscal Responsibility Act 2007.

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[1] This External Borrowing guideline was culled from the National Debt Management Framework. Details of the guidelines can be accessed at the DMO website: www.dmo.gov.ng

2.0 Guidelines for External Borrowing:

International best practice for overall debt sustainability in low income countries (LIC) recommends external debt stock to GDP ratio of not more than 30 percent. Given Nigeria's economic conditions, the need to avoid a relapse into debt unsustainability, as well as the country's increasing emphasis on domestic borrowing and the development of the domestic debt market, an external debt stock GDP ratio of 20 percent is recommended, (It should be noted that according to DRI recommendation, the domestic debt stock – GDP ratio for Nigeria would range between 20 – 25 percent and the upper limit of 25 percent is considered appropriate for Nigeria, given the emphasis on domestic borrowing. Therefore, the recommended total public debt/GDP ratio for the medium term, i.e. 3 – 5 years is 45 percent). Accordingly, the following general guidelines will apply with regards to external borrowing by the Federal and State Governments or their agencies, for the fiscal years 2008 up to 2012, subject to modifications from time to time.

2.1 Purpose of External Borrowing:

i. Any Government in the Federation or its agencies and parastatals desirous of borrowing shall specify the purpose for which the borrowing is intended, demonstrate how this purpose is linked to the developmental objectives embodied in NEEDS II and the Seven-Point Agenda and undertake a cost-benefit analysis, detailing the economic and social benefits of the purpose to which the intended borrowing is to be applied;

ii. Sectors considered under NEEDS II and the Seven-Point Agenda include health, education, rural development, environment, housing development, employment and youth development, gender balance, infrastructure, public sector reforms, privatization, governance, transparency, anti-corruption, service delivery and expenditure reforms, amongst others; and,

iii. Government will express preference towards creditors that provide programme support, on-budget support, un-tied and multi-year predictable financing, and encourages creditors to maintain a constant policy dialogue with the Federal Government, including the Debt Management Office.

2.2 Approval/Approval-in-Principle:

i. Any Government in the Federation, or its agencies and parastatals can only obtain external loans through the Federal Government. The Federal Government negotiates and signs any external loans and then on-lends the funds.

ii. Federal, State Governments and their agencies/parastatals wishing to obtain external loans shall obtain Federal Government's approval-in-principle from the Federal Ministry Finance, prior to full scale negotiations for such loans;

iii. To receive approval-in-principle, the applicant (governments agencies or parastatals) must provide evidence that they have not over-borrowed externally. In this regard, State Governments must demonstrate that the ratio of their projected external debt service plus all other deduction obligations for the next twelve months (inclusive of the new loan under consideration) to their total Federation Accounts Allocation over the preceding twelve months will not exceed 40%. This rule will be applied on a case-by-case basis and may take into account other sources of revenue, as appropriate. Agencies will be required to provide cash flow statements that will enable the appropriate authority to determine the viability and sustainability of their external borrowing;

iv. Every State shall execute a Subsidiary Loan Agreement with the Federal Government which may include an Irrevocable Standing Payment Order (ISPO) that allows the Office of the Accountant General of the Federation (OAGF) to deduct monthly, money from the State's gross allocation to pay back the loan contracted to the lending institution;

v. No external loan will be approved without evidence that appropriate cost-benefit analysis and feasibility studies have been carried out and prioritisation as well as due process procedures have been followed;

vi. All external borrowing proposals of the Federal, State and Local Governments and their agencies/parastatals for the next fiscal year should be submitted not later than 180 days preceding that year to the Minister of Finance for incorporation into the public sector external borrowing programme for the coming year; and,

vii. All external loans must be supported by Federal Government guarantee before final approval. In the case of a State Government wishing to contract external borrowing, the State Executive Council must approve the loan proposal, and this will be followed by a resolution of the State House of Assembly. Thereafter, all (Federal and State Governments and their agencies) proposals should be submitted to the Federal Ministry of Finance and the Debt Management Office for consideration, before being passed to the Federal Ministry of Justice for clearance and to the Federal Executive Council for approval (subject to being contained within the Annual Budget approved by the National Assembly).

2.3 Terms of New External Borrowing:

In line with the government's commitment to maintain debt sustainability, new borrowing will only be considered on concessional terms as evaluated by the DMO. New loans must have a grant element of at least 35 percent when calculated with an appropriate discount rate.

Analysis conducted on total expected disbursements of concessional external funds for 2008 indicates a figure of US$193.6 million. The 2008 budget deficit is to be financed by a mixture of signature bonuses, sales of government properties, privatisation proceeds and domestic borrowing. The latter will finance the bulk of it with around N200 billion of FGN Bonds issuance. However, none of this is earmarked to fund the massive infrastructure investment needed to achieve the new growth target of the government.

2.4 Non-Concessional Borrowing:

i. Where a commercially-oriented project with self-repaying capacity must be undertaken by any government or any government agency (perhaps because such a project also has compelling public interest) and where such a project requires an external loan, funding and project development options that do not commit the Federal Government in terms of guarantee or counterpart funding should be pursued. Such options include Public Private Partnerships (PPPs), Build, Operate, Recover and Transfer (BORT) arrangement, conceding to the external financier a lien on the products and other assets of the project under a hands-on management, which would subsist until the external loan is fully recovered from the profits of such a project. The acceptance of these options by the project promoters and the external financier/technical partner would serve as an implicit test of the level of confidence to be attached to the claim of the two parties (promoter and financier/technical partner) that the project is commercially viable.

Debt Management Office,
THE PRESIDENCY
NDIC Building (1st Floor)
Plot 447 / 448, Constitution Avenue,
Central Business District,
P.M.B. 532 Garki, Abuja – Nigeria.
Tel: 234-9-6725629. Fax: 234-9-5237396
Email: corporateaffairs@dmo.gov.ng
Website: www.dmo.gov.ng