Chapter 3

DEBT SERVICING IN NIGERIA

Francis Ojaide

INTRODUCTION

The word 'debt' is not strange to Christians (see 2 Kings 4:7; Proverbs 22:26; Matthew 18:27; etc). Debt can bring serious distress to both individuals and nations. It can emanate from the inability of a nation to manage her resources well. In Proverbs 29:2, the Holy Bible says, "When the righteous are in authority, the people rejoice; but when the wicked rule, the people groan." No debtor actually has peace in the real sense of it. The wife of one of the sons of the prophets complained to Elisha that a creditor had come to take her two children to be his slaves. The man of God advised her to sell her oil and pay the debts so that she and her sons could live on the rest and thereby have their peace.

Despite all these problems, God has good plans for His children. The Word of God says that "The mercy of the LORD is from everlasting to everlasting upon them that fear him and His righteousness unto children's children" (Psalm 103:17). There is no doubt that righteousness exalts a nation, but sin is a reproach to any people (Proverbs 14:34).

Debt can be categorized into two major categories, internal and external. In the context of this paper, only Nigeria's external debt will be discussed. I have tried as much as possible, in accordance with the directives given to me by the Co-ordinator of this conference, to avoid technical jargon. I was also made to understand that the conference is that of Christian leaders who have a deep burden for this country's problems. The external debt is one of these problems.

EXTERNAL DEBT

External debt is an amount of money owed by one country to another country or foreign agency for goods purchased on credit or/and services rendered to it or its agencies. Such external debts include official trade debts, promissory notes, letters of credit and medium and long-term debts.

Nigeria's external debts problem can be traced back to 1978, when the country obtained substantial commercial loans from the Eurodollar market. In that year, the country's external debt was $2,163.8 million as against $509.9 million in 1977. By 1982, external debt had risen to $13,124.1 million, due to incessant increases in both medium and long-term loans as well as the emergence of trade arrears. By September, 1988, the debt had risen to $25,901.9 million. It is useful to note that most of the country's external debt was contracted between 1980 and 1985.

The problems created by Nigeria's debt became clear in 1981, due to the decline in the international oil price and the lapses in domestic policies in the 1970s and early 1980s. The policies of the 1970s and early 1980s led to structural changes in the pattern of production and consumption of goods and services. They effectively tied the economy to the vicissitudes of the international oil market. The increases in debt happened when developments in the oil market, instability in agricultural commodity prices, adverse terms of trade and high real interest rates altogether made debt and debt servicing obligations of the country unsustainable.

The following factors have contributed greatly to the severity of the country's debt crisis: high fiscal deficits, unfavorable borrowing terms; uncontrolled external borrowing, mismanagement of borrowed funds, excessive use of short-term credit and medium term market loans, inadequate debt management policies, staggering balance of payments deficits and monetary expansion.

BORROWERS AND LENDERS

The borrowers are governments, parastatals and the private sector. The loans are obtained from sources such as the World Bank, African Development Bank (ADB), foreign governments, and private creditors, mainly banks. The lenders of funds (creditors) have organized themselves into two major clubs for the primary purpose of negotiating repayments of principal and interest with individual nations. They are the Paris and London Clubs.

The Paris Club of official creditors handles the rescheduling of loans provided or guaranteed by governments or their official agencies. Among other things, it covers the repayments of arrears due in a specified 12-month period. It requires a debtor nation to have a stabilization programme with the IMF before the terms of rescheduling are honoured. It does not usually deal with debts that already are associated with a stabilization programme with the IMF. Neither does it usually deal with debts that have already been rescheduled or with short-term debts.

The London Club, also popularly known as the London Club of Bankers, is made up of more than 360 creditor banks. This club negotiates commercial bank credits. They always insist on the full payment of arrears of interests before signing any rescheduling agreement as well as the continuous payment of interest, even when the debt is in process of being restructured. Its terms cover loans falling due in the next two years; the linking of interest rates to London Inter-Bank Offer Rate (LIBOR); a refinancing or rescheduling fee of different amounts; the requirement that the debtor nation have an adjustment programme with the IMF before negotiations commence. The terms of the London Club are rarely favorable to debtor countries. Quite often, debtor nations find themselves negotiating rescheduling and paying debts endlessly.

DEBT SERVICING

Debt servicing is the ability of a debtor nation to continue to repay the principal and interest components of an outstanding loan as and when due. In Nigeria, the proportion of interest payments in total debt service has been high in absolute terms and it is still on the increase. Interest payments constitute a major cause of concern in the country's debt servicing difficulties. Interest payments rose from N783.6 million in 1984 to N980.5 million and N987.2 million in 1985 and 1986 respectively. This further rose to N2,251.8 million in 1987 and N5,133.9 million in 1988. In terms of the total debt service, the interest payments constitute 29.7 percent in 1984; 26.4 percent in 1985; 39.5 percent in 1986; 62.7 percent in 1987 and 64.1 percent in 1988.

The implications of the debt problem for the national economy are quite obvious. The completion of a number of projects is frustrated because of the inability of the country to obtain new credit facilities, such as medium and long-term financing. Suppliers build in a risk premium on their prices in an attempt to overcome the delays in payments for goods and services. The debt servicing utilizes a substantial amount of the country's foreign exchange resources. In 1986, an amount of N4.04 billion was about to be budgeted for external debt servicing. The figure was considered too high and the Federal Government decided to reduce the percentage to a level not exceeding 30 percent of export earnings. The debt service ratio was 29.1 percent in 1984; 31.7 percent in 1985; 28.0 percent in 1986; 11.9 percent in 1987 and 244.2 percent in 1988.

Most of the borrowed funds were used to finance ill-conceived Federal and State Government projects. Many of them are still uncompleted or are operating below capacity due to ineffective management, poor financial planning or defective project selection. The right calibre of people were not given opportunity to serve and manage the country's resources effectively. Rather, it became very common to find round pegs in square holes. Sound financial management criteria like Pay Back Period; Internal Rate of Return, Discounted Cash Flow, Profitability Index were ignored when embarking on project analysis in order to conceal the fact that the project was not viable so that the initiators and signatories to the agreement could on their own make maximum profit at the expense of the nation.

MANAGEMENT STRATEGIES

A country that is heavily indebted to foreign creditors has available several options to rescue itself. It has the option of repudiating all or part of its debts; the option of requesting for debt cancellation by creditors; the option of paying in full all debts as and when they fall due; the option of negotiating for debt relief and/or debt reduction. This last option of debt relief and/or debt reduction can be categorized into four main instruments. These are (1) embargoes placed on external borrowing by the nation involved, except in cases where such external loans are specifically identified to viable projects; (2) placing of limits on debt service payments; (3) debt refinancing/rescheduling; (4) debt conversion schemes.

Looking at the various options enumerated above, we should realize it would not be moral for Nigeria to repudiate all or parts of its debts. By debt repudiation we mean the unilateral refusal by an indebted country to settle its debt obligations. Such a radical approach would have adverse consequences on the international reputation of the nation. A nation that undertakes this kind of approach will likely face retaliation from the industrialized countries of the world, which are the main creditors. The foreign creditors may decide to forcefully seize the external assets of such a nation. Generally, under this kind of atmosphere, diplomatic relations will be broken and the short-run economic problems that are being alleviated will be compounded and intensified.

The second option is requesting the foreign creditors to cancel the indebted country's debt. This request, even if it is not accepted, can influence the reactions of foreign creditors because of the in-built risk of further capital injections into the country. They may decide to seriously curtail or cut-off completely capital flow to such a country. Generally, creditors are not happy over such requests. It has been observed that low-income countries in sub-Saharan Africa have enjoyed the benefits of partial debt cancellation. Nigeria is regarded to be in the group of middle-income countries and, in spite of its temporary economic problems, can adequately settle all debt obligations. Even though Nigeria has enjoyed some debt cancellation by a few creditors, the benefit is of a negligible proportion to the total outstanding debt.

The third option of paying in full all debt obligations as they fall due is a possibility, but this will have adverse consequences on Nigeria's economy. Nigeria does not have adequate foreign exchange earnings from exports to be able to settle such debts. Without the recent debt management strategies such as debt refinancing/rescheduling, the country would have faced more serious short-term economic problems.

The fourth option of debt relief and/or debt reduction has been pursued consistently by Nigeria for the past five years. This option allows a country to lower its debt service payments. As earlier mentioned, since the early 1980s, Nigeria placed an embargo on external borrowing, unless such loans are clearly identified to special and viable projects. The Federal Government has ensured that state governments and government parastatals do not indulge in haphazard external borrowing. Due to the same objective, the Federal Government, in its 1986 Budget, decided to limit debt service payments to 30 percent of foreign exchange earnings. Such a decision cannot be made unilaterally. It is based on the projected success emanating from the current loan rescheduling and other negotiations with foreign creditors.

The fourth option is debt refinancing or rescheduling. A debt refinancing scheme is the process whereby a new medium-term loan is used to repay an equivalent amount of debt falling due for repayment, whereas debt rescheduling involves a rearrangement of the existing repayment terms of an original loan. A rescheduling scheme assists a debtor country to defer the repayment of debts falling due in a particular period with some initial periods of grace. A rescheduling may cover the repayment of principal, or principal and interests due to creditor countries. Under this scheme, the debtor country will continue to pay interests on the outstanding loan until it is fully repaid to the creditors. Such a rescheduling scheme frees a country temporarily from the debt burden and gives the country an opportunity to restructure her economy. The IMF encourages debtor countries to undertake Structural Adjustment Programmes supported by it during debt negotiations.

In most cases, debt rescheduling is first undertaken multilaterally with the Paris and London Clubs of creditors, before the bi-lateral negotiations between individual debtors and creditors begin. This method of refinancing/rescheduling debts first started in 1983. Even though it gives a debtor country short-term relief from severe debt burden, it is obvious that the scheme merely postpones debts into the future and increases the likelihood of higher interest rates.

The fifth option, debt conversion, is simply the exchange of a debtor country's external debt for a domestic debt in local currency or equity participation in a domestic development project. There are several types of debt conversion techniques. The most common are the debt for equity conversion, debt for debt conversion, debt for cash conversion, debt for exports conversion and the debt for nature conversion. Briefly, the debt for equity conversion is the exchange of a country's external debt in foreign currency for local currency which may be used to establish new business or buy equity shares in existing businesses which have been specified for that primary purpose. The debt for debt conversion is the exchange of a country's external debt for domestic debt which may be disposed off in cash in the secondary market. The debt for cash conversion is the exchange of external debt for local currency which can be used for loan repayments, local tax payments and local working capital. The debt for exports conversion is the exchange of external debt for a country's exports. The debt for nature conversion is the exchange of external debt for local currency which can be used to finance projects that are meant for environmental purposes. Generally, debt conversion is seen as a potent instrument that brings in new money that can be used to finance vital domestic projects in indebted countries with the primary objective of stimulating structural adjustment processes.

The banks, investors and the debtor country are the three main groups of participants in a debt conversion process, but where an external debt is traded at a discount, a secondary market is inevitable. The external debt papers are held by banks. The investors are companies willing to buy external debt in the secondary market and invest in the indebted country. The investors are usually motivated by the discount given to them on the purchase of a such a debt. If the investors later decide to dispose off the debt, they may earn higher amounts of local currency. The debtor country encourages debt-equity swaps because of the benefits derived from re-investing the debts to promote economic activities.

CONCLUSION

There is no running away. A debtor must always pay his debts personally or, at death, through his estate. This same principle applies to a nation. If these accumulated debts are not paid during our generation, they must definitely be paid by our children or children's children. This country requires our fervent prayers. The resources which were plentiful are drastically dwindling. A continuation of this trend will result in serious hardships , even hunger. The kind of debt burden this nation is carrying is not a pleasant one at all. We should start sewing our clothes according to the size of the cloth and not the size of our national body.