



*Summary Report*

# Mutual interests – mutual benefits

Evaluation of the 2005 debt relief  
agreement between the Paris Club  
and Nigeria

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## Foreword

This is the summary of the main report of the joint evaluation of the debt relief agreement concluded by the Paris Club and Nigeria in 2005.

In 2009, the Special Evaluation Office of International Cooperation of the Belgian Federal Public Service Foreign Affairs, Foreign Trade and Development Cooperation and the Policy and Operations Evaluation Department of the Dutch Ministry of Foreign Affairs started making preparations for the evaluation. Though their invitation to other members of the DAC Network on Development Evaluation to join them met with considerable interest from potential participants, for various reasons none of them took an active part. After an international call for tenders in early 2010, the contract for the evaluation was awarded to a consortium comprising Ecorys Nederland BV and Oxford Policy Management.

The deal agreed by Nigeria's creditors, united in the Paris Club, and the government of the Federal Republic of Nigeria in October 2005 was controversial, to say the least. Nigeria owed its creditors more than US\$ 30 billion. It agreed to repay US\$ 12 billion from its higher oil revenues, while the creditors cancelled the remaining debt of US\$ 18 billion. That was not exactly peanuts. At that time, US\$ 18 billion amounted to € 12 billion.

The controversy generated by the deal continued unabated not only in some creditor countries, but also in Nigeria itself, with 150 million inhabitants the country with the biggest population in Africa. However, the debate often was based not on convincing arguments or facts, but on political convictions. In the creditor countries, opponents of the deal portrayed Nigeria as a well-nigh failed state where corruption was rife, the majority of people had no share in the oil wealth, and outbursts of political, religious and ethnic violence were regular occurrences, making democracy and the rule of law little more than a joke. It was high time for an independent evaluation to throw light on the background to, and nature and consequences of the biggest debt cancellation deal ever made, barring the one with Iraq in 2004.

The four most urgent questions were as follows. What were the reasons for the deal? Was agreeing it the right decision? Did it have to cost so much? And last but not least, what were the results?

A team of independent evaluators first turned these questions into almost 30 sub-questions, which they answered with great expertise. The answers are included in this report. Reality is rarely totally straightforward. One thing is clear, however: both parties benefited by the deal. Nigeria – the second biggest economy in Sub-Saharan African – saw its foreign debt virtually disappear, while the creditor nations got back more than they expected. The evaluation clearly shows how this worked.

Were there no losers? Some people say there were. The debt cancellation was reported as Official Development Assistance. In some countries, however, it was not regarded as

expenditure over and above the existing budget, raising their ODA performance, but as an item on the development cooperation budget. Funds originally intended for other development-related expenditure had therefore to be used to cancel what amounted mainly to export credits which, in all probability, also benefited both parties when they were first agreed.

The evaluation team's analysis is firmly based on the intervention theory underpinning the phenomenon of debt relief, and the underlying mechanisms are fairly technical. Besides the main report, which contains an excellent Glossary, we have therefore opted to present two summaries. This summary was written by the evaluators and is mainly of interest to specialists. The second summary is more accessible to a wider group of interested readers. It does not contain technical analyses or go into detail, but gives a clear account of the main findings and conclusions of the joint evaluation, and lessons learned. This specialist summary is available in English, French and Dutch, the general summary in French and Dutch.

Readers will thus find much to interest them. The main report comprises the full text, including annexes and an Executive Summary. The enclosed CD-Rom contains not only the full report, but also an interesting paper providing background information on Nigeria. It was specially written for readers with little knowledge of this West African country by Dr Bukola Adeyemi Oyeniyi of the Faculty of History and International Relations at the Joseph Ayo Babalola University, Ikeji Arekeji, Osun State, Nigeria.

The documents are available on the Internet, on <http://diplomatie.belgium.be/en> and <http://www.minbuza.nl/en>.

We would like to thank everyone who contributed to this evaluation as a respondent. Their names are listed in Annex 3 of the main report. We are also very grateful to the Abuja Advisory Group and the European Reference Group for their constructive ideas and useful comments on the draft reports.

The evaluators are responsible for the contents of this report. The Special Evaluation Office of International Cooperation and the Policy and Operations Evaluation Department guarantee the quality of the evaluation.

The purpose of evaluations is to render account and to learn lessons for the future. We hope you enjoy reading this report.

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*Ministry of Foreign Affairs*

## Authors' preface

The main report of the evaluation is the product of team work. The authors are grateful to team members Kenneth Chukwuemeka and Adewumi Olajide Ogunsola for their inspiring ideas and for their important support in collecting and processing information before and during the field visits in Nigeria. We also would like to thank all stakeholders interviewed in Nigeria, Brussels, The Hague, and Washington DC, for their time and for generously sharing their information. We are also very grateful to everyone else, in particular from the Abuja Advisory Group, the European Reference Group and the Evaluation Steering and Management Group for their constructive ideas and helpful comments on our presentations and subsequent draft reports. We also thank Ed Humphrey of Oxford Policy Management (OPM), Albert de Groot of ECORYS and Daniel Rogger, our internal peer reviewer, for their many useful comments at the different phases of this report. In Nigeria, Mariam Obia Chukwuemeka was a great help in organising the logistics of the field work. In Europe student assistants Luuk de Blok, Bianca Huizer and José Nederhand contributed to the realisation of this evaluation report. We are deeply grateful to everyone.

The final responsibility for the content of the report rests with the authors.

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Mutual interests – mutual benefits

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Chronology of key events in the history of Nigeria



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Map 1 Africa and Nigeria

## Chronology of key events in the history of Nigeria

### *Pre-colonial period*

<b>Circa 500 BC onwards</b>	First Nok settlements (earliest iron-using culture).
<b>Circa 11th century onwards</b>	Kingdoms and city-states established.
<b>16th to 18th century</b>	Transatlantic slave trade.
<b>Early 19th century</b>	Islamic Fulani empire founded.
<b>Circa 1850</b>	British establish a presence around Lagos.
<b>Second half of 19th century</b>	Christian missionaries active in the south.

### *Colonial period*

<b>1903 onwards</b>	Great Britain controls south and north of country through local leaders ('indirect rule').
<b>1914</b>	Great Britain unites northern and southern regions as one colony.
<b>1958</b>	Shell starts oil production in the Niger delta.

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### *Independence*

<b>1960</b>	Nigeria gains its independence.
<b>1962-1963</b>	Controversial censuses fuel religious and ethnic tensions.

### *Military rule*

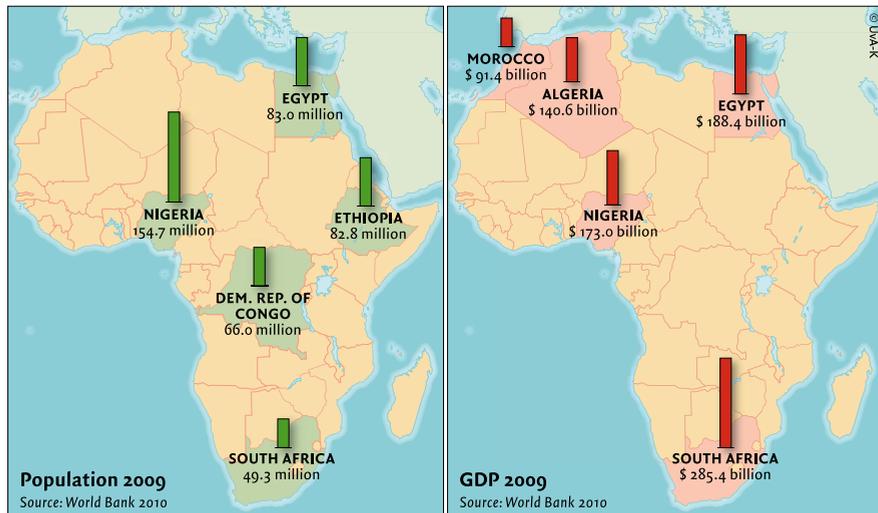
<b>1966</b>	Military coup, followed by counter-coup.
<b>1967-1970</b>	Failed attempt by three southeastern states to establish the Republic of Biafra. Civil war results in an estimated one million deaths.
<b>1970s</b>	Oil production soars.
<b>1976</b>	General Olusegun Obasanjo becomes head of state and promises democratic elections.
<b>1979-1983</b>	Temporary interruption of military rule. Civilian government under President Shehu Shagari.
<b>1983</b>	Military coup. General Muhammad Buhari becomes head of state.
<b>1985</b>	General Ibrahim Babangida seizes power.

- 1993** Babangida is forced to hand over power after annulling elections. Ernest Shonekan heads an interim government, but is then forced out by General Sani Abacha.
- 1995** Execution of Ken Saro-Wiwa and eight other activists who campaigned against the oil industry in Ogoniland. EU sanctions follow, and Nigeria is suspended from the Commonwealth.
- 1998** Abacha dies and is succeeded by General Abdulsalam Abubakar. Nigeria's suspension from Commonwealth and the EU sanctions are lifted.

*Civilian rule*

- 1999** Olusegun Obasanjo becomes president following democratic elections.
- 2000** Introduction of Sharia law begins in northern states. Hundreds die in ensuing violence between Christians and Muslims.
- 2001** Thousands of people are displaced as a result of ethnic conflict in Benue state.
- 2003** Obasanjo is elected for second term following disputed elections.
- 2004** State of emergency in Plateau state after violence between Christians and Muslims.
- 2005** Paris Club and Nigeria sign debt relief agreement.
- 2007** Umaru Yar'Adua is elected president in April.
- 2008** Oil prices rise, driven partly by violence involving militant groups in the Niger delta.
- In November at least two hundred people die in violence between Christians and Muslims in the city of Jos, Plateau State.
- 2009** In July Islamist movement Boko Haram tries to impose Sharia law on entire country through campaign of violence. Hundreds die in northeastern Nigeria.
- 2010** In January and March at least 269 deaths in violence between Christians and Muslims in Jos.
- President Yar'Adua dies in May after long illness. Vice- president Goodluck Jonathan succeeds him. Presidential elections planned for April 2011.
- In December thirty die in Plateau State in Christmas Eve bomb attacks.

Map 2 The 36 States of the Federal Republic of Nigeria



Map 3 Africa's Top-5: Population and GDP

## List of Abbreviations

CBN	Central Bank of Nigeria
CGD	Center for Global Development (Washington)
CGS	Conditional Grant Scheme
COPE	Care of The People
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
CWIQ	Core Welfare Indicators Questionnaire
DAC	Development Assistance Committee (of OECD)
DMO	Debt Management Office
DSA	Debt Sustainability Analysis
ECA	Excess Crude Account
EFCC	Economic and Financial Crimes Commission
EITI	Extractive Industries Transparency Initiative
ESMG	Evaluation Steering and Management Group
FDI	Foreign Direct Investment
GDF	Global Development Finance (WB database)
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
ICPC	Independent Corruption Practices Commission
IDA	International Development Association
IMF	International Monetary Fund
IOB	Policy and Operations Evaluation Department (Inspectie Ontwikkelingssamenwerking en Beleidsevaluatie) , Ministry of Foreign Affairs (The Netherlands)
IPPIS	Integrated Personnel and Payroll Information System
I-PRSP	Interim Poverty Reduction Strategy Paper
MDAs	Ministries, Departments and Agencies
MDG	Millennium Development Goal
M&E	Monitoring and Evaluation
MTEF	Medium Term Expenditure Framework
N	Naira
NAPEP	National Poverty Eradication Programme
NBS	National Bureau of Statistics
NEEDS	National Economic Empowerment and Development Strategy
NGO	Non Governmental Organisation
NIPC	Nigeria Investment Promotion Commission
NISER	Nigerian Institute of Social and Economic Research
NPV	Net Present Value
OAGF	Office of the Accountant General to the Federation
ODA	Official Development Assistance
OPEN	Overview of Public Expenditure of NEEDS
OSSAP	Office of the Senior Special Assistant to the President
PFM	Public Finance Management

## Mutual interests – mutual benefits

PHC	Primary Health Care
PRSP	Poverty Reduction Strategy Paper
PSI	Policy Support Instrument
SEEDS	States Economic Empowerment and Development Strategy
SEO	Special Evaluation Office of International Cooperation, FPS Foreign Affairs, Foreign Trade and Development Cooperation (Belgium)
SMP	Staff Monitored Programme
TI	Transparency International
UK	United Kingdom
US	United States
VPF	Virtual Poverty Fund

1

# Introduction

## 1.1 Objective of the evaluation

The aim of the evaluation is two-fold; first, to account for US\$ 18 billion of ODA funds (Official Development Assistance) registered as debt cancellation to Nigeria<sup>1</sup> and for the payment of around US\$ 12 billion by Nigeria to its creditors. Second, to learn lessons from this debt relief experience and all its components, including the agreement itself between the Paris Club creditors and Nigeria, and the conditions that were attached to the agreement. Although this evaluation is undertaken by the Dutch and Belgian evaluation departments, it is expected that the results will be relevant for Nigeria and for the thirteen other creditors involved in the operation, as well as for a broader audience of academics and policy makers. As it is impossible to separate the effect of debt relief supplied by Belgium and the Netherlands from the other 13 Paris Club members, we analyse the impact of the full Paris Club operation.

A total of 6 main evaluation questions and 29 specific evaluation questions were formulated on context and background, inputs, outputs, outcomes, impact, sustainability and lessons learnt. The six main evaluation questions are:

1. What political, economic and institutional developments led to the comprehensive debt deal?
2. Did the debt deal result in or lead to a sustainable debt?
3. What role did the conditionalities play which accompanied the debt agreement?
4. How effective was the Virtual Poverty Fund?
5. How sustainable are the outcomes?
6. What lessons can be drawn regarding the validity and appropriateness of the intervention theory underlying debt relief as a means to contribute to economic growth and poverty alleviation?

<sup>1</sup> According to DAC criteria (Development Assistance Committee), the cancellation of export credit loans is classified as ODA, while cancellation of aid loans is not, because aid loans have already been counted as ODA when they were disbursed. Export credit loans constituted almost 98 per cent of the total cancellation, see section 3.3.1 of main report.

# 2

## Evaluation methodology, approach, and organisation

## 2.1 Methodology

For this evaluation a *logical framework* has been developed. The intervention theory behind this logical framework is that debt relief may have a positive effect on economic growth, which can occur via three possible channels:

- A stock channel: Via a decrease of the size of the outstanding debt (the debt stock), which may lead to a reduction of the debt overhang. The absence of a high debt stock that burdens the future may lead to renewed access to international private capital, and thus increases in investments, and to improved policies;
- A flow channel: Via a reduction of the debt service. Lower debt service payments may lead to more resources available for imports (effect on balance of payments) and create fiscal space for public investment in physical and social infrastructure (effect on fiscal accounts), leading to improved service delivery;
- The conditionality channel: Via the reform conditions attached to debt relief, which may lead to policy improvements; provided the right conditions have been selected, these conditions may stimulate economic growth and poverty reduction via, for instance, increased public investment and social spending.

The three channels can be categorised as follows, in inputs, outputs and outcome:

	<b>Stock channel</b>	<b>Flow channel</b>	<b>Conditionality channel</b>
Input	The debt relief deal: payment up-front, cancellation and buy-back		Conditions for policies and governance
Output	Debt reduction	Lower debt service, increased government spending, for investment and MDGs	Changes in policies and governance
Outcome	<ul style="list-style-type: none"> <li>• Higher inflows of private capital</li> <li>• Increased private investment</li> <li>• Better policies</li> </ul>	Better quality of, and more access to, public services	<ul style="list-style-type: none"> <li>• Improved investment climate, leading to higher private investment</li> <li>• More and better service delivery</li> </ul>
Impact	Economic growth and poverty reduction		

## 2.2 Approach

The evaluation comprised two main phases; a desk study phase and a field study phase. During the desk study phase, interviews were held in Brussels, The Hague, and Washington. The field study phase comprised two visits to Nigeria. In the first visit to Nigeria, the team spent two weeks in Abuja, the federal capital, from 2-14 August 2010. In this period, the team carried out interviews with a range of stakeholders from government agencies, Non Governmental Organisations (NGOs) and representatives of development agencies and the private sector. Between 15 and 20 August, three team members visited two states, Kano and Cross River state, in order to analyse the possible impact of the debt deal at state level on government expenditure and poverty reduction (in the context of the Virtual Poverty Fund), public finance management (PFM), and debt management. The visits are not meant to validate findings at the federal level, but merely serve as illustrations of how the debt deal was perceived at state level and whether the two states visited identified any direct impact of the debt deal.

## 2.3 Organisation

This evaluation was prepared, commissioned and steered by the evaluation departments of the Belgian and Dutch Ministries of Foreign Affairs, the Special Evaluation Office of International Cooperation (SEO, Belgium), and the Policy and Operations Evaluation Department (IOB, the Netherlands). IOB was the lead agency for this joint evaluation. The Evaluation Steering and Management Group (ESMG) prepared the Terms of Reference and provided comments on all draft reports.<sup>2</sup>

External quality control of this evaluation was provided in the form of two review panels, one in Abuja (Abuja Advisory Group) and one in The Hague (European Reference Group). The review panels were also important to raise the sense of ownership among relevant policymakers in Nigeria and in the involved creditor countries, Belgium and the Netherlands. The Intermediate Report of this evaluation was discussed in the European Reference Group in June 2010 and in the Abuja Advisory Group in August 2010, on the first day of the field work. At the end of the three weeks of field work, the evaluation team met with the Abuja Advisory Group to present and discuss the preliminary findings, again leading to helpful comments.

The first draft of the final report was discussed with the Abuja Advisory Group on 2 November 2010. A revised draft final report was submitted for comments to the Abuja Advisory Group (by e-mail) and on 1 December discussed with the European Reference Group. A third draft of the final report was submitted to the European Reference Group in late December (by e-mail). Many useful comments and suggestions were received. The definitive version was submitted to the Evaluation Steering and Management Group in January 2011.

<sup>2</sup> The ESGM had developed an Approach Paper that was discussed with stakeholders in Nigeria. The resulting draft Terms of Reference was submitted to key stakeholders in Nigeria before being finalised in the official Terms of Reference of the joint evaluation.

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## Context and background

### 3.1 Introduction

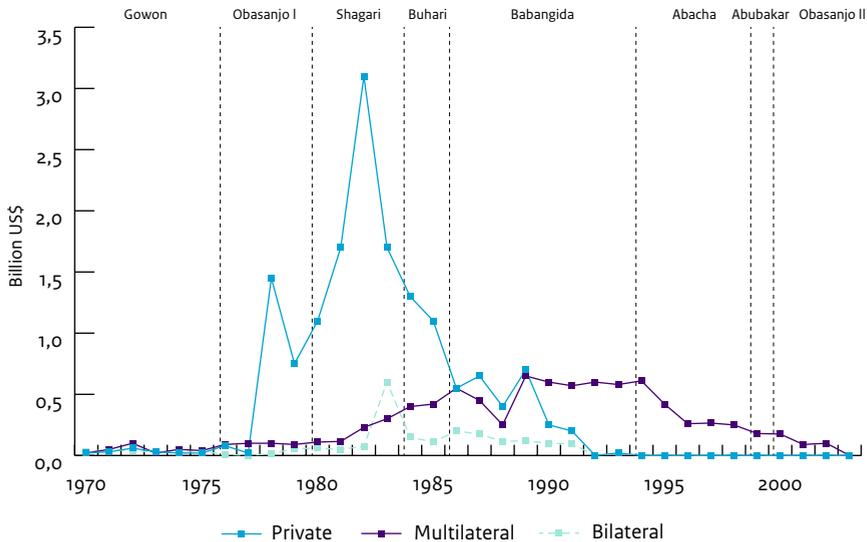
The evaluation questions related to context and background are listed in the box text below.

#### Evaluation Questions: context and background

1. What was the origin and nature of the sovereign debt problem in Nigeria and was the debt unsustainable before the debt relief operation?
2. What was the Nigerian debt policy, in particular its debt management policy?

### 3.2 Origin and nature of Nigeria's debt

The origin of Nigeria's sovereign debt problem lies in the late 1970s, during the first presidency of (then) Lieutenant-General Obasanjo (1976-1979), see Figure 1. The debt started to increase significantly from the early 1980s, under the presidency of Shehu Shagari, elected in 1979. When interest rates rose and oil prices fell in the beginning of the 1980s, production and consumption patterns that emerged during the oil boom were not addressed. The federal and state governments embarked upon massive external borrowing from the international capital market. This extensive borrowing continued under the military regime of Major-General Muhammad Buhari (Figure 1) who took over power in mid-1983. The debt became unsustainable in the mid-1980s. The borrowing included commercial bank loans, short term insured and uninsured trade credits and longer term officially supported export credits. The overvaluation of the exchange rate not only stimulated excessive imports but also led to over-invoicing of imports and under-invoicing of exports, provoking capital flight. The borrowed funds were often invested on projects which did not give reasonable rates of return, while the Letter of Credit for imports of consumer goods were often given for non-existent imports - leading to capital flight. Furthermore, Nigeria did not service its debt fully which led, through accumulation of arrears, to an even higher debt.

**Figure 1** Loan disbursements under different political leaders, in US\$ billion, 1970-2002

Source: Figures from Worldbank, GDF; presidential periods added as in “Double Standards, Debt Treatment, and World Bank Classification: The Case of Nigeria,” Working Paper 45, Centre for Global Development (CGD), September 1, 2004, page 30.

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### 3.3 Debt policy

The history of Nigeria’s debt prior to 2005 can be divided into five phases. In the first phase, including 1970s and up until 1982, debt service was not a major concern of the government. The high external borrowing in late 1970s and early 1980s did not raise any concerns at that time because oil prices were high and therefore revenues were high enough to pay the debt service.

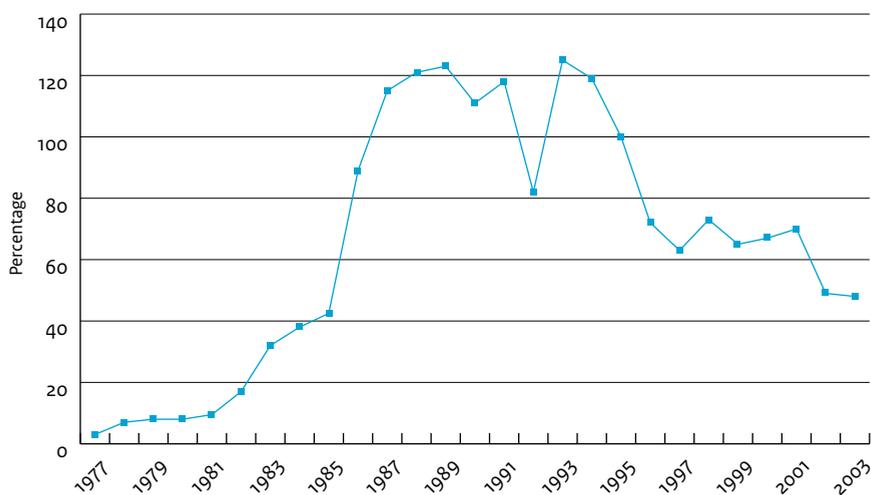
The second phase, from 1982 to 1986, was one of increasing debt service but with continued access to foreign borrowing. When oil prices fell and market interest rates rose, debt service payments became a major expenditure. By 1985, the ratio of external debt service to exports had increased significantly to around 30 per cent. In 1986, the ratio of external debt to GDP (Gross Domestic Product) was 89 per cent, while it climbed to about 120 per cent in the years after 1986 (see Figure 2).

The third period started in 1986 when access to new credit lines was refused and the government considered restructuring its bilateral debt. General Babangida who had seized power in 1985 began to negotiate for a Paris Club rescheduling in 1986. The creditor governments agreed to reschedule more than US\$ 7 billion of medium and long term debt in arrears at the time of the negotiations and falling due over the coming year.

Accompanying this debt rescheduling was the implementation of an International Monetary Fund (IMF) adjustment programme, which did not receive much support from the Nigerian public. The depreciation of the Naira made debt payments of external debt more expensive in local currency.

The country’s continued inability to service its debt caused Nigeria to revisit the Paris Club in 1989 and 1991. Nigeria rescheduled another US\$ 6 billion, including arrears, with the Paris Club in 1989 and a further US\$ 3 billion in 1991. All agreements were accompanied by IMF Standby arrangements, but these programmes frequently went off-track. Nigeria never actually drew on IMF resources but needed the IMF arrangement to monitor and endorse its policies, as this was a condition for Paris Club rescheduling. Nigeria also went to the London Club to reschedule commercial bank debt in 1987 and 1989.

**Figure 2** Ratio of external public and publicly guaranteed debt to GDP, in %, 1977-2004



Source: Own calculations based on WDI, DMO reports and NBS.

The fourth phase in Nigeria's debt began in 1992 and lasted until 1999. In this period, the relations between Nigeria and its different creditors began to diverge. In January 1992, Nigeria managed to agree on a Brady deal. This resulted in US\$ 5.6 billion in commercial debt being converted into US\$ 2.1 billion of new bonds, a discount of 62 per cent (Rieffel, 2005). After this reduction, Nigeria was able to service these debts to private creditors. The commercial debt stock gradually diminished as private creditors did not provide new loans to Nigeria.

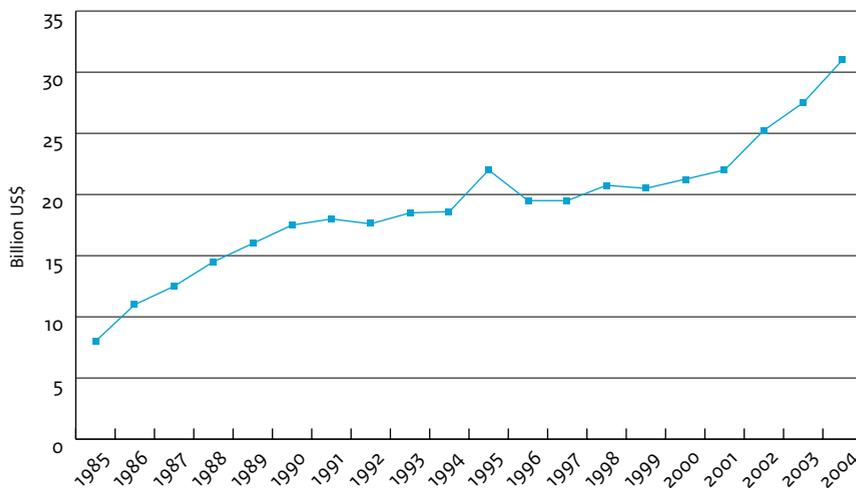
In 1992, it was expected that the Paris Club creditors would offer a similar reduction percentage on the bilateral debt as in the Brady deal for commercial debt. However, the Paris Club refused to offer debt reduction to Nigeria. One reason was that Nigeria was off track with the 1991 IMF programme. Another reason was that the concessional rescheduling (Toronto, London and later Naples terms) were only open for IDA-only countries. Nigeria was not classified as such, having become a 'blend' country (eligible for both IDA and International Bank for Reconstruction and Development (IBRD) borrowings) in 1989.

In the expectation of a concessional debt reduction, Nigeria started to limit payments to Paris Club creditors to no more than 30 per cent of oil revenues (Budina et al., 2007). This led to huge arrears accumulation during the 1990s, especially when oil prices were low in 1994 and 1995. Nigeria also started to discriminate among its Paris Club creditors from 1992 onwards, paying some more than others. The increase in bilateral debt after 1992 was also partly the result of new lending by Paris Club creditors, 60 per cent of which was from Japan.

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The fifth phase was between 1999 and 2005, covering the first and part of the second term of elected president Olusegun Obasanjo. In this period, the government took the decision to work towards debt reduction from the Paris Club (further elaborated upon in section 3.2 of the main report). In 2000, Nigeria entered into an IMF Standby arrangement, followed by a fourth Paris Club rescheduling. Though some debt service payments were made, arrears continued to accrue and by the end of 2004, Nigeria's external debt had reached approximately US\$ 34 billion, of which Paris Club debt was around US\$ 30 billion (see Figure 3).

**Figure 3** Nigeria's debt to creditor countries of the Paris Club, in US\$ billion, 1985-2004



Source: CBN Statistical Bulletin 2003, 2004, 2005.

Before 2000 there was a severe lack of coordination in loan contracting and registration and debt management was weak. Every senior official at federal and states and local government level was authorised to borrow and there was very little oversight on the uses of the loans. Debt recording was scattered among various institutions so that there was no accurate record of the size of the debt stock.

### 3.4 Debt sustainability

At the end of 2004 most debt sustainability ratios were at a sustainable level, to a large extent due to a rising oil price from 2002 onward. The only ratio that was marginally unsustainable was the relation between NPV debt to GDP, which was just above 40 per cent. The debt sustainability analysis carried out by the IMF in early 2005 concluded that the external debt was sustainable, but made the comment that it could become unsustainable under a scenario in which the oil price fell by more than one standard deviation. However, within Nigeria it was broadly felt in parliament, labor unions and in the media that these debts should not be paid or not paid in full. The reasons include that the country had already paid back the original loan amounts, and that most of the debt consisted of arrears built up under dictators. Therefore, although on the basis of most debt sustainability ratios the debt could be judged *economically sustainable* in 2005, the debt could be considered *politically unsustainable*.

4

Inputs

## 4.1 Introduction

The evaluation questions related to inputs are listed in the box text below.

### Evaluation questions: Inputs

3. How was the debt relief operation designed and what were its conditions?
4. Who were the main actors in Nigeria in the debt relief deal and what role did they play?
5. What goals did the government of Nigeria pursue by concluding the debt deal? To what extent were the deal and its conditions 'owned'?
6. What goals did the Paris Club countries pursue by concluding the debt deal?
7. How did the Nigerian debt relief deal and its conditions fit in Belgian and Dutch international cooperation and debt relief policies?
8. How did the Nigerian debt relief deal fit in international debt relief policies of Paris Club members and of the Bretton Woods Institutions, in particular how did it relate to the enhanced HIPC (Highly Indebted Poor Countries) initiative?

## 4.2 Design debt relief

The Paris Club creditors made it clear that a debt reduction would only be considered if Nigeria had put its 'house in order'. This implied, among other things, reconciling the debt figures with all creditors, carrying out responsible macroeconomic policies, improving public finance management (PFM), and reducing corruption. These conditions had to be met before a debt relief agreement would be agreed.

The debt relief agreement in 2005 involved the full US\$ 30.4 billion of Paris Club debt (see Table 2). Nigeria was expected to pay US\$ 12.4 billion, while the creditors would cancel US\$ 18 billion, implying an overall debt reduction of about 60 per cent. In the first phase, Nigeria paid all arrears to Paris Club members and the so-called 'levelling up'. The creditors then cancelled 33 per cent of the remaining debt. In the second phase, the creditors cancelled 34 per cent of the debt after Nigeria had paid debt service on all post cut off date debts and an amount for the buy-back of the debt remaining after the two cancellations; the discount on the buy-back was around 35 per cent.

	Debt	Relief	Payment
Debt stock	30.4		
Payments of arrears and levelling up			6.3
Remaining debt	24.1		
First cancellation of 33% (of remaining debt)		8.0	
Payment of post cut off date debt and payment of buy-back			6.1
Second cancellation 34%		8.0	
Discount of buy-back (around 35%)		2.0	
Remaining debt	0		

The debt relief agreement stressed that the Nigerian government should continue and fully implement the reform programme as set out in the Policy Support Instrument (PSI) agreed with the IMF, especially focussing on strengthening the economy, improving of PFM, and fighting poverty. The latter implied the tracking of MDG-related (Millennium Development Goals related) expenditure and the setting up of a Virtual Poverty Fund (VPF) to use the annual savings in debt service.

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The reform programme is set out in the Letter of Intent of the PSI, which includes (IMF, 2005c):

1. Quantitative assessment criteria and (for later periods) indicative targets;
2. Structural assessment criteria; and
3. Structural benchmarks.

Quantitative assessment criteria include targets for the federal government non-oil primary balance, for reserve money, for the stock of net foreign assets, for non-concessional external debt (zero) and for external arrears (zero). The structural assessment criteria refer to financial sector reform, trade, transparency of the oil sector, and to market regulation of utilities. Within the structural benchmarks, the focus was on PFM, privatisation and market regulation, and financial sector reform. One of the structural benchmarks was the gradual introduction of an expenditure tracking system within the Medium Term Expenditure Framework (MTEF) for six MDG-related sectors: health, education, water, agriculture, power and roads. This would be applied in the budget and in the Chart of Accounts.

The second phase of the debt cancellation was contingent upon approval by the IMF of the first review of the PSI. The PSI was a two-year programme and included four reviews.

### 4.3 Main actors: Nigeria

For President Obasanjo, in office between 1999 and 2007, achieving debt relief was one of his main objectives. After his re-election in 2003, he installed a new economic management team and debt relief was a primary aim for this team. Main agencies involved in the negotiations were the Ministry of Finance (Minister Ms Ngozi Okonjo-Iweala who also led the economic management team), the Debt Management Office (Mansur Muhtar, Director General of DMO) and the Central Bank of Nigeria (Professor Charles Soludo, Governor).

### 4.4 Objectives of Nigeria and ownership

The Nigerian government wanted to achieve a comprehensive debt deal with the Paris Club because it considered the debt neither economically nor politically sustainable. Also it wished to free resources for expenditure on the MDGs. There existed a strong repudiation movement within Nigerian civil society, parliament and the public at large, but going along with this was not an option as the government wanted to maintain and improve relationships with the western world. The government therefore preferred an orderly settlement of the debt in cooperation with the creditors, but this settlement needed to include a significant debt reduction. Especially from 2003 onwards, the government carried out substantial policy reforms, including the oil price based fiscal rule which had led to substantial savings on the Excess Crude Account (ECA). These savings, combined with a still rising oil price in 2005, induced the government to consider a buy-back modality for the debt relief deal.

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The conditions of the PSI were fully based on NEEDS 2004-2007 (National Economic Empowerment and Development Strategy), the government's own policy reform programme. NEEDS can be seen as a document consolidating the reforms that were being implemented by the new economic management team that started in 2003. It can also be regarded as a follow up reform programme of the Interim-PRSP (Poverty Reduction Strategy Paper). NEEDS focused on four areas (Okonjo-Iweala and Osafo-Kwaako, 2007):

1. Improving macroeconomic environment;
2. Structural reforms;
3. Strengthening PFM;
4. Implementing institutional and governance reforms.

The development of NEEDS at federal level was complemented by State Economic Empowerment and Development Strategies (SEEDS).

Therefore the PSI reforms reflected a high degree of ownership by the Nigerian government. The value added of the PSI, relative to NEEDS, was that the PSI gave more specific quantitative targets and more exact timelines to the policies the government intended to implement.

## 4.5 Objectives of the Paris Club

The main motivations for the creditors to engage in the debt deal included:

- Strategic interests: Nigeria is a large and important West African country that plays a role in the stabilisation of the region and in the fight against terrorism. This motivation held in particular for the US;
- Oil security: a favourable debt treatment would help secure the flow of oil to the US and other countries in the West;
- Financial interests: creditors received an immediate payment of 40 per cent of the debt outstanding which was potentially more than they would have received in the immediate future in the absence of the deal;
- Long-term economic interests: by allowing this comprehensive exit strategy, Nigeria would become creditworthy again, allowing for expansion of trade with and investment in the country in general;
- Humanitarian interests: the deal would help Nigeria to reduce poverty and achieve the MDGs;
- 'Reputational' interests: the deal inflated ODA figures without disbursing fresh money; this held in particular for donors with no fixed ODA budget such as the United Kingdom (UK) and Germany.

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## 4.6 Dutch and Belgian policies

The Nigerian debt to the Netherlands amounted to about € 1.3 billion and to Belgium about € 470 million. The Netherlands was the 6<sup>th</sup> most important creditor to Nigeria. Both Belgium and the Netherlands were initially not in favour of a debt cancellation, because they considered the Nigerian external debt to be sustainable. Dutch and Belgian policy makers felt under pressure to agree with the G8-decision that was made early June, 2005; they had to agree because the Paris Club operates by consensus and the Club is considered to be an important institution for settling international debt positions.

The Netherlands was more active in its protest in the Paris Club. In addition, the Netherlands tried to influence the conditions of the deal; in line with the earlier Dutch attempts to influence the contents of the HIPC (Highly Indebted Poor Countries) initiative, Dutch policymakers stressed the importance of the PSI and of ensuring that freed resources would be used for poverty reduction.

Financial interests were to some extent important for both countries and were used to defend the deal in the Dutch parliament. The other official motivation for the Dutch government was humanitarian; the deal was expected to lead to higher social spending via the establishment of the Virtual Poverty Fund from the debt relief savings. For Belgium the reputational interests played a role as all money involved in the cancellation and buy-back was registered as ODA and led to an increase in the ODA figures.

After the Paris Club meeting in 2005, Belgium cancelled € 270 million (in total) out of the € 470 million of claims on Nigeria, which were then accounted for as ODA. The Netherlands cancelled € 731 million (in total) out of the € 1.3 billion of the claims on Nigeria, of which around € 622 million was accounted for as ODA. The Netherlands did not classify the discount on the debt buy-back (around € 110 million) as ODA. For the Netherlands, with a fixed ODA budget in per cent of GDP, the deal reduced other aid flows to developing countries in the years 2005-2007. However, the consequences for existing programmes were limited due to higher GDP growth than expected in this period and to the fact that the discount on the buy-back was not registered as ODA.

## 4.7 Comparison with international debt relief policies

The Paris Club agreement with Nigeria eliminated the debt fully. Another special feature of the agreement was the debt buy-back. Furthermore, the role of the IMF was different from other debt deals. The IMF did not need to assess the payment capacity of Nigeria in order to establish the degree of concessionality of the rescheduling or forgiveness. In addition, Nigeria was the first country for which a Paris Club agreement was accompanied by a PSI.

A difference with the HIPC initiative is that this deal only concerned the bilateral Paris Club debt while HIPC involves debt to all creditors. In addition, the overall debt reduction was not based on Nigeria's capacity to pay and was lower than in most HIPC cases. Furthermore, the deal with Nigeria was a full stock treatment. Nigeria had to pay a large amount up front but received an even larger immediate cancellation of the (full) debt stock with the Paris Club. Finally, the conditionality was different. There was extensive 'informal' conditionality before any debt reduction would be considered, and there was no requirement to elaborate and implement a Poverty Reduction Strategy Paper (PRSP). The requirements of having an IMF programme and being on track with that programme for at least six months (the first review) is similar to the condition for reaching the HIPC Completion Point.

5

Outputs

## 5.1 Introduction

The evaluation questions related to outputs are listed in the box text below.

### Evaluation questions: Outputs

9. What is the counterfactual for the flow and stock effect? Would debts have been serviced? Would ODA from the 15 creditors have been higher in absence of the debt relief operation?
10. What was the effect of the debt relief operation on debt stock and on debt service, both for federal and for state governments?
11. What was the effect of the debt relief operation on the balance of payments (in particular imports, exports, reserves)?
12. What was the effect of the debt relief operation on federal government and state government public finance accounts? (deficit, revenue and expenditure, composition of expenditure (investment-recurrent, spending by sector), financing of eventual deficit)?
13. What was the effect on MDG-related expenditure in the six sectors (health, education, water, power, roads, and agriculture), both in and outside of the VPF; and both at federal and at state level?
14. What changes in macroeconomic policies, public sector reform, debt management, anti-corruption policies and poverty reduction policies occurred in anticipation of a possible debt deal?
15. Were the conditions in the PSI with respect to macroeconomic policies, public sector reform, anti-corruption policies and poverty reduction policies implemented?
16. Did debt management improve, both at federal government level (Debt Management Office, DMO) and at state government level? Have other institutions played a role in improving debt management?

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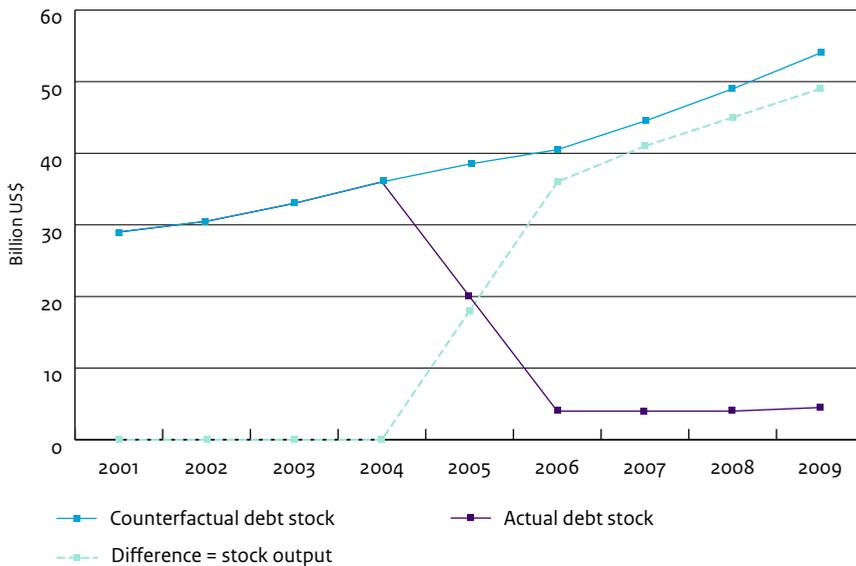
## 5.2 Counterfactual scenario debt relief

In the absence of the 2005 debt deal, Nigeria would have partially serviced its debt to the Paris Club creditors. The most likely counterfactual scenario would have been a debt service of about US\$ 1 billion annually, in line with what Nigeria was paying in 2003-2004. The US\$ 1 billion debt service paid to the Paris Club was about one-third of the annual debt service due in the years 2003 and 2004, and for this reason arrears accumulated and the Paris Club debt stock continued to increase between 2002 and 2004. Assuming that debt service *due* would remain at a level of US\$ 3 billion during the years 2005-2009, the arrears would have continued to increase *at the same pace*<sup>3</sup> as during 2003-2004 and so would have the Paris Club

<sup>3</sup> The annual increase in arrears not only consists of the US\$ 2 billion not paid, but also of interest payments and penalty interest payments on current and previous debt service not paid, resulting in an annually increasing arrears accumulation.

debt stock. Under this scenario, Nigeria's external debt stock would have increased from US\$ 36 billion in 2004 to US\$ 54 billion in 2009 (see Figure 4). Compared to an actual external debt stock of US\$ 4 billion in 2009, the counterfactual *stock effect* by end 2009 is US\$ 50 billion. Because it is likely that debt service *due* would also have increased as a result of the arrears accumulation, this is a conservative estimate of the counterfactual debt stock and the stock effect.

**Figure 4** Actual total external debt, counterfactual external debt and stock output of debt deal, in US\$ billion



Source: Table 4.3 of main report

Under the assumption of a counterfactual debt service payment of about US\$ 1 billion a year, and given that Nigeria had to pay around US\$ 12 billion as part of the agreement, the *flow effect* is negative up to 2019. Aid flows were not reduced as a result of the debt deal, so the flow effect was not further impacted by reduced aid flows.

## 5.3 Policy reform before and after the debt deal

### 5.3.1 Actual policy reforms

Policy reform in Nigeria can be divided into four periods:

- The period 1999-2003; initiating the reform agenda
- The period 2003-2005; expanding the reform agenda
- The period 2005-2007; reform continuation
- The period 2007 to date: reform consolidation and stagnation

In 1999, with the start of the democratic rule of the Obasanjo administration, an era of reforms was initiated. In his first term Obasanjo focused on consolidating democracy, but also started anti-corruption measures such as establishing the Independent Corruption Practices Commission (ICPC). Obasanjo's administration began implementing existing legislation which had not been implemented before. The Obasanjo administration resumed the dialogue with the IFIs and in January 1999 the IMF began a Staff Monitored Programme (SMP) which led to a Standby arrangement in August 2000. However, government expenditure increased way beyond the targets and this programme was 'off track' quickly. In 2002 the government presented an Interim PRSP (I-PRSP). In 2003 the government approved the law which founded the Economic and Financial Crimes Commission (EFCC) and the organisation started its activities.

In 2003, President Obasanjo appointed a new economic team that was very reform-minded. This team initiated NEEDS. The focus of reform was very much on macroeconomic stability. Important reforms initiated in this 2003-2005 period were:

- Fiscal policy (the introduction of an oil price based fiscal rule, see also section 5.4);
- PFM reforms (making transfers more transparent, improving cash management, introduction MTEF (Medium Term Expenditure Framework), extending the due process in procurement to all ministries and parastatals;
- Implementation of a disciplined monetary policy;
- Structural reforms focused on privatisation, civil service reform, banking sector reform, and trade policy reform;
- Governance reform (fighting corruption, EFCC, EITI (Extractive Industries Transparency Initiative)).

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The reforms in the period 2005-2007 were mostly reflected in the PSI, as the government of Nigeria used the PSI as a way to specify and set a concrete time frame for the reforms. The PSI reflected a strong focus on PFM reform in the period 2005-2007 with 8 structural assessment criteria and 9 structural benchmarks. Reforms focussed on:

- Improving transparency and accountability (publication of revenues to all three tiers of government, identifying MDG expenditure in budget classification, producing quarterly expenditure reports on VPF, auditing arrears, oil and gas sector auditing);
- Improving debt management (establish primary dealer structure);
- Expenditure control (introduction of the Integrated Personnel and Payroll Information System (IPPIS) database pensioners, settle contractor arrears);
- Improve revenue collection (automated tax collection, tax policy unit, custom service reform).

Furthermore, the government continued with its privatisation programme and organisational structures for the reforming ministries were reviewed and rationalised. Banking sector reform focused in the period 2005-2007 on improved banking supervision. Parliament approved the new Procurement Act (which is based on the due process mechanism) in 2006. However, Okonjo-Iweala & Osafo-Kwaako (2007) identified in 2007 that a substantial part of the reform agenda still needed to be implemented at state level. Gillies (2007) confirms this view. In 2009 the IMF also concluded that some economic reforms still had to be implemented at the state and local level, especially addressing PFM.

Most key stakeholders identified a slow down in reforms after 2007. This can be partly explained by the fact that reforms after 2007 were more focused on implementation of new laws and regulations. In addition, some Acts reached the point of roll out to the states (such as the Procurement Act and the Fiscal Responsibility Act). This is a slow process, as every state needs to assess the Acts, translate to their own specific circumstances and complete a political consultation process with state assemblies. Furthermore, a new government took office in 2007 with a less rigorous approach to reform. Although the new government was still committed to the reforms, fewer new initiatives could be identified, as well as a less rigorous approach to implementing existing reforms.

### 5.3.2 Effect of the debt deal on policy reform

The anticipation of the debt deal has had a moderate to strong effect on policy reforms carried out before 2005, and especially from 2003 onwards. After the change in government in 1999 some reforms would have been implemented anyway. However, the prospect of possible debt reduction gave political leverage to more controversial reforms such as macroeconomic policies (in particular the application of the oil price based fiscal rule), civil service reforms, privatisations, EITI, and the fight against corruption. The anticipation of a debt deal also helped achieve a stronger focus on spending for the MDGs and on poverty reduction policies (social safety net, human development). In the absence of the prospect of the debt deal, much lower savings would have accumulated in the ECA.

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In the period 2005-2007 the PSI helped to maintain prudent macroeconomic policies by setting specific quantitative targets with a clear timeline for foreign reserves and government expenditure. However, towards the end of the 2005-2007 period and especially before the 2007 elections, reform implementation became weaker. Although savings in the ECA continued to accumulate, the oil price based fiscal rule, and its accompanying ECA, were not followed as strictly as before. After 2007, some reforms continued but in other areas there was some backsliding.

## 5.4 Public finance

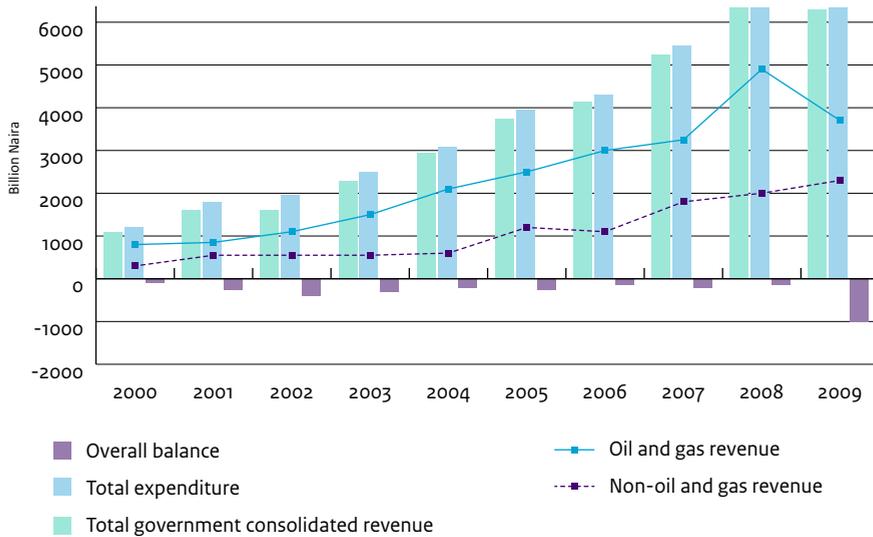
### 5.4.1 Actual developments in public finance

Figure 5 presents total government consolidated revenue, oil/gas and non-oil/gas, total expenditure and the overall balance for the period 2000-2009. In the period 2000-2009 total government consolidated revenue increased by a factor six in nominal terms. In the period 2002-2005 the revenue increase was already strong, mainly as a result of rising oil and gas revenues. Non-oil revenue also experienced substantial growth, especially in the period 2005-2009.

Total government expenditure also increased substantially. In 2004 Nigeria introduced the oil price based fiscal rule. The objective of this rule was to disconnect government revenues and expenditure by introducing more conservative oil prices on which the government budget is based. Initially the oil price based fiscal rule kept the government deficit under control. In 2009 the consequences of the global economic crisis became apparent in

Nigeria's budget. As a result of falling oil prices the overall balance moved to minus 995 billion N (equal to a deficit of approximately 6 per cent of non-oil GDP in 2009). For 2010, a minor deficit is expected.

**Figure 5** Consolidated government revenue, expenditure and overall balance, in billions of Naira, 2000-2009

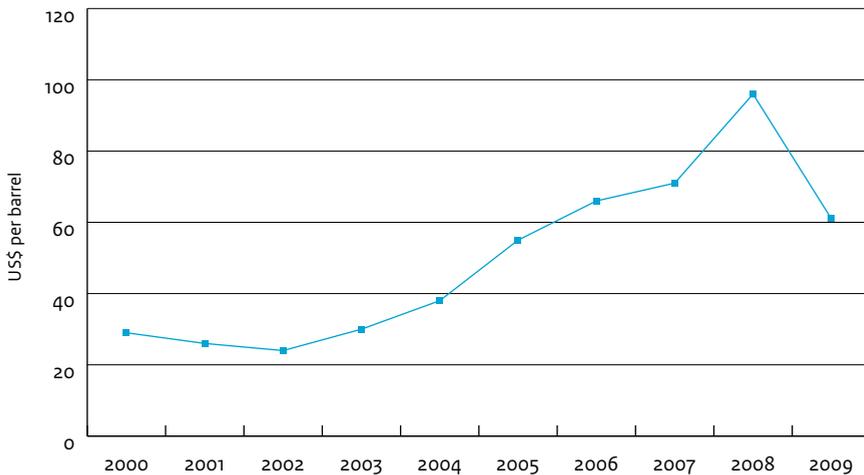


Source: CBN Annual reports 2009 (p. 233), 2007, 2004 (p. 128-134).

The increase in government expenditure over the period 2000-2009 is noticeable at the federal, state and local level. Up to 2008, a clear trend was observable in that state and local government were becoming more important for government spending relative to federal government expenditure. In 2000, state and local governments were responsible for 35 per cent of government expenditure, whereas by 2008 it had accumulated to 50 per cent. However, after 2008, it declined again to roughly 40 per cent of total expenditure.

The movement of the oil price has been crucial for the public finance position of Nigeria. During the period 2002-2008 the oil price had been on an increase, more than tripling its value. After 2008 this trend was abruptly reversed (see Figure 6).

**Figure 6** Average yearly oil price (Bonny light), per barrel, in US\$, 2000-2009



Source: CBN (oil price CBN Annual report 2008, CBN Statistical Bulletin 2004, figures 2009 based on internet data CBN website).

#### 5.4.2 Effect of the debt deal on public finance

The US\$ 12 billion paid in 2005 and 2006 by Nigeria to its creditors was paid from the ECA. The ECA is the account in which oil revenues over and above a prudent annual estimate are accumulated, through the application of the oil price based fiscal rule. This rule practically de-linked public expenditure from (oil driven) public revenues, by stating that government expenditure should be based on a prudent oil price benchmark. Key interviewees and the IMF (2009) stated that this may have been one of the most important macroeconomic reforms, and most interviewees emphasised that the anticipation of possible debt reduction gave the political leverage for it. The debt deal itself, through the PSI, contributed to continued implementation of the oil price based fiscal rule after 2005.

This rule contained expenditure growth in the context of an economic boom and kept the fiscal deficit under control. In addition, as a result of increasing oil prices to well above the conservative oil price used for the budget, substantial fiscal savings were achieved of up to US\$ 18.5 billion by 2005. In the absence of the anticipation of a debt deal, the savings in the ECA would have been much lower. For this reason, the US\$ 12 billion payment did not hamper government expenditure. Some important stakeholders indicated that if the Nigerian government had spent the US\$ 12 billion within a short period (2003-2005), the beneficial effects would have been limited and perhaps even zero or negative: for the overall stability of the economy it was better to save this money than to spend it in the short term. Although technically the flow effect on the fiscal accounts is negative, there has not been a

negative effect on the economy. In Nigeria the payment of the US\$ 12 billion is seen as a sunk cost or an investment that eliminated the debt stock and created annual debt relief savings of US\$ 1 billion from 2007 onward. However, in 2007 and 2008 this effect was not noticeable due to the continued sharp rise in the oil price. This changed in 2009, when government revenues were lower and the positive flow effect of the US\$ 1 billion debt relief savings was noticeable.

At state level the conclusion is different. The states' share in total Paris Club debt was around 25 per cent, so the states also had to pay 25 per cent of the US\$ 12 billion from their share of the ECA. The states with a higher share in the Paris Club debt than their share in the ECA had to make proportional compensation payments to states with lower debts. This means that these states experienced a negative flow effect from the debt deal, often phased over several years.

## 5.5 Effect of the debt deal on the balance of payments

The payment by Nigeria to its creditors of US\$ 12 billion coincided with a rising oil price and consequently a rapidly rising export income. The high export income led to an increase in savings on the ECA which is considered part of the gross official foreign reserves. These reserves were already at US\$ 17 billion in 2004, or six months of imports, and they increased further in the following years as a result of the rising oil price. Imports were therefore not constrained by these payments. In 2007 and 2008 the oil price continued to rise and export revenues were buoyant. In these years, export income was so high that the US\$ 1 billion in debt relief savings did not have any noticeable effect on import capacity. This changed in 2009, when exports declined from a high of US\$ 84 billion in 2008 to US\$ 46 billion, and the overall balance became negative. In 2009, we can conclude that a positive flow effect of the debt deal became noticeable.

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## 5.6 Debt management

### 5.6.1 Actual development of debt management

Prior to 1999, debt recording was poor with mostly inaccurate data and debt management functions were scattered among various agencies. This led to the setting up of the Debt Management Office (DMO) in 1999. Over the period 1999-2005, debt management improved substantially and the government's commitment to debt management has continued beyond the completion of the debt relief agreement. DMO has improved a number of important debt management functions:

- First, it has brought together recording of all borrowing into a single agency, which previously was scattered across several agencies resulting in poor coordination;
- Second, debt data has been verified and validated so that detailed accurate and up to date

data is now available. Delays in data retrieval have been substantially reduced and accuracy improved with the recruitment of competent staff and a substantial training programme, especially in the application of the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS);

- Third, negotiating skills on external borrowing have improved and the capacity to analyse various borrowing options has been strengthened;
- Fourth, DMO now carries out debt sustainability analysis;
- Fifth, progress has also been made in the development of a legal framework for contracting debts.

### 5.6.2 Effect of the debt deal on debt management

Although debt management and debt recording would have advanced somewhat without the (prospect of a) debt deal, the anticipation of possible debt reduction provided a strong motivation to implement improvements at the federal level faster and more thoroughly. The debt deal itself brought attention to the issue of improving debt management capacities of the states, but these capacities vary and are often still weak.

## 5.7 MDG-expenditure and VPF

### 5.7.1 Actual MDG-expenditure for development

Table 3 shows that the shares of total actual expenditure for the different MDG related sectors are highly fluctuating without clear trends. While the share of education expenditure decreased in 2006, that for health increased. In 2005, the federal government began to give a grant to all states for 'universal basic education'. As a share of total spending, this flow decreased slightly over time.

	2004	2005	2006	2007	2008
Agriculture	1.2	1.2	1.1	2.4	4.9
Water resources <sup>2</sup>	2.5	5.4	4.7	3.9	
Power and Steel	4.8	0.7	4.4	2.5	1.1
Education	9.4	17.6	8.1	8.2	7.0
Universal basic education	0.0	2.4	1.8	2.0	1.6
Health	4.2	1.4	5.2	5.7	4.3
NAPEP	0.2	0.1	0.2	0.1	0.1
Women affairs	1.4	0.1	0.2	0.1	0.1
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

<sup>1</sup> The sum of these shares is not 100 because not all sectors are presented.

<sup>2</sup> In 2008, expenditure for Water is included in that for Agriculture.

Source: Own calculations on the basis of data from OAGF.

The share of education within total *capital* expenditure increased enormously after 2004 and for health especially between 2005 and 2006, with the establishment of the VPF (see Table 4). This suggests that the VPF spending has been additional (see also below).

	2004	2005	2006	2007	2008
Agriculture	1.1	0.7	0.8	4.4	11.1
Water resources <sup>2</sup>	9.4	18.7	14.6	8.4	
Power and Steel	18.8	1.8	14.4	6.5	2.7
Education	2.2	0.5	1.7	3.6	5.0
Universal basic education	0.0	8.8	6.1	5.5	4.3
Health	0.1	1.9	4.1	6.4	4.1
NAPEP	0.1	0.0	0.3	0.0	0.0
Women affairs	0.0	0.1	0.3	0.2	0.0
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

<sup>1</sup> The sum of these shares is not 100 because not all sectors are presented.

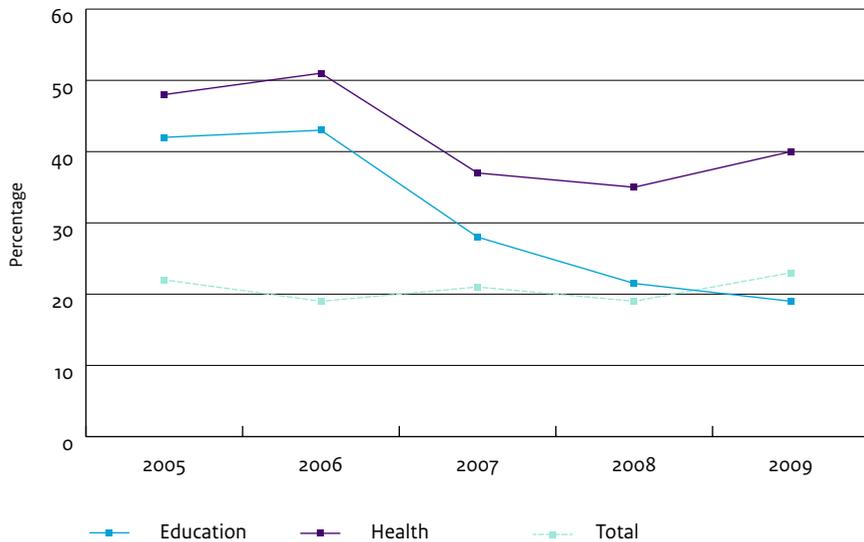
<sup>2</sup> In 2008, expenditure for Water is included in that for Agriculture.

Source: own calculations on the basis of OAGF figures.

Figure 7 shows that the share of MDG expenditure (capital plus recurrent) within total budgeted expenditure remained constant between 2005 and 2009, fluctuating between 19 and 23 per cent.<sup>4</sup> The share of MDG spending within the health sector decreased between 2006 and 2008, and increased again after 2008. For the education sector, the share of MDG spending in total sector spending continued to decline after 2006.

<sup>4</sup> This is based on a study that identified MDG expenditure by line item within each sector, so it gives a more accurate picture of MDG spending than the analysis by sector presented in Tables 3 and 4. Unfortunately, these figures are only available for budgeted expenditure.

**Figure 7** Share of MDG spending in budgeted expenditures (capital plus recurrent) for total spending and for spending in health and education, federal level, in %, 2005-2009



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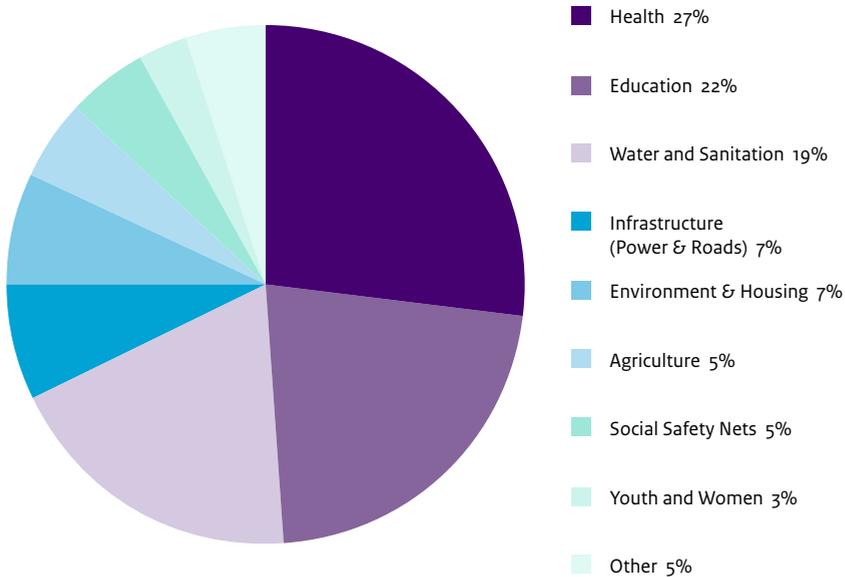
Source: Elaboration of data from OSSAP/MDG 2010.

### 5.7.2 MDG-expenditure and the debt deal: the VPF

The creation of a Virtual Poverty Fund in Nigeria was a condition of the debt relief agreement and it would not have been established in its absence. Therefore it can be attributed fully to the debt relief agreement, and in particular to the conditions attached to that agreement. In fact, debt relief conditionality comprised of two components: first, the tracking of MDG expenditure at federal level within the capital budget of the different MDAs. This was indicated as MDG-spending in the budget. Second, the establishment of the VPF for US\$ 1 billion of debt service savings. Via the VPF, the debt service savings would be used for additional MDG spending.

The MDG-expenditure was tracked in the federal budget from 2006 onwards and a VPF of about US\$ 750 million was established - proportional to the federal share in debt relief savings. There is no VPF at state level, but since 2007 part of the federal VPF is transferred to the states for MDG-related projects with matching funds from the states through the Conditional Grant Scheme (CGS). Actual VPF spending has been around three quarters of budgeted spending. Most money has been allocated to strengthen primary health care, primary education and to provide access to water and sanitation (see Figure 8). Smaller shares were allocated to social safety net projects, including a (still small) conditional cash transfer programme, and to improving rural infrastructure.

**Figure 8** VPF allocation to federal MDAs, in %, 2006-2010



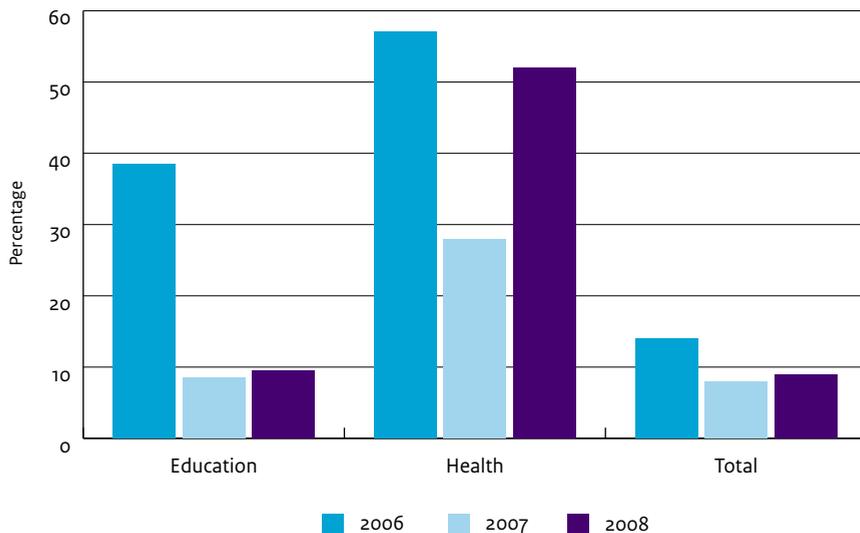
Source: OSSAP/MDG.

The VPF has designed innovative practices for, in particular, the planning and costing of projects, and for monitoring and evaluation (M&E). VPF projects are not only tracked in the budget, but their outputs and outcomes are monitored via a decentralised M&E framework (OPEN, Overview of Public Expenditure of NEEDS) in which the private sector and civil society are involved. As VPF projects are implemented through ministries, departments and agencies, and also through states (since 2007) and local governments (to be started in 2010 or 2011), the VPF aims to institutionalise these practices more broadly.

### 5.7.3 Additionality

Total government expenditure increased in real terms over the years 2005-2009, as did capital expenditure. The share of spending on the MDGs in the federal government budget was maintained at around 23 per cent in this period, which means that in absolute terms MDG-spending increased. Actual VPF spending fluctuated between US\$ 490 million and US\$ 725 million annually in the period 2006-2009, with no clear trend. Over the years 2006-2008, VPF expenditure decreased from 14 to 8 per cent relative to the total capital expenditure of the federal government. For sectors such as health and education, the share of the VPF in total capital expenditure was high in 2006 (for health 57 per cent and for education 38 per cent, see Figure 9). However, the share for education declined in later years. According to relevant stakeholders, most of the VPF spending has been additional to other spending for the MDGs; additionality is higher for the states and smaller federal MDAs than for the larger federal MDAs.

**Figure 9** *Share of VPF actual spending in total actual capital spending, for total expenditures and for health and education, in %, 2006-2008*



Source: Own calculations based on data from OSSAP-MDG and from OAGF.



6

# Outcomes

## 6.1 Introduction

The evaluation questions related to outcomes are listed in the box text below.

### Evaluation questions: Outcomes

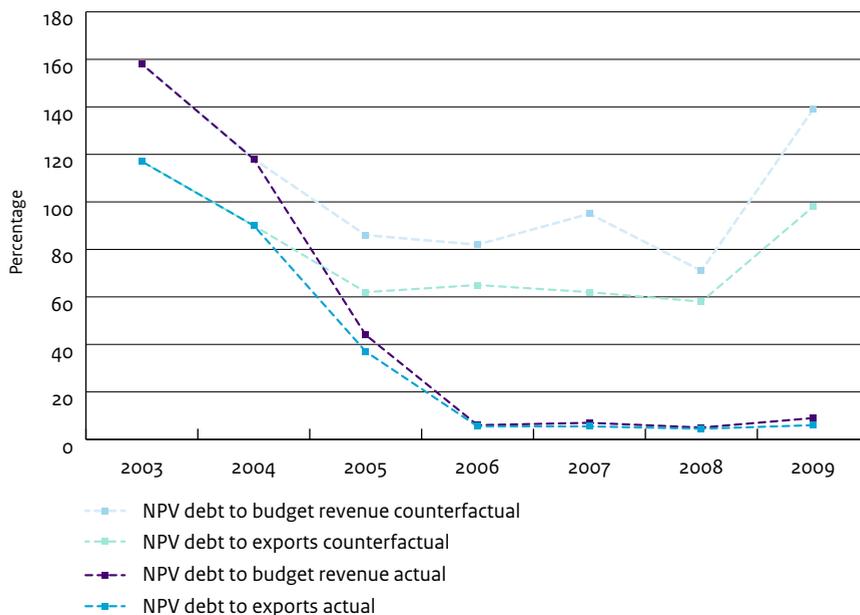
17. Did the debt deal and possibly improved debt management, both federal government level and states, result in a more sustainable external debt and in a sustainable total public debt? Why or why not? What was the role of DMO and other institutions?
18. Did the reduction in the debt stock lead to improved incentives for designing and implementing development policies, at both federal and state government level?
19. Did the reduction in the debt stock lead to reduced domestic interest rates and improved creditworthiness?
20. To the extent that interest rates reduced and creditworthiness improved, have these development led to an increase in private investment and in inflows of private capital from abroad?
21. To the extent that (federal and state) government expenditure on MDG related sectors increased, within or outside of the Virtual Poverty Fund, what was the effect on improved access of the poor to social services, water, power, agricultural services, and roads? What was the effect on agricultural production? Are there any differences between states and/or regions? What was the role of the VPF?
22. Has there been 'crowding in' of induced higher public investment (no. 12) on private investment? Did public sector reforms induce growth of the private sector?
23. What were the effects of possibly improved macroeconomic (financial and monetary) policies on intermediary variables such as macroeconomic stability, exports and investment? Were exports influenced by eventual effect of debt relief operation on exchange rate?
24. Did public sector reforms and better anti-corruption policies improve governance and accountability at both federal and state level, and lower corruption? Why or why not?

## 6.2 Debt sustainability

According to the Debt Sustainability Analyses (DSAs) carried out by the IMF in 2007, 2009 and 2010, the sustainability of Nigeria's external debt is assured in the long term. All debt sustainability ratios show that the external debt has become very sustainable after the debt deal, while it would have been marginally sustainable in the absence of the debt deal. Figure 10 shows the trend in two solvency ratios, NPV (Net Present Value) of external debt to exports and NPV of external debt to budget revenue for both actual and counterfactual scenarios. Although the counterfactual ratios are much higher than the actuals, both are well below the HIPC thresholds of 150 per cent for the NPV debt to exports ratio and 250 per cent for the debt to revenue ratio. In the counterfactual, liquidity debt sustainability

indicators such as external debt service to exports and external debt service to budget revenue are both within the sustainable level.

**Figure 10** Actual and counterfactual NPV external debt<sup>1</sup> to exports ratios and NPV external debt to revenue ratios, in %, 2003-2009



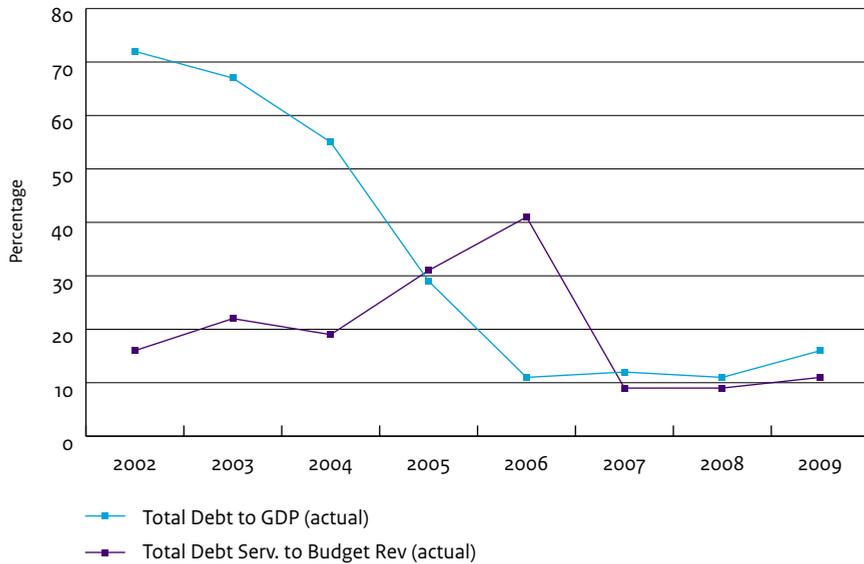
<sup>1</sup> NPV computed as 95 per cent of actual or counterfactual debt, as explained in 5.2.1 of main report.

Source: Own calculations on the basis of DMO reports, IMF Article 4 reports (2005, 2008, 2009), CBN reports.

Figure 11 shows total debt to GDP, which measures the overall debt burden, and total debt service to budget revenue, which measures liquidity and the impact on government revenue. Actual total debt to GDP fell significantly from 2002 until 2005 and started to increase slightly from 2006, due to an increase in domestic debt. However, the rise in the domestic debt stock does not lead to an unsustainable public debt, as total debt to GDP is still much lower than the potential benchmarks of 60 per cent and 40 per cent.<sup>5</sup>

<sup>5</sup> The threshold of the total debt to GDP ratio of 60 per cent is based on the norms of the Euro area; however, it is claimed that debt/GDP ratios for low and middle income countries should remain within 40 per cent, and DMO Nigeria accepts this.

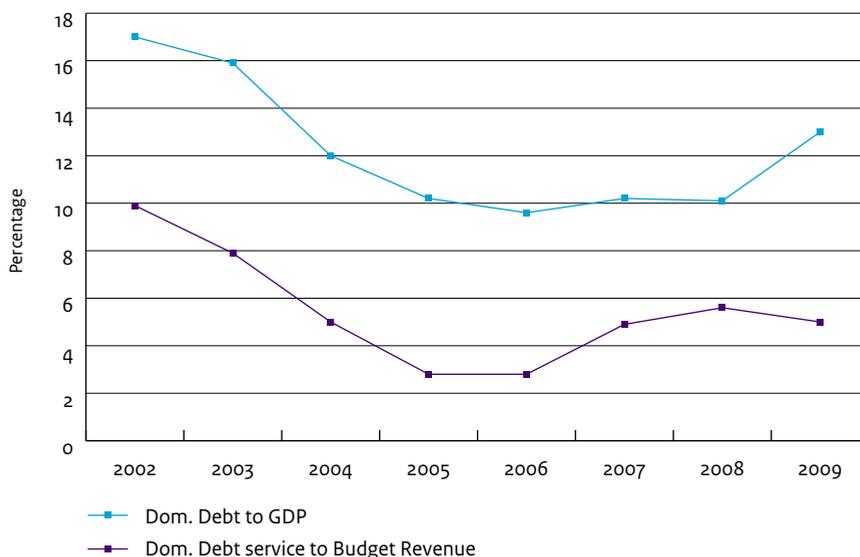
**Figure 11** Actual total debt to GDP and total debt service to Budget revenue ratios, in %, 2002-2009



Source: DMO reports, CBN annual reports, NBS.

The relatively positive counterfactual scenario, described earlier, is due to the high growth rates and high oil prices in the years after the debt deal. After obtaining debt relief, the external debt sustainability ratios have declined substantially and have placed Nigeria in a very comfortable position. The prospects for debt sustainability in the future are good. However, the recently rapidly increasing domestic debt, although still at a low level, is cause of concern (see Figure 12). The fact that debt management at federal level improved strongly is a reassuring factor in maintaining a sustainable public debt.

**Figure 12** Domestic debt to GDP ratio and Domestic debt service to Budget revenue ratio, in %, 2002-2009



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Source: DMO annual reports, DMO Debt Sustainability Analysis report 2010.

### 6.3 Improved policies

The reduction of the debt stock eliminated the debt overhang, which has been shown by others to be the cause of the high volatility of fiscal expenditure in Nigeria from 1984 onwards (Budina et al., 2007). This high fiscal volatility was one of the causes of low economic growth. The elimination of the debt overhang therefore allows for better fiscal policies. This is not so much an effect of improved incentives for better policies, as would be the theoretical assumption, but more an effect of the removal of a real constraint.

### 6.4 Interest rates and creditworthiness

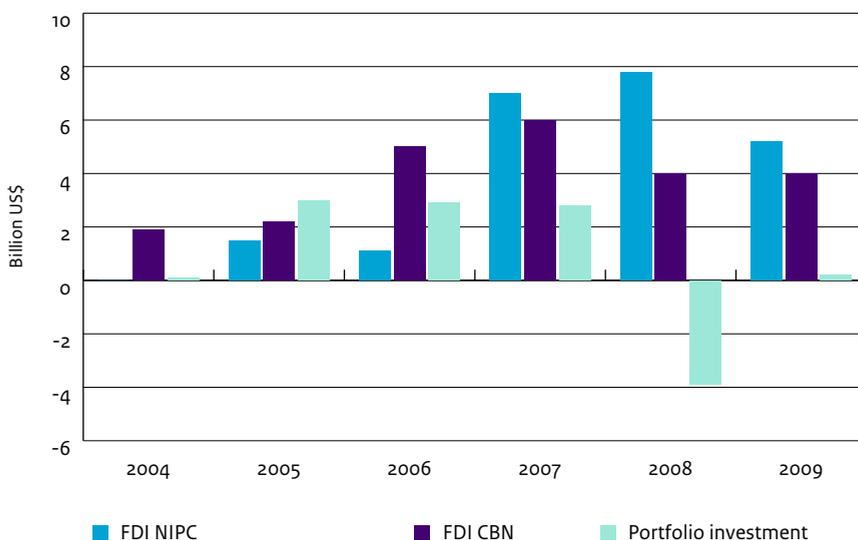
After 2005, nominal interest rates fell, especially interest rates on 3-month Treasury bills. However, this trend cannot be ascribed to the debt relief agreement. Nigeria's creditworthiness clearly improved as evidenced by the first sovereign rating ever given to Nigeria just after the debt deal. Nigeria obtained a BB-rating from Fitch Ratings in January 2006 and gained the same rating from Standard & Poor in February 2006. This was partly the result of the elimination of the debt overhang, but also of the many policy reforms carried out - in turn to a large extent induced by the anticipation of debt relief. The debt deal also served as a signal that policies had improved.

## 6.5 Inflows of private capital and private investment

Public investment increased but not as a result of debt relief savings. This means that there cannot have been a 'crowding in' effect on private investment from the debt relief induced public investment. However, the combination of policy reforms and the elimination of the debt overhang led to improved creditworthiness and the debt agreement itself acted as a signal that policies had improved and this further improved investor confidence. As a consequence, there was an increase in foreign direct investment and portfolio capital inflows, at least until the global crisis hit, 2008 or 2009 (see Figure 13). It can theoretically be expected that the same combination of factors would lead to an increase in private investment but the private investment figures are not sufficiently reliable to confirm this. According to national data, total investment (public plus private) has been at a level of between 6 and 8 per cent of GDP since 1995. It jumped to 10 per cent in 2003 but then decreased to 5.5 per cent in 2005. In later years, it hovered around 8 or 9 per cent.

It is clear that the private sector response also depends on many other factors and that Nigeria's investment climate still faces many challenges, most notably the frequent power cuts but also the continuing violence and high level of corruption. It is therefore difficult to attribute a particular trend in private investment to the debt deal, over and above the many other factors influencing this variable.

**Figure 13** Foreign Direct Investment (FDI) and Portfolio capital inflows, in US\$ billion, 2004-2009



Source: Nigeria Investment Promotion Commission for FDI (as indicated), and Central Bank of Nigeria, Annual Reports for FDI (as indicated) and for portfolio investment.

## 6.6 Macroeconomic stability

The prospect of debt reduction helped establish the oil price based fiscal rule and the related accumulation of savings in the ECA. The PSI helped to continue this rule and to maintain expenditure caps and specific targets with a clear timeline for foreign reserves. As a result, the balance on the ECA was higher than it would have been in the absence of the (prospect of a) debt agreement. The expenditure caps that were maintained may have had some influence on the containment of inflation. In addition, the accumulated savings on the ECA allowed for a stimulating fiscal policy in 2009, when Nigeria suffered from lower government revenues as a result of the global economic crisis. The balance of the ECA decreased from US\$ 20.3 billion in 2008 to US\$ 6.5 billion in 2009 and US\$ 3.3 billion in mid-2010. In the counterfactual, therefore, the crisis would either have led to increased borrowing with risks for future debt sustainability and possibly growth, or (in case of no additional spending) it would have affected growth directly.

However, some key interviewees doubt whether fiscal stimulus actually impacted economic development in 2009. There are even more doubts on the economic rationale for a stimulating fiscal policy in 2010. The first results of 2010 present positive economic results of 7.4 per cent GDP growth in the first quarter of 2010 and 7.7 per cent GDP growth in the second quarter as a result of an increasing oil price and further development of the non-oil sectors. Given the much less vigorous application of the oil price based fiscal rule in 2010, future fiscal sustainability (and thus macroeconomic stability) may be under threat.

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## 6.7 Governance

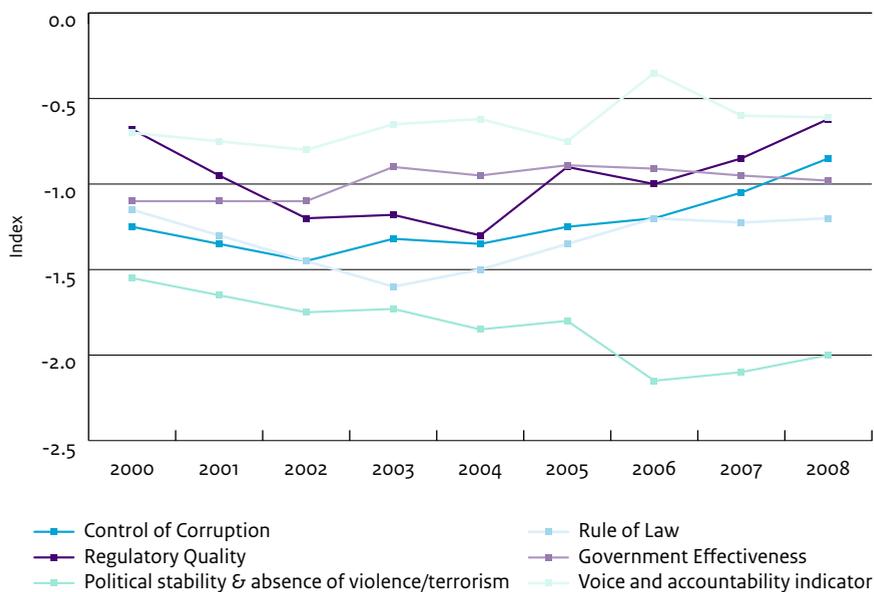
The anti-corruption policies carried out since 2000, and especially since 2003 (the ICPC, the EFCC, the new procurement regulations and the participation in EITI), had some impact on governance and corruption indicators, such as the Transparency International corruption index (see Table 5) and the World Governance Indicators (see Figure 14).

Year	Index	Ranking
2001	1	90/91 (0.99)
2002	1.6	101/102 (0.99)
2003	1.4	132/133 (0.99)
2004	1.6	144/145 (0.99)
2005	1.9	152/158 (0.96)
2006	2.2	142/163 (0.87)
2007	2.2	147/179 (0.82)
2008	2.7	121/180 (0.67)
2009	2.5	130/180 (0.72)

Source: Transparency International (various reports).

These indicators in general improved between 2002/2004 and 2007/2008, and this can be partly attributed to the (anticipation of a) debt deal that led to more vigorous anti-corruption policies especially between, roughly, 2003 and 2007 (see section 5.2). After 2007/2008 most indicators deteriorated slightly.

**Figure 14** Kaufmann Governance indicators for Nigeria, 2000-2008



Source: Kaufmann et al. (2009).

Note: No indicators were constructed for 2001. In the figure we have averaged the 2000 and 2002 value for illustrative purposes.

## 6.8 Access and quality of public services

The Virtual Poverty Fund, fully attributable to the debt agreement, has already produced some intermediate outcomes. Some of the quantitatively more important outputs of the VPF, including the CGS, include:

- 22,000 households benefited from the Conditional Cash Transfer Programme Care of the People (COPE)
- 900 rural electrification projects were completed
- 5,200 microcredit cooperatives were funded
- 300,000 teachers were trained
- 74,000 new teachers were recruited and trained
- 1,453 classrooms were constructed
- 126 million vaccines were procured
- more than 3,000 PHC (Primary Health Care) centers were constructed
- 6,673 health workers were trained
- 2.5 million malaria nets were distributed
- 2,500 midwives were engaged and deployed
- more than 36,000 water schemes were built
- 1,423 toilets were constructed

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From these outputs and also from the data on budget allocation, it is clear that there has been a strong focus on improving primary health care and primary education, as well as on enlarging access to water and sanitation. The VPF projects and programmes were focused on critical areas for MDG achievement. The Monitoring and Evaluation reports reveal that there have been implementation problems, but many challenges have been addressed and completion rates have improved over time.

Table 6 and 7 give some available access indicators for the areas that the VPF targeted. The *access to services* is the more direct outcome of possible increased and improved service delivery.<sup>6</sup> Most indicators show an improvement. Primary enrolment increased between 2004 and 2008, and so did the ratio of girls to boys in primary education. This is probably due to the Universal Basic Education promoted since the beginning of the decade and the accompanying grants from federal to state governments for this aim, but there will also have been some influence from the VPF.

The proportion of the population that has visited a health facility dramatically increased between 2006 and 2008. The proportion of children immunised also increased (both tables), as did the proportion of children sleeping under insecticide-treated bed nets although the number is still low. However, access to pre-natal care decreased between 2006 and 2008 and the trend in the proportion of births attended by skilled health staff is erratic. It appears that the effects of the increased number of midwives trained and deployed are not yet visible in the 2008 figures. In the area of water and sanitation, the results are mixed.

<sup>6</sup> The ultimate outcome indicators are discussed in section 7.4 of this summary.

Access to water increased between 2006 and 2008, but access to modern toilet facilities appears to have decreased. The latter also holds for access to electricity.

	2003	2004	2005	2006	2007	2008	2009 <sup>1</sup>
Primary enrolment rate		81	85	88	90 <sup>1</sup>	89 <sup>1</sup>	
Pupils starting grade 1 who reach grade 5	84	74	74	74	74 <sup>1</sup>	72 <sup>1</sup>	
Children under 1 fully immunised against measles	31	50	60			41	74
Births attended by skilled health staff	36	35	44	44	44	39	
Children under 5 sleeping under insecticides-treated bednet	2					6	11

<sup>1</sup> Preliminary figures.

Source: Government of the Federal Republic of Nigeria (2010), Nigeria MDG Report 2010.

CWIQ Indicators	2006	2008 <sup>1</sup>	Comments
Access to potable water	51	54	Improvement
Use of modern toilet facility	58	40	Worsening
Access to electricity	55	46	Worsening
Pre-natal care	72	43	Worsening
Child immunisation	24	42	Improvement
Visited health facility in 2 weeks	55	80	Improvement

<sup>1</sup> Preliminary figures.

Source: NBS Core Welfare Indicators Questionnaire Survey 2006 and 2008/2009.

The activities financed by the VPF, in combination with the increased efforts for achieving the MDGs from the beginning of the decade, have contributed to increased primary enrolment rates, higher immunisation rates, increased use of primary health care facilities and increased access to potable water, among other achievements.

The institutional effects of the VPF on poverty reduction are perhaps even more important. The M&E system of the VPF is widely seen as good practice, but federal agencies and states are not (yet) applying the VPF framework for their other expenditure. Yet there seems to be some influence already on project formulation and planning, as MDG costing exercises are becoming more common and these exercises are integrated in Medium Term Sector Strategies. These changes are likely to lead to more effective government spending and thus to better service delivery in the future.

7

## Impact, sustainability and lessons learnt

## 7.1 Introduction

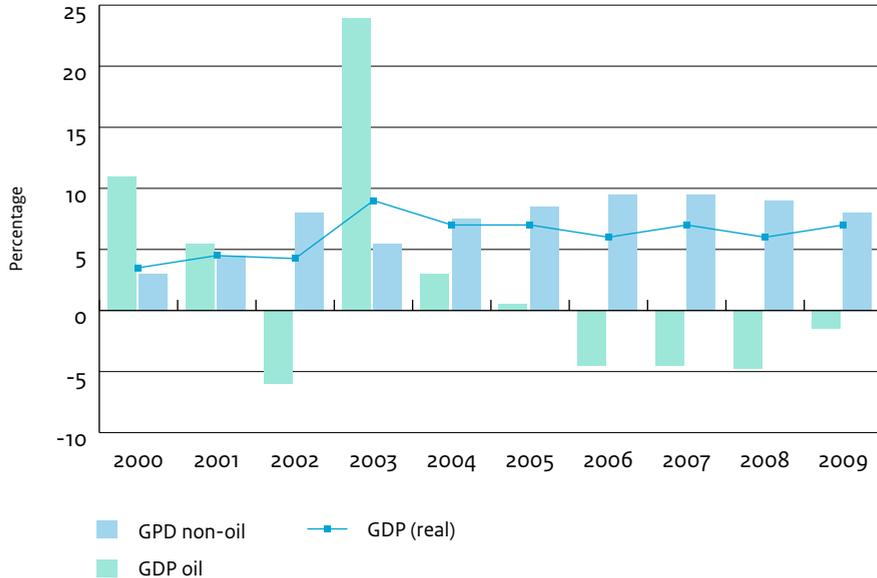
The evaluation questions related to impact, sustainability, and lessons learnt are listed in the box text below.

### **Evaluation questions: impact, sustainability and lessons learnt**

25. What is the impact of the debt relief operation, via the possible outcomes such as improved debt sustainability and debt management, higher public and private investment, higher private capital inflows, improved macroeconomic stability, and higher exports on economic growth?
26. Is there an effect from economic growth on income poverty reduction?
27. What are the effects of (possibly) improved poverty reduction policies and more access of the poor to social and other services on income and non-income poverty?
28. To what extent are the (possible) results in terms of outcomes (debt sustainability, improved macroeconomic framework and PFM, reduced corruption) and impact (growth, poverty reduction - both income poverty and social indicators) sustainable?
29. What lessons can be learnt regarding validity and appropriateness of the intervention theory underlying debt relief as a means to contribute to economic growth and poverty alleviation?

## 7.2 Impact on economic growth

In the years 2004-2009, annual economic growth has been at around 6 or 7 per cent, while non-oil growth was even higher at 8 or 9 per cent (see Figure 15). Growth was particularly high in agriculture and services (see Table 8).

**Figure 15** GDP growth (oil and non-oil), in %, 2000-2009

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Source: CBN annual report 2009 (p. 246), 2007(p. 207), 2005 (p. 175).

Table 8 GDP growth per sector, in %, 2004-2008					
	2004	2005	2006	2007	2008
Agriculture	6.5	7.1	7.4	7.2	6.5
Industry	4.2	1.7	-2.5	-2.2	-2.2
Services	8.8	8	9.2	9.9	10.5

Source: CBN.

According to the theory-based evaluation methodology, some of this growth can be ascribed to the debt relief if, and to the extent that, positive stock, flow or conditionality outcomes of the debt deal can be identified. We have shown that the stock and the conditionality channel have produced some outcomes. These outcomes include full debt sustainability, improved confidence in the economy and improved creditworthiness, leading to some increase in foreign capital inflows, and improved macroeconomic stability and in particular the possibility to cushion the effects of the 2009 global economic crisis. In addition, the improved policies in general will have benefited the investment climate. Some of the outputs of the VPF such as improved rural infrastructure and some components of the social safety net can also be expected to have contributed to growth and will continue to do so in the future.

### 7.3 Effect on income poverty reduction via economic growth

Income inequality in Nigeria is high, but it has been decreasing over time. The World Bank estimated in its Nigeria Poverty Assessment (2007) a decrease in the inequality (Gini) coefficient from 53 in 1996 to 49 in 2004 to 44.3 in 2007. With such a decreasing trend, it can be assumed that economic growth has been pro-poor, and has led to a decrease in the poverty incidence.

Given the conclusion that the debt deal had *some* impact on economic growth, it may also have an (indirect) effect on poverty reduction *via* this economic growth. The high agricultural growth rate suggests that there has been some income poverty reduction, as poverty has proven to be strongly correlated with having a rural occupation (World Bank, 2007). However, there is also evidence that growth in the recent past (1999-2008) has not been accompanied by increases in formal employment.

Regional figures show that between 2004 and 2007, income poverty decreased in the North and in the South West of the country but not in the South South and the South East (see Table 9). The recent reduction in violence in the South following the amnesty agreement in 2009 may imply that growth will now also be accompanied by some poverty reduction in the South. On balance, given that growth was somewhat enhanced by debt relief, it can be concluded that debt relief also contributed modestly to income poverty reduction in Nigeria.

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Zones	Gini Coefficient 1996*	Gini Coefficient 2004**	Poverty incidence 2004**	Poverty incidence 2007***
North East	0.47	0.46	72.2	67.3
North West	0.30	0.37	71.2	63.9
North Central	0.53	0.39	66.9	63.3
South East	0.55	0.45	26.7	34.2
South West	0.57	0.55	43.0	20.9 (Oyo state)
South South	0.60	0.51	35.1	59.3
National	0.53	0.49	54.4	54.7
Male	0.52	-	-	-
Female	0.55	-	-	-
Rural	-	0.51	63.3	63.8
Urban	-	0.54	43.2	43.1

Source: \* Computed from Aigbokhan, (2000) *Poverty, Growth and Inequity in Nigeria – A Case Study*. AERC. Research Paper 102. \*\*Akande et al (2009) *Impacts of price change on poverty: The Nigerian Experience*, NISER. \*\*\*World Bank (2007) *Nigeria Poverty Assessment, based on 2004 poverty survey*.

## 7.4 Direct impact on income and non-income poverty

Several non-income poverty indicators have improved between 2003 and 2008, such as literacy rates, infant mortality rates and maternal mortality rates. These improvements can be attributed to improved poverty alleviation policies since the beginning of the decade, partly as a result of the anticipation of debt reduction, and to a limited extent to the VPF, which was established as part of the debt deal in 2006. Income poverty indicators for the period after the debt deal are not available yet, so no definite conclusions with regard to income poverty can be drawn. However, we can conclude that the outputs of the VPF (including the institutional changes it induced) are likely to have an effect on both income and non-poverty outcome and impact indicators in the future.

## 7.5 Sustainability

The debt relief agreement has made the external debt more sustainable and eliminated the debt overhang that reinforced the volatility of the economy, which negatively impacted economic growth. These positive effects will certainly be sustained over the next three to five years.

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Most key stakeholders identified a slow down in reforms after 2007 (see section 5.3). It can be concluded that the effect of the conditionality on macroeconomic and other policies is gradually waning, although some of the achievements are resilient. This includes the important oil price based fiscal rule which has been maintained, although it has been implemented much less rigorously in recent years.

The VPF has also proved resilient. It will probably be sustained over the medium term as vested interests have been created among a broad group of stakeholders: state and local governments, members of parliament, and civil society. The institutional changes promoted by the VPF in other federal agencies and in state and local governments could become more visible over time and may lead to a greater achievement of the MDGs in the future.

In general, the sustainability of the results depends on the extent to which overall political and economic stability in the country can be maintained.

## 7.6 Lessons learnt

This study confirms the validity and appropriateness of the intervention theory of debt relief, more than has been found in other evaluation studies of debt relief. The somewhat more positive results for Nigeria can be explained by the fact that in this case the debt was eliminated completely. The conditionality channel was also more effective than in other cases. The *prospect* of debt relief provided the political leverage for policy reforms and the motivation to appoint an economic team with strong ownership of the reform package. The political leverage of the reform conditionality of the agreement itself was weaker than the

political leverage induced by the prospect of debt relief. However, the conditionality of the agreement had a positive influence on the timeliness of policy implementation. In addition, the VPF was established, which will have a lasting effect on poverty reduction in the country.

Finally, the question must be answered whether these positive findings justify the use of around US\$ 18 billion in aid money and the use of US\$ 12 billion of Nigerian resources in cancelling the debt. We think they do. The investment is substantial, but the potential benefits are also huge: Nigeria has a large population of which more than half was still below the poverty line in 2004. The debt deal not only removed Nigeria's debt overhang but also improved government policies, including poverty reduction policies. Even if not all of these policy changes can be sustained, there are already positive effects on the welfare of approximately 150 million people in Sub-Sahara Africa.

From the perspective of Nigeria, the spending of the US\$ 12 billion can be seen as an investment for achieving a fresh start in its relations with its bilateral creditors and private sector investors, both domestic and foreign. It also made an end to the accumulation of arrears and the annual payment of US\$ 1 billion of debt service, which would have continued to reduce available resources for poverty reduction, with particular harmful effects in years with lower oil revenues. In addition, there have been positive effects on debt management, debt sustainability and poverty reduction policies, especially via the funding and institutional contributions of the VPF.

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*Summary Report*

# **Mutual interests – mutual benefits**

Evaluation of the 2005 debt relief  
agreement between the Paris Club  
and Nigeria

## Foreword

This is the summary of the main report of the joint evaluation of the debt relief agreement concluded by the Paris Club and Nigeria in 2005.

In 2009, the Special Evaluation Office of International Cooperation of the Belgian Federal Public Service Foreign Affairs, Foreign Trade and Development Cooperation and the Policy and Operations Evaluation Department of the Dutch Ministry of Foreign Affairs started making preparations for the evaluation. Though their invitation to other members of the DAC Network on Development Evaluation to join them met with considerable interest from potential participants, for various reasons none of them took an active part. After an international call for tenders in early 2010, the contract for the evaluation was awarded to a consortium comprising Ecorys Nederland BV and Oxford Policy Management.

The deal agreed by Nigeria's creditors, united in the Paris Club, and the government of the Federal Republic of Nigeria in October 2005 was controversial, to say the least. Nigeria owed its creditors more than US\$ 30 billion. It agreed to repay US\$ 12 billion from its higher oil revenues, while the creditors cancelled the remaining debt of US\$ 18 billion. That was not exactly peanuts. At that time, US\$ 18 billion amounted to € 12 billion.

The controversy generated by the deal continued unabated not only in some creditor countries, but also in Nigeria itself, with 150 million inhabitants the country with the biggest population in Africa. However, the debate often was based not on convincing arguments or facts, but on political convictions. In the creditor countries, opponents of the deal portrayed Nigeria as a well-nigh failed state where corruption was rife, the majority of people had no share in the oil wealth, and outbursts of political, religious and ethnic violence were regular occurrences, making democracy and the rule of law little more than a joke. It was high time for an independent evaluation to throw light on the background to, and nature and consequences of the biggest debt cancellation deal ever made, barring the one with Iraq in 2004.

The four most urgent questions were as follows. What were the reasons for the deal? Was agreeing it the right decision? Did it have to cost so much? And last but not least, what were the results?

A team of independent evaluators first turned these questions into almost 30 sub-questions, which they answered with great expertise. The answers are included in this report. Reality is rarely totally straightforward. One thing is clear, however: both parties benefited by the deal. Nigeria – the second biggest economy in Sub-Saharan African – saw its foreign debt virtually disappear, while the creditor nations got back more than they expected. The evaluation clearly shows how this worked.

Were there no losers? Some people say there were. The debt cancellation was reported as Official Development Assistance. In some countries, however, it was not regarded as

expenditure over and above the existing budget, raising their ODA performance, but as an item on the development cooperation budget. Funds originally intended for other development-related expenditure had therefore to be used to cancel what amounted mainly to export credits which, in all probability, also benefited both parties when they were first agreed.

The evaluation team's analysis is firmly based on the intervention theory underpinning the phenomenon of debt relief, and the underlying mechanisms are fairly technical. Besides the main report, which contains an excellent Glossary, we have therefore opted to present two summaries. This summary was written by the evaluators and is mainly of interest to specialists. The second summary is more accessible to a wider group of interested readers. It does not contain technical analyses or go into detail, but gives a clear account of the main findings and conclusions of the joint evaluation, and lessons learned. This specialist summary is available in English, French and Dutch, the general summary in French and Dutch.

Readers will thus find much to interest them. The main report comprises the full text, including annexes and an Executive Summary. The enclosed CD-Rom contains not only the full report, but also an interesting paper providing background information on Nigeria. It was specially written for readers with little knowledge of this West African country by Dr Bukola Adeyemi Oyeniyi of the Faculty of History and International Relations at the Joseph Ayo Babalola University, Ikeji Arekeji, Osun State, Nigeria.

The documents are available on the Internet, on <http://diplomatie.belgium.be/en> and <http://www.minbuza.nl/en>.

We would like to thank everyone who contributed to this evaluation as a respondent. Their names are listed in Annex 3 of the main report. We are also very grateful to the Abuja Advisory Group and the European Reference Group for their constructive ideas and useful comments on the draft reports.

The evaluators are responsible for the contents of this report. The Special Evaluation Office of International Cooperation and the Policy and Operations Evaluation Department guarantee the quality of the evaluation.

The purpose of evaluations is to render account and to learn lessons for the future. We hope you enjoy reading this report.

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## Authors' preface

The main report of the evaluation is the product of team work. The authors are grateful to team members Kenneth Chukwuemeka and Adewumi Olajide Ogunsola for their inspiring ideas and for their important support in collecting and processing information before and during the field visits in Nigeria. We also would like to thank all stakeholders interviewed in Nigeria, Brussels, The Hague, and Washington DC, for their time and for generously sharing their information. We are also very grateful to everyone else, in particular from the Abuja Advisory Group, the European Reference Group and the Evaluation Steering and Management Group for their constructive ideas and helpful comments on our presentations and subsequent draft reports. We also thank Ed Humphrey of Oxford Policy Management (OPM), Albert de Groot of ECORYS and Daniel Rogger, our internal peer reviewer, for their many useful comments at the different phases of this report. In Nigeria, Mariam Obia Chukwuemeka was a great help in organising the logistics of the field work. In Europe student assistants Luuk de Blok, Bianca Huizer and José Nederhand contributed to the realisation of this evaluation report. We are deeply grateful to everyone.

The final responsibility for the content of the report rests with the authors.

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Mutual interests – mutual benefits

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Chronology of key events in the history of Nigeria



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Map 1 Africa and Nigeria

## Chronology of key events in the history of Nigeria

### *Pre-colonial period*

<b>Circa 500 BC onwards</b>	First Nok settlements (earliest iron-using culture).
<b>Circa 11th century onwards</b>	Kingdoms and city-states established.
<b>16th to 18th century</b>	Transatlantic slave trade.
<b>Early 19th century</b>	Islamic Fulani empire founded.
<b>Circa 1850</b>	British establish a presence around Lagos.
<b>Second half of 19th century</b>	Christian missionaries active in the south.

### *Colonial period*

<b>1903 onwards</b>	Great Britain controls south and north of country through local leaders ('indirect rule').
<b>1914</b>	Great Britain unites northern and southern regions as one colony.
<b>1958</b>	Shell starts oil production in the Niger delta.

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### *Independence*

<b>1960</b>	Nigeria gains its independence.
<b>1962-1963</b>	Controversial censuses fuel religious and ethnic tensions.

### *Military rule*

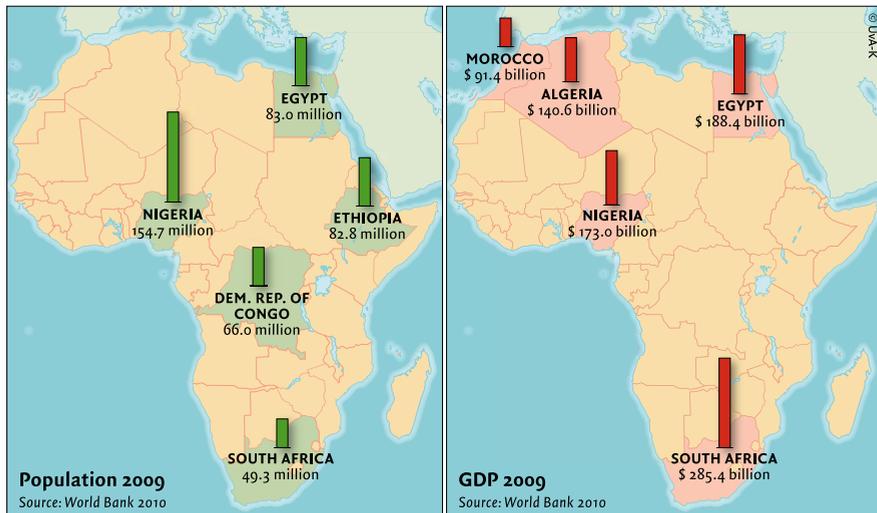
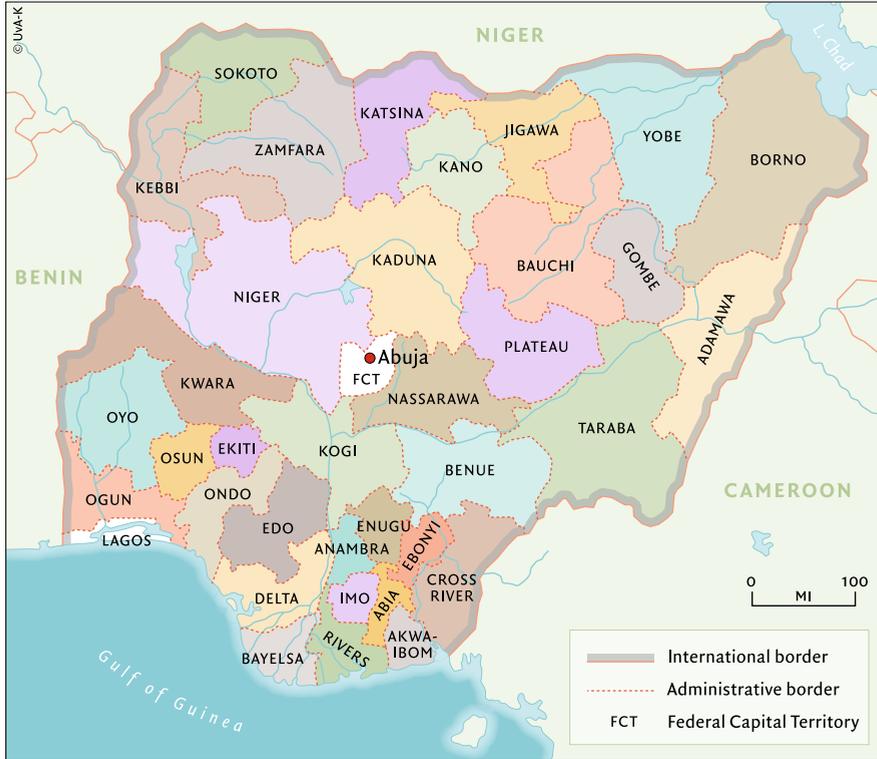
<b>1966</b>	Military coup, followed by counter-coup.
<b>1967-1970</b>	Failed attempt by three southeastern states to establish the Republic of Biafra. Civil war results in an estimated one million deaths.
<b>1970s</b>	Oil production soars.
<b>1976</b>	General Olusegun Obasanjo becomes head of state and promises democratic elections.
<b>1979-1983</b>	Temporary interruption of military rule. Civilian government under President Shehu Shagari.
<b>1983</b>	Military coup. General Muhammad Buhari becomes head of state.
<b>1985</b>	General Ibrahim Babangida seizes power.

- 1993** Babangida is forced to hand over power after annulling elections. Ernest Shonekan heads an interim government, but is then forced out by General Sani Abacha.
- 1995** Execution of Ken Saro-Wiwa and eight other activists who campaigned against the oil industry in Ogoniland. EU sanctions follow, and Nigeria is suspended from the Commonwealth.
- 1998** Abacha dies and is succeeded by General Abdulsalam Abubakar. Nigeria's suspension from Commonwealth and the EU sanctions are lifted.

*Civilian rule*

- 1999** Olusegun Obasanjo becomes president following democratic elections.
- 2000** Introduction of Sharia law begins in northern states. Hundreds die in ensuing violence between Christians and Muslims.
- 2001** Thousands of people are displaced as a result of ethnic conflict in Benue state.
- 2003** Obasanjo is elected for second term following disputed elections.
- 2004** State of emergency in Plateau state after violence between Christians and Muslims.
- 2005** Paris Club and Nigeria sign debt relief agreement.
- 2007** Umaru Yar'Adua is elected president in April.
- 2008** Oil prices rise, driven partly by violence involving militant groups in the Niger delta.
- In November at least two hundred people die in violence between Christians and Muslims in the city of Jos, Plateau State.
- 2009** In July Islamist movement Boko Haram tries to impose Sharia law on entire country through campaign of violence. Hundreds die in northeastern Nigeria.
- 2010** In January and March at least 269 deaths in violence between Christians and Muslims in Jos.
- President Yar'Adua dies in May after long illness. Vice- president Goodluck Jonathan succeeds him. Presidential elections planned for April 2011.
- In December thirty die in Plateau State in Christmas Eve bomb attacks.

Map 2 The 36 States of the Federal Republic of Nigeria



Map 3 Africa's Top-5: Population and GDP

## List of Abbreviations

CBN	Central Bank of Nigeria
CGD	Center for Global Development (Washington)
CGS	Conditional Grant Scheme
COPE	Care of The People
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
CWIQ	Core Welfare Indicators Questionnaire
DAC	Development Assistance Committee (of OECD)
DMO	Debt Management Office
DSA	Debt Sustainability Analysis
ECA	Excess Crude Account
EFCC	Economic and Financial Crimes Commission
EITI	Extractive Industries Transparency Initiative
ESMG	Evaluation Steering and Management Group
FDI	Foreign Direct Investment
GDF	Global Development Finance (WB database)
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
ICPC	Independent Corruption Practices Commission
IDA	International Development Association
IMF	International Monetary Fund
IOB	Policy and Operations Evaluation Department (Inspectie Ontwikkelingssamenwerking en Beleidsevaluatie) , Ministry of Foreign Affairs (The Netherlands)
IPPIS	Integrated Personnel and Payroll Information System
I-PRSP	Interim Poverty Reduction Strategy Paper
MDAs	Ministries, Departments and Agencies
MDG	Millennium Development Goal
M&E	Monitoring and Evaluation
MTEF	Medium Term Expenditure Framework
N	Naira
NAPEP	National Poverty Eradication Programme
NBS	National Bureau of Statistics
NEEDS	National Economic Empowerment and Development Strategy
NGO	Non Governmental Organisation
NIPC	Nigeria Investment Promotion Commission
NISER	Nigerian Institute of Social and Economic Research
NPV	Net Present Value
OAGF	Office of the Accountant General to the Federation
ODA	Official Development Assistance
OPEN	Overview of Public Expenditure of NEEDS
OSSAP	Office of the Senior Special Assistant to the President
PFM	Public Finance Management

## Mutual interests – mutual benefits

PHC	Primary Health Care
PRSP	Poverty Reduction Strategy Paper
PSI	Policy Support Instrument
SEEDS	States Economic Empowerment and Development Strategy
SEO	Special Evaluation Office of International Cooperation, FPS Foreign Affairs, Foreign Trade and Development Cooperation (Belgium)
SMP	Staff Monitored Programme
TI	Transparency International
UK	United Kingdom
US	United States
VPF	Virtual Poverty Fund

1

# Introduction

## 1.1 Objective of the evaluation

The aim of the evaluation is two-fold; first, to account for US\$ 18 billion of ODA funds (Official Development Assistance) registered as debt cancellation to Nigeria<sup>1</sup> and for the payment of around US\$ 12 billion by Nigeria to its creditors. Second, to learn lessons from this debt relief experience and all its components, including the agreement itself between the Paris Club creditors and Nigeria, and the conditions that were attached to the agreement. Although this evaluation is undertaken by the Dutch and Belgian evaluation departments, it is expected that the results will be relevant for Nigeria and for the thirteen other creditors involved in the operation, as well as for a broader audience of academics and policy makers. As it is impossible to separate the effect of debt relief supplied by Belgium and the Netherlands from the other 13 Paris Club members, we analyse the impact of the full Paris Club operation.

A total of 6 main evaluation questions and 29 specific evaluation questions were formulated on context and background, inputs, outputs, outcomes, impact, sustainability and lessons learnt. The six main evaluation questions are:

1. What political, economic and institutional developments led to the comprehensive debt deal?
2. Did the debt deal result in or lead to a sustainable debt?
3. What role did the conditionalities play which accompanied the debt agreement?
4. How effective was the Virtual Poverty Fund?
5. How sustainable are the outcomes?
6. What lessons can be drawn regarding the validity and appropriateness of the intervention theory underlying debt relief as a means to contribute to economic growth and poverty alleviation?

<sup>1</sup> According to DAC criteria (Development Assistance Committee), the cancellation of export credit loans is classified as ODA, while cancellation of aid loans is not, because aid loans have already been counted as ODA when they were disbursed. Export credit loans constituted almost 98 per cent of the total cancellation, see section 3.3.1 of main report.

# 2

## Evaluation methodology, approach, and organisation

## 2.1 Methodology

For this evaluation a *logical framework* has been developed. The intervention theory behind this logical framework is that debt relief may have a positive effect on economic growth, which can occur via three possible channels:

- A stock channel: Via a decrease of the size of the outstanding debt (the debt stock), which may lead to a reduction of the debt overhang. The absence of a high debt stock that burdens the future may lead to renewed access to international private capital, and thus increases in investments, and to improved policies;
- A flow channel: Via a reduction of the debt service. Lower debt service payments may lead to more resources available for imports (effect on balance of payments) and create fiscal space for public investment in physical and social infrastructure (effect on fiscal accounts), leading to improved service delivery;
- The conditionality channel: Via the reform conditions attached to debt relief, which may lead to policy improvements; provided the right conditions have been selected, these conditions may stimulate economic growth and poverty reduction via, for instance, increased public investment and social spending.

The three channels can be categorised as follows, in inputs, outputs and outcome:

Table 1 Intervention theory debt relief			
	Stock channel	Flow channel	Conditionality channel
Input	The debt relief deal: payment up-front, cancellation and buy-back		Conditions for policies and governance
Output	Debt reduction	Lower debt service, increased government spending, for investment and MDGs	Changes in policies and governance
Outcome	<ul style="list-style-type: none"> <li>• Higher inflows of private capital</li> <li>• Increased private investment</li> <li>• Better policies</li> </ul>	Better quality of, and more access to, public services	<ul style="list-style-type: none"> <li>• Improved investment climate, leading to higher private investment</li> <li>• More and better service delivery</li> </ul>
Impact	Economic growth and poverty reduction		

## 2.2 Approach

The evaluation comprised two main phases; a desk study phase and a field study phase. During the desk study phase, interviews were held in Brussels, The Hague, and Washington. The field study phase comprised two visits to Nigeria. In the first visit to Nigeria, the team spent two weeks in Abuja, the federal capital, from 2-14 August 2010. In this period, the team carried out interviews with a range of stakeholders from government agencies, Non Governmental Organisations (NGOs) and representatives of development agencies and the private sector. Between 15 and 20 August, three team members visited two states, Kano and Cross River state, in order to analyse the possible impact of the debt deal at state level on government expenditure and poverty reduction (in the context of the Virtual Poverty Fund), public finance management (PFM), and debt management. The visits are not meant to validate findings at the federal level, but merely serve as illustrations of how the debt deal was perceived at state level and whether the two states visited identified any direct impact of the debt deal.

## 2.3 Organisation

This evaluation was prepared, commissioned and steered by the evaluation departments of the Belgian and Dutch Ministries of Foreign Affairs, the Special Evaluation Office of International Cooperation (SEO, Belgium), and the Policy and Operations Evaluation Department (IOB, the Netherlands). IOB was the lead agency for this joint evaluation. The Evaluation Steering and Management Group (ESMG) prepared the Terms of Reference and provided comments on all draft reports.<sup>2</sup>

External quality control of this evaluation was provided in the form of two review panels, one in Abuja (Abuja Advisory Group) and one in The Hague (European Reference Group). The review panels were also important to raise the sense of ownership among relevant policymakers in Nigeria and in the involved creditor countries, Belgium and the Netherlands. The Intermediate Report of this evaluation was discussed in the European Reference Group in June 2010 and in the Abuja Advisory Group in August 2010, on the first day of the field work. At the end of the three weeks of field work, the evaluation team met with the Abuja Advisory Group to present and discuss the preliminary findings, again leading to helpful comments.

The first draft of the final report was discussed with the Abuja Advisory Group on 2 November 2010. A revised draft final report was submitted for comments to the Abuja Advisory Group (by e-mail) and on 1 December discussed with the European Reference Group. A third draft of the final report was submitted to the European Reference Group in late December (by e-mail). Many useful comments and suggestions were received. The definitive version was submitted to the Evaluation Steering and Management Group in January 2011.

<sup>2</sup> The ESGM had developed an Approach Paper that was discussed with stakeholders in Nigeria. The resulting draft Terms of Reference was submitted to key stakeholders in Nigeria before being finalised in the official Terms of Reference of the joint evaluation.

3

## Context and background

### 3.1 Introduction

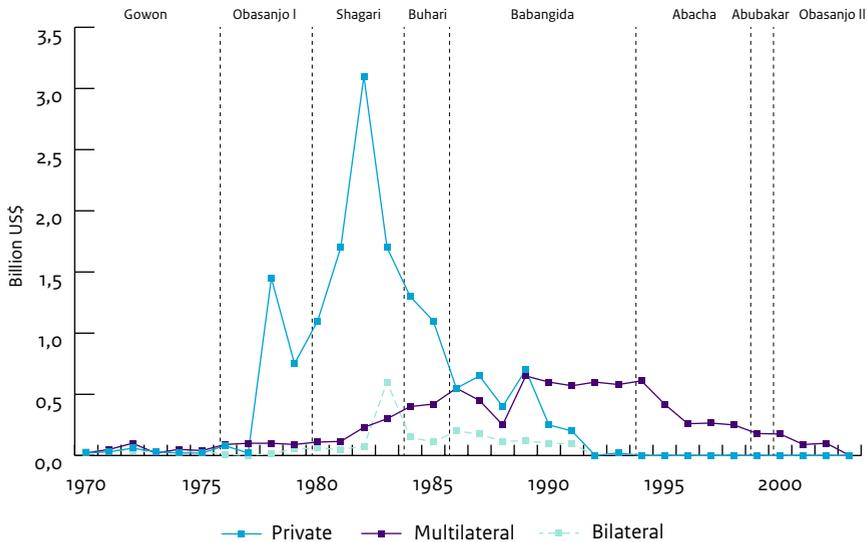
The evaluation questions related to context and background are listed in the box text below.

#### Evaluation Questions: context and background

1. What was the origin and nature of the sovereign debt problem in Nigeria and was the debt unsustainable before the debt relief operation?
2. What was the Nigerian debt policy, in particular its debt management policy?

### 3.2 Origin and nature of Nigeria's debt

The origin of Nigeria's sovereign debt problem lies in the late 1970s, during the first presidency of (then) Lieutenant-General Obasanjo (1976-1979), see Figure 1. The debt started to increase significantly from the early 1980s, under the presidency of Shehu Shagari, elected in 1979. When interest rates rose and oil prices fell in the beginning of the 1980s, production and consumption patterns that emerged during the oil boom were not addressed. The federal and state governments embarked upon massive external borrowing from the international capital market. This extensive borrowing continued under the military regime of Major-General Muhammad Buhari (Figure 1) who took over power in mid-1983. The debt became unsustainable in the mid-1980s. The borrowing included commercial bank loans, short term insured and uninsured trade credits and longer term officially supported export credits. The overvaluation of the exchange rate not only stimulated excessive imports but also led to over-invoicing of imports and under-invoicing of exports, provoking capital flight. The borrowed funds were often invested on projects which did not give reasonable rates of return, while the Letter of Credit for imports of consumer goods were often given for non-existent imports - leading to capital flight. Furthermore, Nigeria did not service its debt fully which led, through accumulation of arrears, to an even higher debt.

**Figure 1** Loan disbursements under different political leaders, in US\$ billion, 1970-2002

Source: Figures from Worldbank, GDF; presidential periods added as in “Double Standards, Debt Treatment, and World Bank Classification: The Case of Nigeria,” Working Paper 45, Centre for Global Development (CGD), September 1, 2004, page 30.

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### 3.3 Debt policy

The history of Nigeria’s debt prior to 2005 can be divided into five phases. In the first phase, including 1970s and up until 1982, debt service was not a major concern of the government. The high external borrowing in late 1970s and early 1980s did not raise any concerns at that time because oil prices were high and therefore revenues were high enough to pay the debt service.

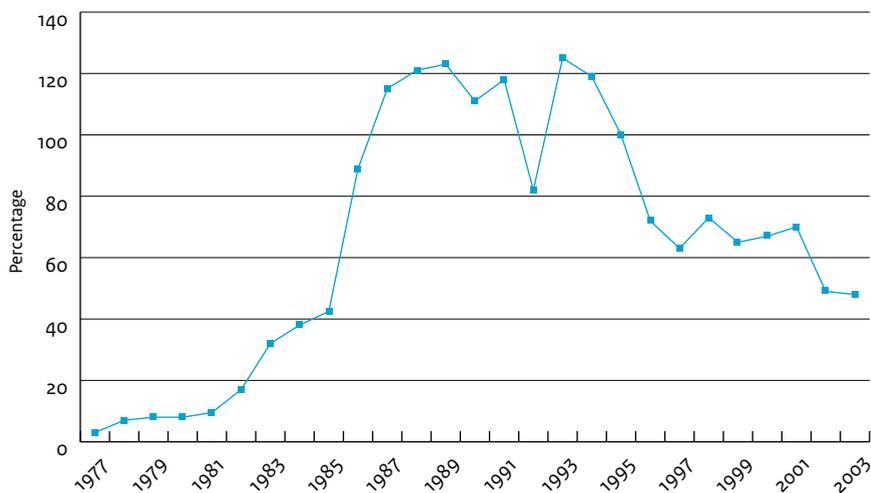
The second phase, from 1982 to 1986, was one of increasing debt service but with continued access to foreign borrowing. When oil prices fell and market interest rates rose, debt service payments became a major expenditure. By 1985, the ratio of external debt service to exports had increased significantly to around 30 per cent. In 1986, the ratio of external debt to GDP (Gross Domestic Product) was 89 per cent, while it climbed to about 120 per cent in the years after 1986 (see Figure 2).

The third period started in 1986 when access to new credit lines was refused and the government considered restructuring its bilateral debt. General Babangida who had seized power in 1985 began to negotiate for a Paris Club rescheduling in 1986. The creditor governments agreed to reschedule more than US\$ 7 billion of medium and long term debt in arrears at the time of the negotiations and falling due over the coming year.

Accompanying this debt rescheduling was the implementation of an International Monetary Fund (IMF) adjustment programme, which did not receive much support from the Nigerian public. The depreciation of the Naira made debt payments of external debt more expensive in local currency.

The country’s continued inability to service its debt caused Nigeria to revisit the Paris Club in 1989 and 1991. Nigeria rescheduled another US\$ 6 billion, including arrears, with the Paris Club in 1989 and a further US\$ 3 billion in 1991. All agreements were accompanied by IMF Standby arrangements, but these programmes frequently went off-track. Nigeria never actually drew on IMF resources but needed the IMF arrangement to monitor and endorse its policies, as this was a condition for Paris Club rescheduling. Nigeria also went to the London Club to reschedule commercial bank debt in 1987 and 1989.

**Figure 2** Ratio of external public and publicly guaranteed debt to GDP, in %, 1977-2004



Source: Own calculations based on WDI, DMO reports and NBS.

The fourth phase in Nigeria's debt began in 1992 and lasted until 1999. In this period, the relations between Nigeria and its different creditors began to diverge. In January 1992, Nigeria managed to agree on a Brady deal. This resulted in US\$ 5.6 billion in commercial debt being converted into US\$ 2.1 billion of new bonds, a discount of 62 per cent (Rieffel, 2005). After this reduction, Nigeria was able to service these debts to private creditors. The commercial debt stock gradually diminished as private creditors did not provide new loans to Nigeria.

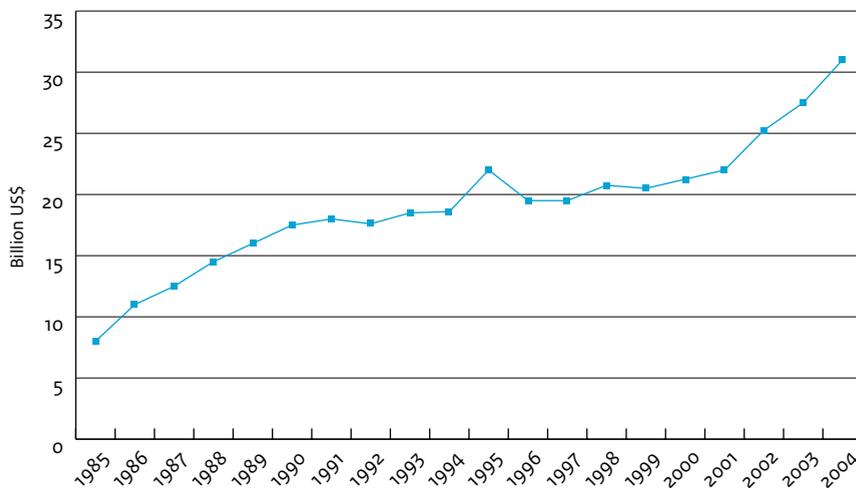
In 1992, it was expected that the Paris Club creditors would offer a similar reduction percentage on the bilateral debt as in the Brady deal for commercial debt. However, the Paris Club refused to offer debt reduction to Nigeria. One reason was that Nigeria was off track with the 1991 IMF programme. Another reason was that the concessional rescheduling (Toronto, London and later Naples terms) were only open for IDA-only countries. Nigeria was not classified as such, having become a 'blend' country (eligible for both IDA and International Bank for Reconstruction and Development (IBRD) borrowings) in 1989.

In the expectation of a concessional debt reduction, Nigeria started to limit payments to Paris Club creditors to no more than 30 per cent of oil revenues (Budina et al., 2007). This led to huge arrears accumulation during the 1990s, especially when oil prices were low in 1994 and 1995. Nigeria also started to discriminate among its Paris Club creditors from 1992 onwards, paying some more than others. The increase in bilateral debt after 1992 was also partly the result of new lending by Paris Club creditors, 60 per cent of which was from Japan.

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The fifth phase was between 1999 and 2005, covering the first and part of the second term of elected president Olusegun Obasanjo. In this period, the government took the decision to work towards debt reduction from the Paris Club (further elaborated upon in section 3.2 of the main report). In 2000, Nigeria entered into an IMF Standby arrangement, followed by a fourth Paris Club rescheduling. Though some debt service payments were made, arrears continued to accrue and by the end of 2004, Nigeria's external debt had reached approximately US\$ 34 billion, of which Paris Club debt was around US\$ 30 billion (see Figure 3).

**Figure 3** Nigeria's debt to creditor countries of the Paris Club, in US\$ billion, 1985-2004



Source: CBN Statistical Bulletin 2003, 2004, 2005.

Before 2000 there was a severe lack of coordination in loan contracting and registration and debt management was weak. Every senior official at federal and states and local government level was authorised to borrow and there was very little oversight on the uses of the loans. Debt recording was scattered among various institutions so that there was no accurate record of the size of the debt stock.

### 3.4 Debt sustainability

At the end of 2004 most debt sustainability ratios were at a sustainable level, to a large extent due to a rising oil price from 2002 onward. The only ratio that was marginally unsustainable was the relation between NPV debt to GDP, which was just above 40 per cent. The debt sustainability analysis carried out by the IMF in early 2005 concluded that the external debt was sustainable, but made the comment that it could become unsustainable under a scenario in which the oil price fell by more than one standard deviation. However, within Nigeria it was broadly felt in parliament, labor unions and in the media that these debts should not be paid or not paid in full. The reasons include that the country had already paid back the original loan amounts, and that most of the debt consisted of arrears built up under dictators. Therefore, although on the basis of most debt sustainability ratios the debt could be judged *economically sustainable* in 2005, the debt could be considered *politically unsustainable*.

4

Inputs

## 4.1 Introduction

The evaluation questions related to inputs are listed in the box text below.

### Evaluation questions: Inputs

3. How was the debt relief operation designed and what were its conditions?
4. Who were the main actors in Nigeria in the debt relief deal and what role did they play?
5. What goals did the government of Nigeria pursue by concluding the debt deal? To what extent were the deal and its conditions 'owned'?
6. What goals did the Paris Club countries pursue by concluding the debt deal?
7. How did the Nigerian debt relief deal and its conditions fit in Belgian and Dutch international cooperation and debt relief policies?
8. How did the Nigerian debt relief deal fit in international debt relief policies of Paris Club members and of the Bretton Woods Institutions, in particular how did it relate to the enhanced HIPC (Highly Indebted Poor Countries) initiative?

## 4.2 Design debt relief

The Paris Club creditors made it clear that a debt reduction would only be considered if Nigeria had put its 'house in order'. This implied, among other things, reconciling the debt figures with all creditors, carrying out responsible macroeconomic policies, improving public finance management (PFM), and reducing corruption. These conditions had to be met before a debt relief agreement would be agreed.

The debt relief agreement in 2005 involved the full US\$ 30.4 billion of Paris Club debt (see Table 2). Nigeria was expected to pay US\$ 12.4 billion, while the creditors would cancel US\$ 18 billion, implying an overall debt reduction of about 60 per cent. In the first phase, Nigeria paid all arrears to Paris Club members and the so-called 'levelling up'. The creditors then cancelled 33 per cent of the remaining debt. In the second phase, the creditors cancelled 34 per cent of the debt after Nigeria had paid debt service on all post cut off date debts and an amount for the buy-back of the debt remaining after the two cancellations; the discount on the buy-back was around 35 per cent.

	Debt	Relief	Payment
Debt stock	30.4		
Payments of arrears and levelling up			6.3
Remaining debt	24.1		
First cancellation of 33% (of remaining debt)		8.0	
Payment of post cut off date debt and payment of buy-back			6.1
Second cancellation 34%		8.0	
Discount of buy-back (around 35%)		2.0	
Remaining debt	0		

The debt relief agreement stressed that the Nigerian government should continue and fully implement the reform programme as set out in the Policy Support Instrument (PSI) agreed with the IMF, especially focussing on strengthening the economy, improving of PFM, and fighting poverty. The latter implied the tracking of MDG-related (Millennium Development Goals related) expenditure and the setting up of a Virtual Poverty Fund (VPF) to use the annual savings in debt service.

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The reform programme is set out in the Letter of Intent of the PSI, which includes (IMF, 2005c):

1. Quantitative assessment criteria and (for later periods) indicative targets;
2. Structural assessment criteria; and
3. Structural benchmarks.

Quantitative assessment criteria include targets for the federal government non-oil primary balance, for reserve money, for the stock of net foreign assets, for non-concessional external debt (zero) and for external arrears (zero). The structural assessment criteria refer to financial sector reform, trade, transparency of the oil sector, and to market regulation of utilities. Within the structural benchmarks, the focus was on PFM, privatisation and market regulation, and financial sector reform. One of the structural benchmarks was the gradual introduction of an expenditure tracking system within the Medium Term Expenditure Framework (MTEF) for six MDG-related sectors: health, education, water, agriculture, power and roads. This would be applied in the budget and in the Chart of Accounts.

The second phase of the debt cancellation was contingent upon approval by the IMF of the first review of the PSI. The PSI was a two-year programme and included four reviews.

### 4.3 Main actors: Nigeria

For President Obasanjo, in office between 1999 and 2007, achieving debt relief was one of his main objectives. After his re-election in 2003, he installed a new economic management team and debt relief was a primary aim for this team. Main agencies involved in the negotiations were the Ministry of Finance (Minister Ms Ngozi Okonjo-Iweala who also led the economic management team), the Debt Management Office (Mansur Muhtar, Director General of DMO) and the Central Bank of Nigeria (Professor Charles Soludo, Governor).

### 4.4 Objectives of Nigeria and ownership

The Nigerian government wanted to achieve a comprehensive debt deal with the Paris Club because it considered the debt neither economically nor politically sustainable. Also it wished to free resources for expenditure on the MDGs. There existed a strong repudiation movement within Nigerian civil society, parliament and the public at large, but going along with this was not an option as the government wanted to maintain and improve relationships with the western world. The government therefore preferred an orderly settlement of the debt in cooperation with the creditors, but this settlement needed to include a significant debt reduction. Especially from 2003 onwards, the government carried out substantial policy reforms, including the oil price based fiscal rule which had led to substantial savings on the Excess Crude Account (ECA). These savings, combined with a still rising oil price in 2005, induced the government to consider a buy-back modality for the debt relief deal.

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The conditions of the PSI were fully based on NEEDS 2004-2007 (National Economic Empowerment and Development Strategy), the government's own policy reform programme. NEEDS can be seen as a document consolidating the reforms that were being implemented by the new economic management team that started in 2003. It can also be regarded as a follow up reform programme of the Interim-PRSP (Poverty Reduction Strategy Paper). NEEDS focused on four areas (Okonjo-Iweala and Osafo-Kwaako, 2007):

1. Improving macroeconomic environment;
2. Structural reforms;
3. Strengthening PFM;
4. Implementing institutional and governance reforms.

The development of NEEDS at federal level was complemented by State Economic Empowerment and Development Strategies (SEEDS).

Therefore the PSI reforms reflected a high degree of ownership by the Nigerian government. The value added of the PSI, relative to NEEDS, was that the PSI gave more specific quantitative targets and more exact timelines to the policies the government intended to implement.

## 4.5 Objectives of the Paris Club

The main motivations for the creditors to engage in the debt deal included:

- Strategic interests: Nigeria is a large and important West African country that plays a role in the stabilisation of the region and in the fight against terrorism. This motivation held in particular for the US;
- Oil security: a favourable debt treatment would help secure the flow of oil to the US and other countries in the West;
- Financial interests: creditors received an immediate payment of 40 per cent of the debt outstanding which was potentially more than they would have received in the immediate future in the absence of the deal;
- Long-term economic interests: by allowing this comprehensive exit strategy, Nigeria would become creditworthy again, allowing for expansion of trade with and investment in the country in general;
- Humanitarian interests: the deal would help Nigeria to reduce poverty and achieve the MDGs;
- 'Reputational' interests: the deal inflated ODA figures without disbursing fresh money; this held in particular for donors with no fixed ODA budget such as the United Kingdom (UK) and Germany.

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## 4.6 Dutch and Belgian policies

The Nigerian debt to the Netherlands amounted to about € 1.3 billion and to Belgium about € 470 million. The Netherlands was the 6<sup>th</sup> most important creditor to Nigeria. Both Belgium and the Netherlands were initially not in favour of a debt cancellation, because they considered the Nigerian external debt to be sustainable. Dutch and Belgian policy makers felt under pressure to agree with the G8-decision that was made early June, 2005; they had to agree because the Paris Club operates by consensus and the Club is considered to be an important institution for settling international debt positions.

The Netherlands was more active in its protest in the Paris Club. In addition, the Netherlands tried to influence the conditions of the deal; in line with the earlier Dutch attempts to influence the contents of the HIPC (Highly Indebted Poor Countries) initiative, Dutch policymakers stressed the importance of the PSI and of ensuring that freed resources would be used for poverty reduction.

Financial interests were to some extent important for both countries and were used to defend the deal in the Dutch parliament. The other official motivation for the Dutch government was humanitarian; the deal was expected to lead to higher social spending via the establishment of the Virtual Poverty Fund from the debt relief savings. For Belgium the reputational interests played a role as all money involved in the cancellation and buy-back was registered as ODA and led to an increase in the ODA figures.

After the Paris Club meeting in 2005, Belgium cancelled € 270 million (in total) out of the € 470 million of claims on Nigeria, which were then accounted for as ODA. The Netherlands cancelled € 731 million (in total) out of the € 1.3 billion of the claims on Nigeria, of which around € 622 million was accounted for as ODA. The Netherlands did not classify the discount on the debt buy-back (around € 110 million) as ODA. For the Netherlands, with a fixed ODA budget in per cent of GDP, the deal reduced other aid flows to developing countries in the years 2005-2007. However, the consequences for existing programmes were limited due to higher GDP growth than expected in this period and to the fact that the discount on the buy-back was not registered as ODA.

## 4.7 Comparison with international debt relief policies

The Paris Club agreement with Nigeria eliminated the debt fully. Another special feature of the agreement was the debt buy-back. Furthermore, the role of the IMF was different from other debt deals. The IMF did not need to assess the payment capacity of Nigeria in order to establish the degree of concessionality of the rescheduling or forgiveness. In addition, Nigeria was the first country for which a Paris Club agreement was accompanied by a PSI.

A difference with the HIPC initiative is that this deal only concerned the bilateral Paris Club debt while HIPC involves debt to all creditors. In addition, the overall debt reduction was not based on Nigeria's capacity to pay and was lower than in most HIPC cases. Furthermore, the deal with Nigeria was a full stock treatment. Nigeria had to pay a large amount up front but received an even larger immediate cancellation of the (full) debt stock with the Paris Club. Finally, the conditionality was different. There was extensive 'informal' conditionality before any debt reduction would be considered, and there was no requirement to elaborate and implement a Poverty Reduction Strategy Paper (PRSP). The requirements of having an IMF programme and being on track with that programme for at least six months (the first review) is similar to the condition for reaching the HIPC Completion Point.

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# Outputs

## 5.1 Introduction

The evaluation questions related to outputs are listed in the box text below.

### Evaluation questions: Outputs

9. What is the counterfactual for the flow and stock effect? Would debts have been serviced? Would ODA from the 15 creditors have been higher in absence of the debt relief operation?
10. What was the effect of the debt relief operation on debt stock and on debt service, both for federal and for state governments?
11. What was the effect of the debt relief operation on the balance of payments (in particular imports, exports, reserves)?
12. What was the effect of the debt relief operation on federal government and state government public finance accounts? (deficit, revenue and expenditure, composition of expenditure (investment-recurrent, spending by sector), financing of eventual deficit)?
13. What was the effect on MDG-related expenditure in the six sectors (health, education, water, power, roads, and agriculture), both in and outside of the VPF; and both at federal and at state level?
14. What changes in macroeconomic policies, public sector reform, debt management, anti-corruption policies and poverty reduction policies occurred in anticipation of a possible debt deal?
15. Were the conditions in the PSI with respect to macroeconomic policies, public sector reform, anti-corruption policies and poverty reduction policies implemented?
16. Did debt management improve, both at federal government level (Debt Management Office, DMO) and at state government level? Have other institutions played a role in improving debt management?

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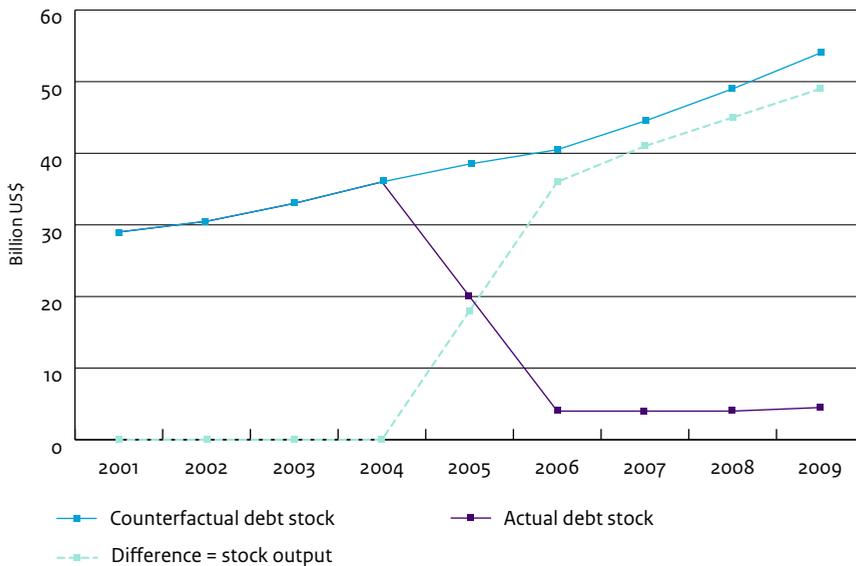
## 5.2 Counterfactual scenario debt relief

In the absence of the 2005 debt deal, Nigeria would have partially serviced its debt to the Paris Club creditors. The most likely counterfactual scenario would have been a debt service of about US\$ 1 billion annually, in line with what Nigeria was paying in 2003-2004. The US\$ 1 billion debt service paid to the Paris Club was about one-third of the annual debt service due in the years 2003 and 2004, and for this reason arrears accumulated and the Paris Club debt stock continued to increase between 2002 and 2004. Assuming that debt service *due* would remain at a level of US\$ 3 billion during the years 2005-2009, the arrears would have continued to increase *at the same pace*<sup>3</sup> as during 2003-2004 and so would have the Paris Club

<sup>3</sup> The annual increase in arrears not only consists of the US\$ 2 billion not paid, but also of interest payments and penalty interest payments on current and previous debt service not paid, resulting in an annually increasing arrears accumulation.

debt stock. Under this scenario, Nigeria's external debt stock would have increased from US\$ 36 billion in 2004 to US\$ 54 billion in 2009 (see Figure 4). Compared to an actual external debt stock of US\$ 4 billion in 2009, the counterfactual *stock effect* by end 2009 is US\$ 50 billion. Because it is likely that debt service *due* would also have increased as a result of the arrears accumulation, this is a conservative estimate of the counterfactual debt stock and the stock effect.

**Figure 4** Actual total external debt, counterfactual external debt and stock output of debt deal, in US\$ billion



Source: Table 4.3 of main report

Under the assumption of a counterfactual debt service payment of about US\$ 1 billion a year, and given that Nigeria had to pay around US\$ 12 billion as part of the agreement, the *flow effect* is negative up to 2019. Aid flows were not reduced as a result of the debt deal, so the flow effect was not further impacted by reduced aid flows.

## 5.3 Policy reform before and after the debt deal

### 5.3.1 Actual policy reforms

Policy reform in Nigeria can be divided into four periods:

- The period 1999-2003; initiating the reform agenda
- The period 2003-2005; expanding the reform agenda
- The period 2005-2007; reform continuation
- The period 2007 to date: reform consolidation and stagnation

In 1999, with the start of the democratic rule of the Obasanjo administration, an era of reforms was initiated. In his first term Obasanjo focused on consolidating democracy, but also started anti-corruption measures such as establishing the Independent Corruption Practices Commission (ICPC). Obasanjo's administration began implementing existing legislation which had not been implemented before. The Obasanjo administration resumed the dialogue with the IFIs and in January 1999 the IMF began a Staff Monitored Programme (SMP) which led to a Standby arrangement in August 2000. However, government expenditure increased way beyond the targets and this programme was 'off track' quickly. In 2002 the government presented an Interim PRSP (I-PRSP). In 2003 the government approved the law which founded the Economic and Financial Crimes Commission (EFCC) and the organisation started its activities.

In 2003, President Obasanjo appointed a new economic team that was very reform-minded. This team initiated NEEDS. The focus of reform was very much on macroeconomic stability. Important reforms initiated in this 2003-2005 period were:

- Fiscal policy (the introduction of an oil price based fiscal rule, see also section 5.4);
- PFM reforms (making transfers more transparent, improving cash management, introduction MTEF (Medium Term Expenditure Framework), extending the due process in procurement to all ministries and parastatals;
- Implementation of a disciplined monetary policy;
- Structural reforms focused on privatisation, civil service reform, banking sector reform, and trade policy reform;
- Governance reform (fighting corruption, EFCC, EITI (Extractive Industries Transparency Initiative)).

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The reforms in the period 2005-2007 were mostly reflected in the PSI, as the government of Nigeria used the PSI as a way to specify and set a concrete time frame for the reforms. The PSI reflected a strong focus on PFM reform in the period 2005-2007 with 8 structural assessment criteria and 9 structural benchmarks. Reforms focussed on:

- Improving transparency and accountability (publication of revenues to all three tiers of government, identifying MDG expenditure in budget classification, producing quarterly expenditure reports on VPF, auditing arrears, oil and gas sector auditing);
- Improving debt management (establish primary dealer structure);
- Expenditure control (introduction of the Integrated Personnel and Payroll Information System (IPPIS) database pensioners, settle contractor arrears);
- Improve revenue collection (automated tax collection, tax policy unit, custom service reform).

Furthermore, the government continued with its privatisation programme and organisational structures for the reforming ministries were reviewed and rationalised. Banking sector reform focused in the period 2005-2007 on improved banking supervision. Parliament approved the new Procurement Act (which is based on the due process mechanism) in 2006. However, Okonjo-Iweala & Osafo-Kwaako (2007) identified in 2007 that a substantial part of the reform agenda still needed to be implemented at state level. Gillies (2007) confirms this view. In 2009 the IMF also concluded that some economic reforms still had to be implemented at the state and local level, especially addressing PFM.

Most key stakeholders identified a slow down in reforms after 2007. This can be partly explained by the fact that reforms after 2007 were more focused on implementation of new laws and regulations. In addition, some Acts reached the point of roll out to the states (such as the Procurement Act and the Fiscal Responsibility Act). This is a slow process, as every state needs to assess the Acts, translate to their own specific circumstances and complete a political consultation process with state assemblies. Furthermore, a new government took office in 2007 with a less rigorous approach to reform. Although the new government was still committed to the reforms, fewer new initiatives could be identified, as well as a less rigorous approach to implementing existing reforms.

### 5.3.2 Effect of the debt deal on policy reform

The anticipation of the debt deal has had a moderate to strong effect on policy reforms carried out before 2005, and especially from 2003 onwards. After the change in government in 1999 some reforms would have been implemented anyway. However, the prospect of possible debt reduction gave political leverage to more controversial reforms such as macroeconomic policies (in particular the application of the oil price based fiscal rule), civil service reforms, privatisations, EITI, and the fight against corruption. The anticipation of a debt deal also helped achieve a stronger focus on spending for the MDGs and on poverty reduction policies (social safety net, human development). In the absence of the prospect of the debt deal, much lower savings would have accumulated in the ECA.

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In the period 2005-2007 the PSI helped to maintain prudent macroeconomic policies by setting specific quantitative targets with a clear timeline for foreign reserves and government expenditure. However, towards the end of the 2005-2007 period and especially before the 2007 elections, reform implementation became weaker. Although savings in the ECA continued to accumulate, the oil price based fiscal rule, and its accompanying ECA, were not followed as strictly as before. After 2007, some reforms continued but in other areas there was some backsliding.

## 5.4 Public finance

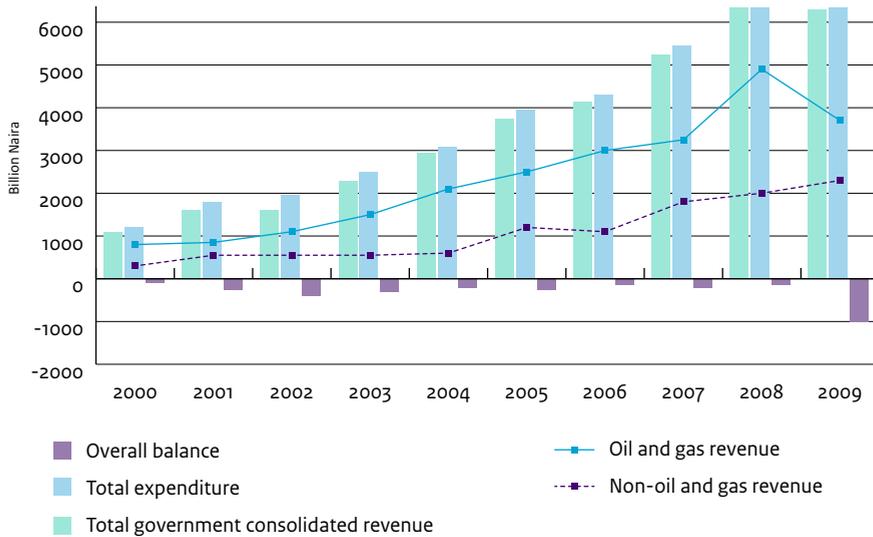
### 5.4.1 Actual developments in public finance

Figure 5 presents total government consolidated revenue, oil/gas and non-oil/gas, total expenditure and the overall balance for the period 2000-2009. In the period 2000-2009 total government consolidated revenue increased by a factor six in nominal terms. In the period 2002-2005 the revenue increase was already strong, mainly as a result of rising oil and gas revenues. Non-oil revenue also experienced substantial growth, especially in the period 2005-2009.

Total government expenditure also increased substantially. In 2004 Nigeria introduced the oil price based fiscal rule. The objective of this rule was to disconnect government revenues and expenditure by introducing more conservative oil prices on which the government budget is based. Initially the oil price based fiscal rule kept the government deficit under control. In 2009 the consequences of the global economic crisis became apparent in

Nigeria's budget. As a result of falling oil prices the overall balance moved to minus 995 billion N (equal to a deficit of approximately 6 per cent of non-oil GDP in 2009). For 2010, a minor deficit is expected.

**Figure 5** Consolidated government revenue, expenditure and overall balance, in billions of Naira, 2000-2009

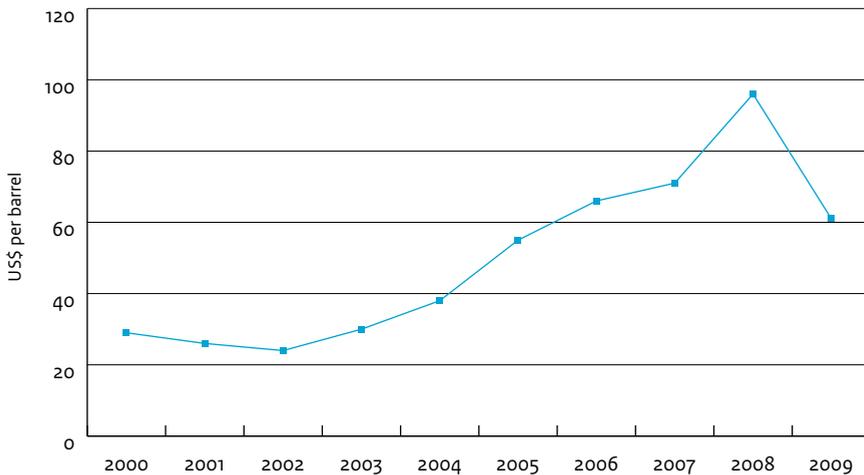


Source: CBN Annual reports 2009 (p. 233), 2007, 2004 (p. 128-134).

The increase in government expenditure over the period 2000-2009 is noticeable at the federal, state and local level. Up to 2008, a clear trend was observable in that state and local government were becoming more important for government spending relative to federal government expenditure. In 2000, state and local governments were responsible for 35 per cent of government expenditure, whereas by 2008 it had accumulated to 50 per cent. However, after 2008, it declined again to roughly 40 per cent of total expenditure.

The movement of the oil price has been crucial for the public finance position of Nigeria. During the period 2002-2008 the oil price had been on an increase, more than tripling its value. After 2008 this trend was abruptly reversed (see Figure 6).

**Figure 6** Average yearly oil price (Bonny light), per barrel, in US\$, 2000-2009



Source: CBN (oil price CBN Annual report 2008, CBN Statistical Bulletin 2004, figures 2009 based on internet data CBN website).

#### 5.4.2 Effect of the debt deal on public finance

The US\$ 12 billion paid in 2005 and 2006 by Nigeria to its creditors was paid from the ECA. The ECA is the account in which oil revenues over and above a prudent annual estimate are accumulated, through the application of the oil price based fiscal rule. This rule practically de-linked public expenditure from (oil driven) public revenues, by stating that government expenditure should be based on a prudent oil price benchmark. Key interviewees and the IMF (2009) stated that this may have been one of the most important macroeconomic reforms, and most interviewees emphasised that the anticipation of possible debt reduction gave the political leverage for it. The debt deal itself, through the PSI, contributed to continued implementation of the oil price based fiscal rule after 2005.

This rule contained expenditure growth in the context of an economic boom and kept the fiscal deficit under control. In addition, as a result of increasing oil prices to well above the conservative oil price used for the budget, substantial fiscal savings were achieved of up to US\$ 18.5 billion by 2005. In the absence of the anticipation of a debt deal, the savings in the ECA would have been much lower. For this reason, the US\$ 12 billion payment did not hamper government expenditure. Some important stakeholders indicated that if the Nigerian government had spent the US\$ 12 billion within a short period (2003-2005), the beneficial effects would have been limited and perhaps even zero or negative: for the overall stability of the economy it was better to save this money than to spend it in the short term. Although technically the flow effect on the fiscal accounts is negative, there has not been a

negative effect on the economy. In Nigeria the payment of the US\$ 12 billion is seen as a sunk cost or an investment that eliminated the debt stock and created annual debt relief savings of US\$ 1 billion from 2007 onward. However, in 2007 and 2008 this effect was not noticeable due to the continued sharp rise in the oil price. This changed in 2009, when government revenues were lower and the positive flow effect of the US\$ 1 billion debt relief savings was noticeable.

At state level the conclusion is different. The states' share in total Paris Club debt was around 25 per cent, so the states also had to pay 25 per cent of the US\$ 12 billion from their share of the ECA. The states with a higher share in the Paris Club debt than their share in the ECA had to make proportional compensation payments to states with lower debts. This means that these states experienced a negative flow effect from the debt deal, often phased over several years.

## 5.5 Effect of the debt deal on the balance of payments

The payment by Nigeria to its creditors of US\$ 12 billion coincided with a rising oil price and consequently a rapidly rising export income. The high export income led to an increase in savings on the ECA which is considered part of the gross official foreign reserves. These reserves were already at US\$ 17 billion in 2004, or six months of imports, and they increased further in the following years as a result of the rising oil price. Imports were therefore not constrained by these payments. In 2007 and 2008 the oil price continued to rise and export revenues were buoyant. In these years, export income was so high that the US\$ 1 billion in debt relief savings did not have any noticeable effect on import capacity. This changed in 2009, when exports declined from a high of US\$ 84 billion in 2008 to US\$ 46 billion, and the overall balance became negative. In 2009, we can conclude that a positive flow effect of the debt deal became noticeable.

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## 5.6 Debt management

### 5.6.1 Actual development of debt management

Prior to 1999, debt recording was poor with mostly inaccurate data and debt management functions were scattered among various agencies. This led to the setting up of the Debt Management Office (DMO) in 1999. Over the period 1999-2005, debt management improved substantially and the government's commitment to debt management has continued beyond the completion of the debt relief agreement. DMO has improved a number of important debt management functions:

- First, it has brought together recording of all borrowing into a single agency, which previously was scattered across several agencies resulting in poor coordination;
- Second, debt data has been verified and validated so that detailed accurate and up to date

data is now available. Delays in data retrieval have been substantially reduced and accuracy improved with the recruitment of competent staff and a substantial training programme, especially in the application of the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS);

- Third, negotiating skills on external borrowing have improved and the capacity to analyse various borrowing options has been strengthened;
- Fourth, DMO now carries out debt sustainability analysis;
- Fifth, progress has also been made in the development of a legal framework for contracting debts.

### 5.6.2 Effect of the debt deal on debt management

Although debt management and debt recording would have advanced somewhat without the (prospect of a) debt deal, the anticipation of possible debt reduction provided a strong motivation to implement improvements at the federal level faster and more thoroughly. The debt deal itself brought attention to the issue of improving debt management capacities of the states, but these capacities vary and are often still weak.

## 5.7 MDG-expenditure and VPF

### 5.7.1 Actual MDG-expenditure for development

Table 3 shows that the shares of total actual expenditure for the different MDG related sectors are highly fluctuating without clear trends. While the share of education expenditure decreased in 2006, that for health increased. In 2005, the federal government began to give a grant to all states for 'universal basic education'. As a share of total spending, this flow decreased slightly over time.

	2004	2005	2006	2007	2008
Agriculture	1.2	1.2	1.1	2.4	4.9
Water resources <sup>2</sup>	2.5	5.4	4.7	3.9	
Power and Steel	4.8	0.7	4.4	2.5	1.1
Education	9.4	17.6	8.1	8.2	7.0
Universal basic education	0.0	2.4	1.8	2.0	1.6
Health	4.2	1.4	5.2	5.7	4.3
NAPEP	0.2	0.1	0.2	0.1	0.1
Women affairs	1.4	0.1	0.2	0.1	0.1
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

<sup>1</sup> The sum of these shares is not 100 because not all sectors are presented.

<sup>2</sup> In 2008, expenditure for Water is included in that for Agriculture.

Source: Own calculations on the basis of data from OAGF.

The share of education within total *capital* expenditure increased enormously after 2004 and for health especially between 2005 and 2006, with the establishment of the VPF (see Table 4). This suggests that the VPF spending has been additional (see also below).

	2004	2005	2006	2007	2008
Agriculture	1.1	0.7	0.8	4.4	11.1
Water resources <sup>2</sup>	9.4	18.7	14.6	8.4	
Power and Steel	18.8	1.8	14.4	6.5	2.7
Education	2.2	0.5	1.7	3.6	5.0
Universal basic education	0.0	8.8	6.1	5.5	4.3
Health	0.1	1.9	4.1	6.4	4.1
NAPEP	0.1	0.0	0.3	0.0	0.0
Women affairs	0.0	0.1	0.3	0.2	0.0
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

<sup>1</sup> The sum of these shares is not 100 because not all sectors are presented.

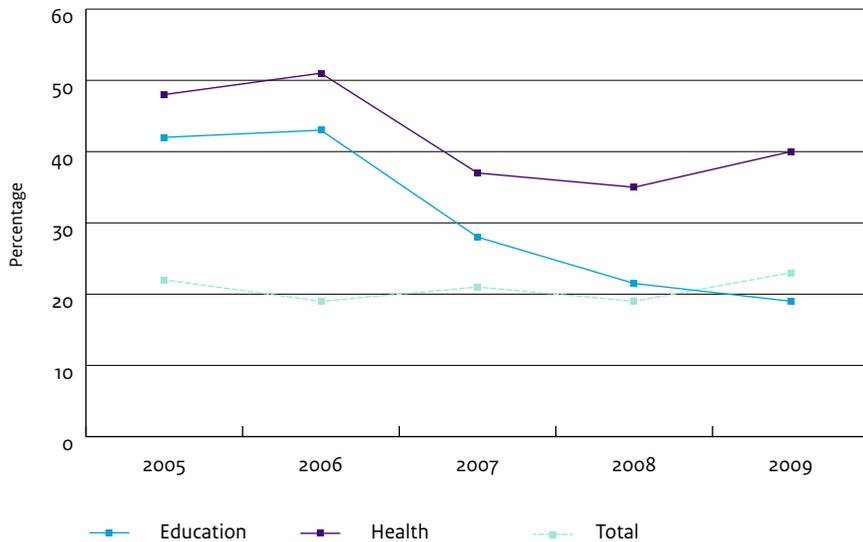
<sup>2</sup> In 2008, expenditure for Water is included in that for Agriculture.

Source: own calculations on the basis of OAGF figures.

Figure 7 shows that the share of MDG expenditure (capital plus recurrent) within total budgeted expenditure remained constant between 2005 and 2009, fluctuating between 19 and 23 per cent.<sup>4</sup> The share of MDG spending within the health sector decreased between 2006 and 2008, and increased again after 2008. For the education sector, the share of MDG spending in total sector spending continued to decline after 2006.

<sup>4</sup> This is based on a study that identified MDG expenditure by line item within each sector, so it gives a more accurate picture of MDG spending than the analysis by sector presented in Tables 3 and 4. Unfortunately, these figures are only available for budgeted expenditure.

**Figure 7** Share of MDG spending in budgeted expenditures (capital plus recurrent) for total spending and for spending in health and education, federal level, in %, 2005-2009



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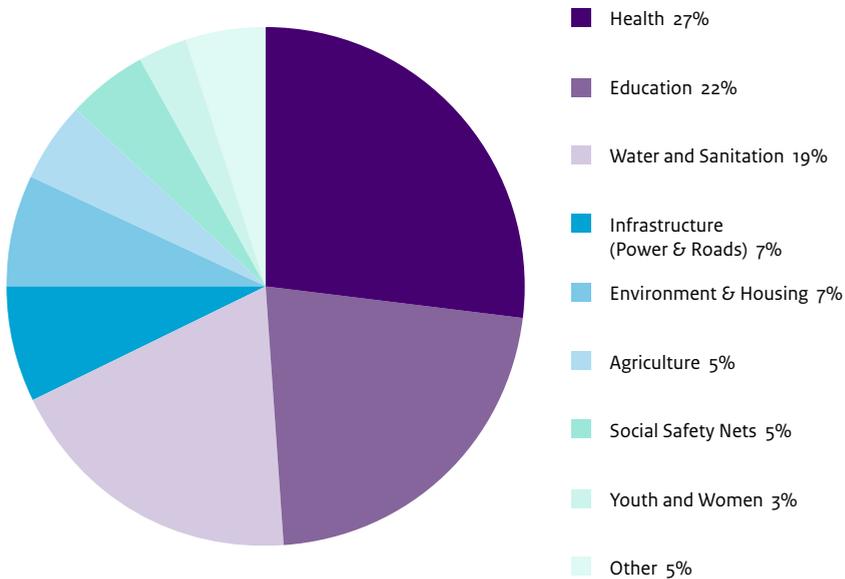
Source: Elaboration of data from OSSAP/MDG 2010.

### 5.7.2 MDG-expenditure and the debt deal: the VPF

The creation of a Virtual Poverty Fund in Nigeria was a condition of the debt relief agreement and it would not have been established in its absence. Therefore it can be attributed fully to the debt relief agreement, and in particular to the conditions attached to that agreement. In fact, debt relief conditionality comprised of two components: first, the tracking of MDG expenditure at federal level within the capital budget of the different MDAs. This was indicated as MDG-spending in the budget. Second, the establishment of the VPF for US\$ 1 billion of debt service savings. Via the VPF, the debt service savings would be used for additional MDG spending.

The MDG-expenditure was tracked in the federal budget from 2006 onwards and a VPF of about US\$ 750 million was established - proportional to the federal share in debt relief savings. There is no VPF at state level, but since 2007 part of the federal VPF is transferred to the states for MDG-related projects with matching funds from the states through the Conditional Grant Scheme (CGS). Actual VPF spending has been around three quarters of budgeted spending. Most money has been allocated to strengthen primary health care, primary education and to provide access to water and sanitation (see Figure 8). Smaller shares were allocated to social safety net projects, including a (still small) conditional cash transfer programme, and to improving rural infrastructure.

**Figure 8** VPF allocation to federal MDAs, in %, 2006-2010



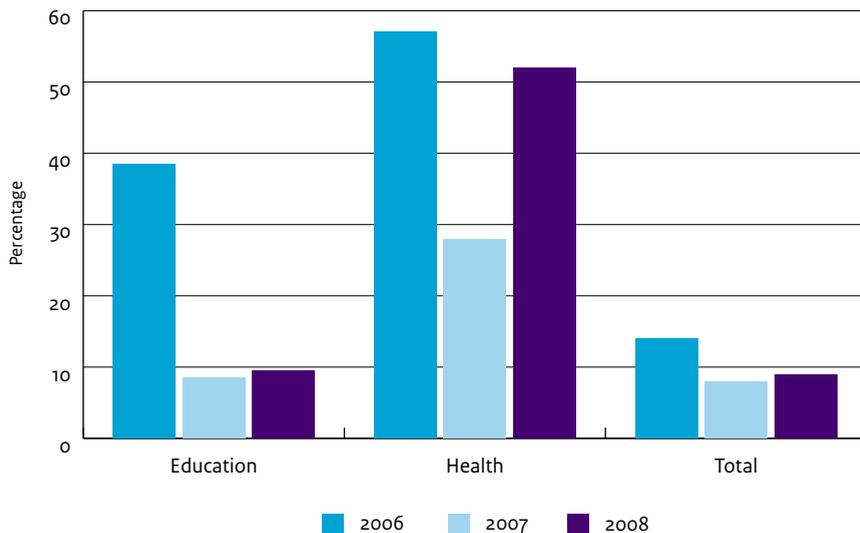
Source: OSSAP/MDG.

The VPF has designed innovative practices for, in particular, the planning and costing of projects, and for monitoring and evaluation (M&E). VPF projects are not only tracked in the budget, but their outputs and outcomes are monitored via a decentralised M&E framework (OPEN, Overview of Public Expenditure of NEEDS) in which the private sector and civil society are involved. As VPF projects are implemented through ministries, departments and agencies, and also through states (since 2007) and local governments (to be started in 2010 or 2011), the VPF aims to institutionalise these practices more broadly.

### 5.7.3 Additionality

Total government expenditure increased in real terms over the years 2005-2009, as did capital expenditure. The share of spending on the MDGs in the federal government budget was maintained at around 23 per cent in this period, which means that in absolute terms MDG-spending increased. Actual VPF spending fluctuated between US\$ 490 million and US\$ 725 million annually in the period 2006-2009, with no clear trend. Over the years 2006-2008, VPF expenditure decreased from 14 to 8 per cent relative to the total capital expenditure of the federal government. For sectors such as health and education, the share of the VPF in total capital expenditure was high in 2006 (for health 57 per cent and for education 38 per cent, see Figure 9). However, the share for education declined in later years. According to relevant stakeholders, most of the VPF spending has been additional to other spending for the MDGs; additionality is higher for the states and smaller federal MDAs than for the larger federal MDAs.

**Figure 9** *Share of VPF actual spending in total actual capital spending, for total expenditures and for health and education, in %, 2006-2008*



Source: Own calculations based on data from OSSAP-MDG and from OAGF.



6

# Outcomes

## 6.1 Introduction

The evaluation questions related to outcomes are listed in the box text below.

### Evaluation questions: Outcomes

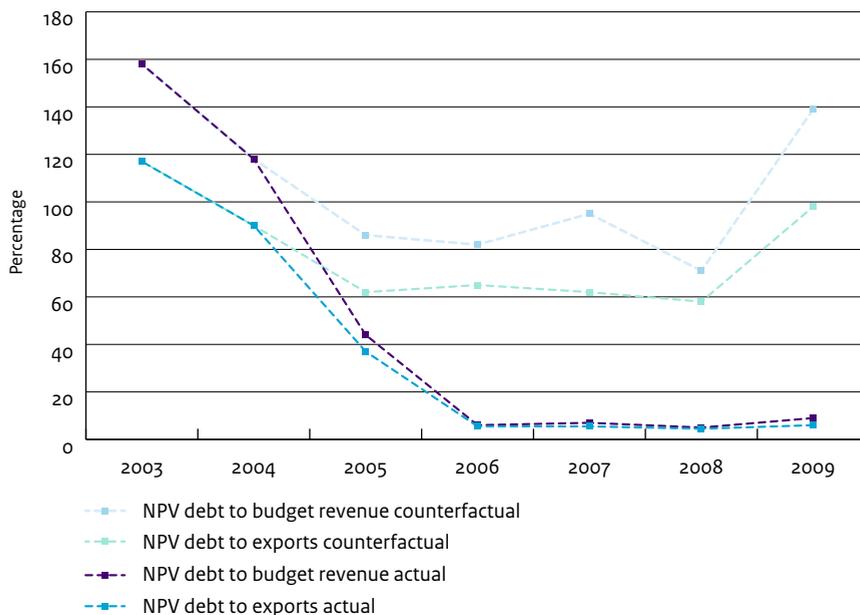
17. Did the debt deal and possibly improved debt management, both federal government level and states, result in a more sustainable external debt and in a sustainable total public debt? Why or why not? What was the role of DMO and other institutions?
18. Did the reduction in the debt stock lead to improved incentives for designing and implementing development policies, at both federal and state government level?
19. Did the reduction in the debt stock lead to reduced domestic interest rates and improved creditworthiness?
20. To the extent that interest rates reduced and creditworthiness improved, have these development led to an increase in private investment and in inflows of private capital from abroad?
21. To the extent that (federal and state) government expenditure on MDG related sectors increased, within or outside of the Virtual Poverty Fund, what was the effect on improved access of the poor to social services, water, power, agricultural services, and roads? What was the effect on agricultural production? Are there any differences between states and/or regions? What was the role of the VPF?
22. Has there been 'crowding in' of induced higher public investment (no. 12) on private investment? Did public sector reforms induce growth of the private sector?
23. What were the effects of possibly improved macroeconomic (financial and monetary) policies on intermediary variables such as macroeconomic stability, exports and investment? Were exports influenced by eventual effect of debt relief operation on exchange rate?
24. Did public sector reforms and better anti-corruption policies improve governance and accountability at both federal and state level, and lower corruption? Why or why not?

## 6.2 Debt sustainability

According to the Debt Sustainability Analyses (DSAs) carried out by the IMF in 2007, 2009 and 2010, the sustainability of Nigeria's external debt is assured in the long term. All debt sustainability ratios show that the external debt has become very sustainable after the debt deal, while it would have been marginally sustainable in the absence of the debt deal. Figure 10 shows the trend in two solvency ratios, NPV (Net Present Value) of external debt to exports and NPV of external debt to budget revenue for both actual and counterfactual scenarios. Although the counterfactual ratios are much higher than the actuals, both are well below the HIPC thresholds of 150 per cent for the NPV debt to exports ratio and 250 per cent for the debt to revenue ratio. In the counterfactual, liquidity debt sustainability

indicators such as external debt service to exports and external debt service to budget revenue are both within the sustainable level.

**Figure 10** Actual and counterfactual NPV external debt<sup>1</sup> to exports ratios and NPV external debt to revenue ratios, in %, 2003-2009



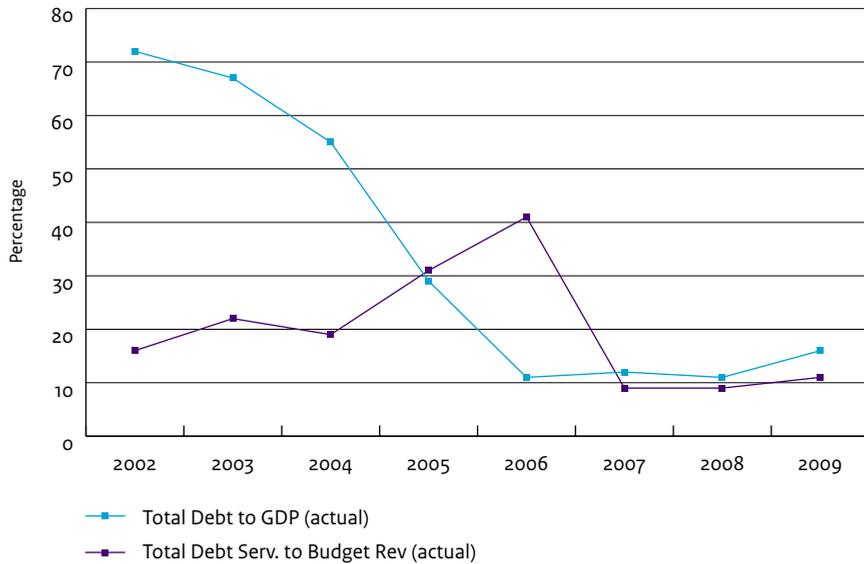
<sup>1</sup> NPV computed as 95 per cent of actual or counterfactual debt, as explained in 5.2.1 of main report.

Source: Own calculations on the basis of DMO reports, IMF Article 4 reports (2005, 2008, 2009), CBN reports.

Figure 11 shows total debt to GDP, which measures the overall debt burden, and total debt service to budget revenue, which measures liquidity and the impact on government revenue. Actual total debt to GDP fell significantly from 2002 until 2005 and started to increase slightly from 2006, due to an increase in domestic debt. However, the rise in the domestic debt stock does not lead to an unsustainable public debt, as total debt to GDP is still much lower than the potential benchmarks of 60 per cent and 40 per cent.<sup>5</sup>

<sup>5</sup> The threshold of the total debt to GDP ratio of 60 per cent is based on the norms of the Euro area; however, it is claimed that debt/GDP ratios for low and middle income countries should remain within 40 per cent, and DMO Nigeria accepts this.

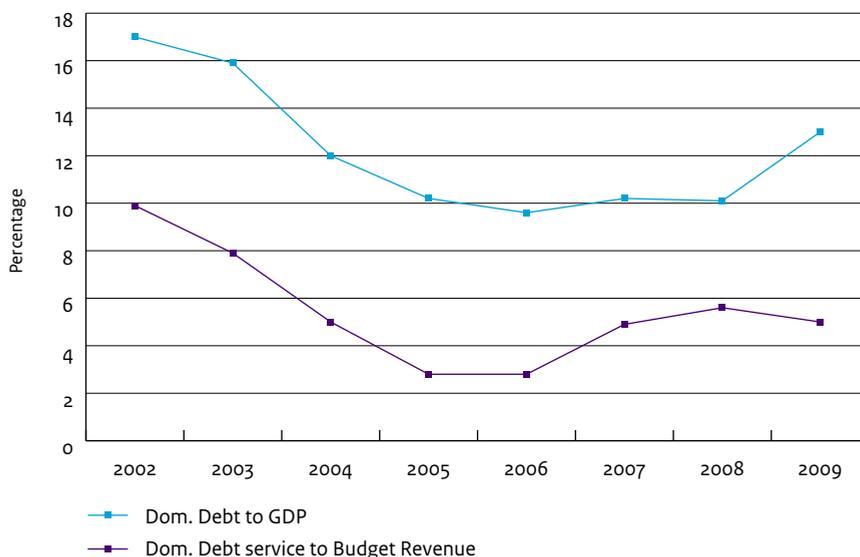
**Figure 11** Actual total debt to GDP and total debt service to Budget revenue ratios, in %, 2002-2009



Source: DMO reports, CBN annual reports, NBS.

The relatively positive counterfactual scenario, described earlier, is due to the high growth rates and high oil prices in the years after the debt deal. After obtaining debt relief, the external debt sustainability ratios have declined substantially and have placed Nigeria in a very comfortable position. The prospects for debt sustainability in the future are good. However, the recently rapidly increasing domestic debt, although still at a low level, is cause of concern (see Figure 12). The fact that debt management at federal level improved strongly is a reassuring factor in maintaining a sustainable public debt.

**Figure 12** Domestic debt to GDP ratio and Domestic debt service to Budget revenue ratio, in %, 2002-2009



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Source: DMO annual reports, DMO Debt Sustainability Analysis report 2010.

### 6.3 Improved policies

The reduction of the debt stock eliminated the debt overhang, which has been shown by others to be the cause of the high volatility of fiscal expenditure in Nigeria from 1984 onwards (Budina et al., 2007). This high fiscal volatility was one of the causes of low economic growth. The elimination of the debt overhang therefore allows for better fiscal policies. This is not so much an effect of improved incentives for better policies, as would be the theoretical assumption, but more an effect of the removal of a real constraint.

### 6.4 Interest rates and creditworthiness

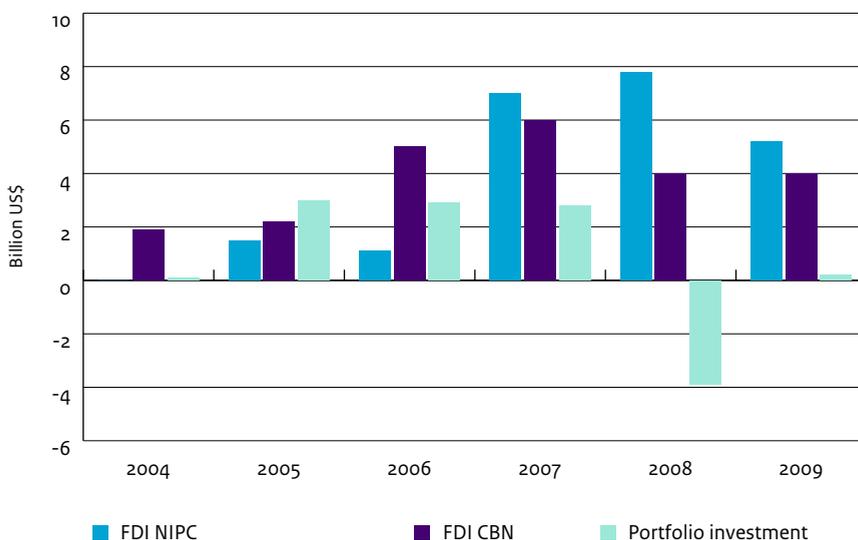
After 2005, nominal interest rates fell, especially interest rates on 3-month Treasury bills. However, this trend cannot be ascribed to the debt relief agreement. Nigeria's creditworthiness clearly improved as evidenced by the first sovereign rating ever given to Nigeria just after the debt deal. Nigeria obtained a BB-rating from Fitch Ratings in January 2006 and gained the same rating from Standard & Poor in February 2006. This was partly the result of the elimination of the debt overhang, but also of the many policy reforms carried out - in turn to a large extent induced by the anticipation of debt relief. The debt deal also served as a signal that policies had improved.

## 6.5 Inflows of private capital and private investment

Public investment increased but not as a result of debt relief savings. This means that there cannot have been a 'crowding in' effect on private investment from the debt relief induced public investment. However, the combination of policy reforms and the elimination of the debt overhang led to improved creditworthiness and the debt agreement itself acted as a signal that policies had improved and this further improved investor confidence. As a consequence, there was an increase in foreign direct investment and portfolio capital inflows, at least until the global crisis hit, 2008 or 2009 (see Figure 13). It can theoretically be expected that the same combination of factors would lead to an increase in private investment but the private investment figures are not sufficiently reliable to confirm this. According to national data, total investment (public plus private) has been at a level of between 6 and 8 per cent of GDP since 1995. It jumped to 10 per cent in 2003 but then decreased to 5.5 per cent in 2005. In later years, it hovered around 8 or 9 per cent.

It is clear that the private sector response also depends on many other factors and that Nigeria's investment climate still faces many challenges, most notably the frequent power cuts but also the continuing violence and high level of corruption. It is therefore difficult to attribute a particular trend in private investment to the debt deal, over and above the many other factors influencing this variable.

**Figure 13** Foreign Direct Investment (FDI) and Portfolio capital inflows, in US\$ billion, 2004-2009



Source: Nigeria Investment Promotion Commission for FDI (as indicated), and Central Bank of Nigeria, Annual Reports for FDI (as indicated) and for portfolio investment.

## 6.6 Macroeconomic stability

The prospect of debt reduction helped establish the oil price based fiscal rule and the related accumulation of savings in the ECA. The PSI helped to continue this rule and to maintain expenditure caps and specific targets with a clear timeline for foreign reserves. As a result, the balance on the ECA was higher than it would have been in the absence of the (prospect of a) debt agreement. The expenditure caps that were maintained may have had some influence on the containment of inflation. In addition, the accumulated savings on the ECA allowed for a stimulating fiscal policy in 2009, when Nigeria suffered from lower government revenues as a result of the global economic crisis. The balance of the ECA decreased from US\$ 20.3 billion in 2008 to US\$ 6.5 billion in 2009 and US\$ 3.3 billion in mid-2010. In the counterfactual, therefore, the crisis would either have led to increased borrowing with risks for future debt sustainability and possibly growth, or (in case of no additional spending) it would have affected growth directly.

However, some key interviewees doubt whether fiscal stimulus actually impacted economic development in 2009. There are even more doubts on the economic rationale for a stimulating fiscal policy in 2010. The first results of 2010 present positive economic results of 7.4 per cent GDP growth in the first quarter of 2010 and 7.7 per cent GDP growth in the second quarter as a result of an increasing oil price and further development of the non-oil sectors. Given the much less vigorous application of the oil price based fiscal rule in 2010, future fiscal sustainability (and thus macroeconomic stability) may be under threat.

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## 6.7 Governance

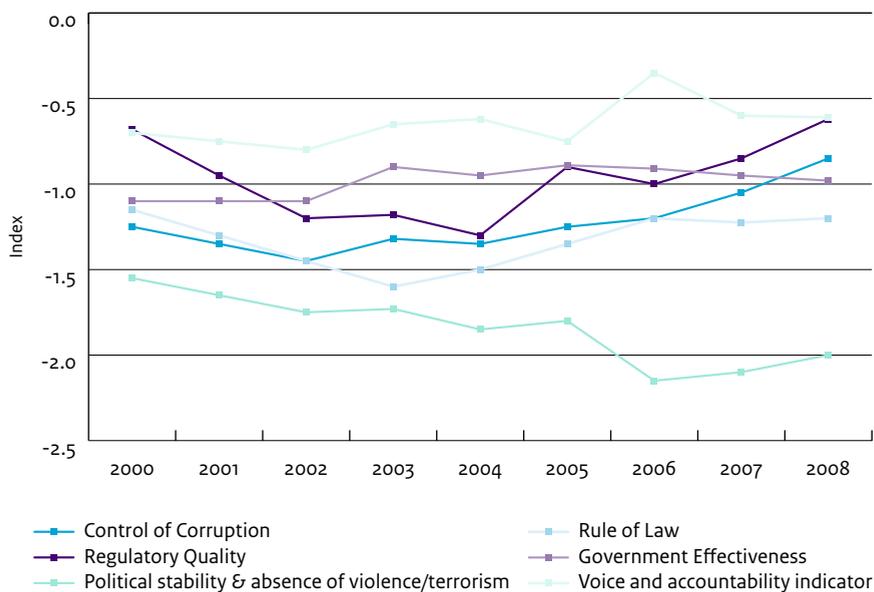
The anti-corruption policies carried out since 2000, and especially since 2003 (the ICPC, the EFCC, the new procurement regulations and the participation in EITI), had some impact on governance and corruption indicators, such as the Transparency International corruption index (see Table 5) and the World Governance Indicators (see Figure 14).

Year	Index	Ranking
2001	1	90/91 (0.99)
2002	1.6	101/102 (0.99)
2003	1.4	132/133 (0.99)
2004	1.6	144/145 (0.99)
2005	1.9	152/158 (0.96)
2006	2.2	142/163 (0.87)
2007	2.2	147/179 (0.82)
2008	2.7	121/180 (0.67)
2009	2.5	130/180 (0.72)

Source: Transparency International (various reports).

These indicators in general improved between 2002/2004 and 2007/2008, and this can be partly attributed to the (anticipation of a) debt deal that led to more vigorous anti-corruption policies especially between, roughly, 2003 and 2007 (see section 5.2). After 2007/2008 most indicators deteriorated slightly.

**Figure 14** Kaufmann Governance indicators for Nigeria, 2000-2008



Source: Kaufmann et al. (2009).

Note: No indicators were constructed for 2001. In the figure we have averaged the 2000 and 2002 value for illustrative purposes.

## 6.8 Access and quality of public services

The Virtual Poverty Fund, fully attributable to the debt agreement, has already produced some intermediate outcomes. Some of the quantitatively more important outputs of the VPF, including the CGS, include:

- 22,000 households benefited from the Conditional Cash Transfer Programme Care of the People (COPE)
- 900 rural electrification projects were completed
- 5,200 microcredit cooperatives were funded
- 300,000 teachers were trained
- 74,000 new teachers were recruited and trained
- 1,453 classrooms were constructed
- 126 million vaccines were procured
- more than 3,000 PHC (Primary Health Care) centers were constructed
- 6,673 health workers were trained
- 2.5 million malaria nets were distributed
- 2,500 midwives were engaged and deployed
- more than 36,000 water schemes were built
- 1,423 toilets were constructed

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From these outputs and also from the data on budget allocation, it is clear that there has been a strong focus on improving primary health care and primary education, as well as on enlarging access to water and sanitation. The VPF projects and programmes were focused on critical areas for MDG achievement. The Monitoring and Evaluation reports reveal that there have been implementation problems, but many challenges have been addressed and completion rates have improved over time.

Table 6 and 7 give some available access indicators for the areas that the VPF targeted. The *access to services* is the more direct outcome of possible increased and improved service delivery.<sup>6</sup> Most indicators show an improvement. Primary enrolment increased between 2004 and 2008, and so did the ratio of girls to boys in primary education. This is probably due to the Universal Basic Education promoted since the beginning of the decade and the accompanying grants from federal to state governments for this aim, but there will also have been some influence from the VPF.

The proportion of the population that has visited a health facility dramatically increased between 2006 and 2008. The proportion of children immunised also increased (both tables), as did the proportion of children sleeping under insecticide-treated bed nets although the number is still low. However, access to pre-natal care decreased between 2006 and 2008 and the trend in the proportion of births attended by skilled health staff is erratic. It appears that the effects of the increased number of midwives trained and deployed are not yet visible in the 2008 figures. In the area of water and sanitation, the results are mixed.

<sup>6</sup> The ultimate outcome indicators are discussed in section 7.4 of this summary.

Access to water increased between 2006 and 2008, but access to modern toilet facilities appears to have decreased. The latter also holds for access to electricity.

	2003	2004	2005	2006	2007	2008	2009 <sup>1</sup>
Primary enrolment rate		81	85	88	90 <sup>1</sup>	89 <sup>1</sup>	
Pupils starting grade 1 who reach grade 5	84	74	74	74	74 <sup>1</sup>	72 <sup>1</sup>	
Children under 1 fully immunised against measles	31	50	60			41	74
Births attended by skilled health staff	36	35	44	44	44	39	
Children under 5 sleeping under insecticides-treated bednet	2					6	11

<sup>1</sup> Preliminary figures.

Source: Government of the Federal Republic of Nigeria (2010), Nigeria MDG Report 2010.

CWIQ Indicators	2006	2008 <sup>1</sup>	Comments
Access to potable water	51	54	Improvement
Use of modern toilet facility	58	40	Worsening
Access to electricity	55	46	Worsening
Pre-natal care	72	43	Worsening
Child immunisation	24	42	Improvement
Visited health facility in 2 weeks	55	80	Improvement

<sup>1</sup> Preliminary figures.

Source: NBS Core Welfare Indicators Questionnaire Survey 2006 and 2008/2009.

The activities financed by the VPF, in combination with the increased efforts for achieving the MDGs from the beginning of the decade, have contributed to increased primary enrolment rates, higher immunisation rates, increased use of primary health care facilities and increased access to potable water, among other achievements.

The institutional effects of the VPF on poverty reduction are perhaps even more important. The M&E system of the VPF is widely seen as good practice, but federal agencies and states are not (yet) applying the VPF framework for their other expenditure. Yet there seems to be some influence already on project formulation and planning, as MDG costing exercises are becoming more common and these exercises are integrated in Medium Term Sector Strategies. These changes are likely to lead to more effective government spending and thus to better service delivery in the future.

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## Impact, sustainability and lessons learnt

## 7.1 Introduction

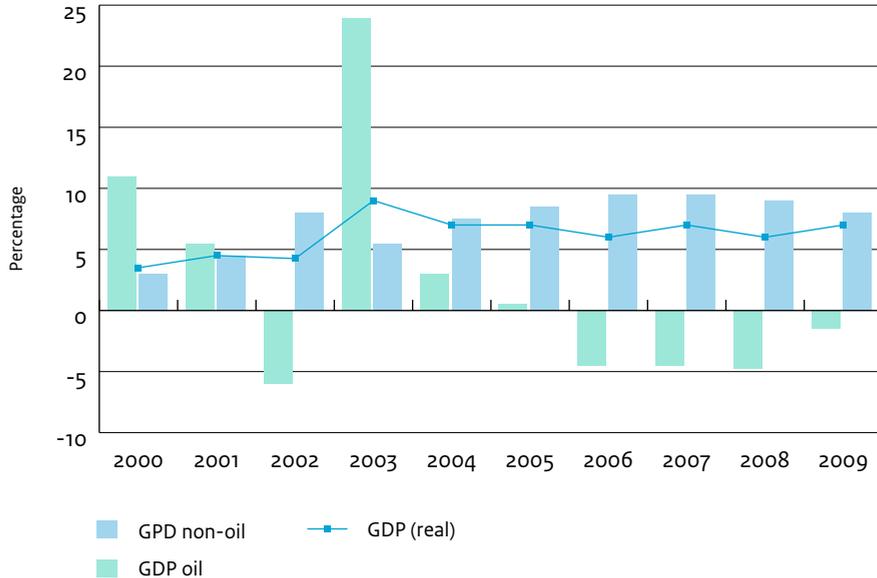
The evaluation questions related to impact, sustainability, and lessons learnt are listed in the box text below.

### **Evaluation questions: impact, sustainability and lessons learnt**

25. What is the impact of the debt relief operation, via the possible outcomes such as improved debt sustainability and debt management, higher public and private investment, higher private capital inflows, improved macroeconomic stability, and higher exports on economic growth?
26. Is there an effect from economic growth on income poverty reduction?
27. What are the effects of (possibly) improved poverty reduction policies and more access of the poor to social and other services on income and non-income poverty?
28. To what extent are the (possible) results in terms of outcomes (debt sustainability, improved macroeconomic framework and PFM, reduced corruption) and impact (growth, poverty reduction - both income poverty and social indicators) sustainable?
29. What lessons can be learnt regarding validity and appropriateness of the intervention theory underlying debt relief as a means to contribute to economic growth and poverty alleviation?

## 7.2 Impact on economic growth

In the years 2004-2009, annual economic growth has been at around 6 or 7 per cent, while non-oil growth was even higher at 8 or 9 per cent (see Figure 15). Growth was particularly high in agriculture and services (see Table 8).

**Figure 15** GDP growth (oil and non-oil), in %, 2000-2009

Source: CBN annual report 2009 (p. 246), 2007(p. 207), 2005 (p. 175).

Table 8 GDP growth per sector, in %, 2004-2008					
	2004	2005	2006	2007	2008
Agriculture	6.5	7.1	7.4	7.2	6.5
Industry	4.2	1.7	-2.5	-2.2	-2.2
Services	8.8	8	9.2	9.9	10.5

Source: CBN.

According to the theory-based evaluation methodology, some of this growth can be ascribed to the debt relief if, and to the extent that, positive stock, flow or conditionality outcomes of the debt deal can be identified. We have shown that the stock and the conditionality channel have produced some outcomes. These outcomes include full debt sustainability, improved confidence in the economy and improved creditworthiness, leading to some increase in foreign capital inflows, and improved macroeconomic stability and in particular the possibility to cushion the effects of the 2009 global economic crisis. In addition, the improved policies in general will have benefited the investment climate. Some of the outputs of the VPF such as improved rural infrastructure and some components of the social safety net can also be expected to have contributed to growth and will continue to do so in the future.

### 7.3 Effect on income poverty reduction via economic growth

Income inequality in Nigeria is high, but it has been decreasing over time. The World Bank estimated in its Nigeria Poverty Assessment (2007) a decrease in the inequality (Gini) coefficient from 53 in 1996 to 49 in 2004 to 44.3 in 2007. With such a decreasing trend, it can be assumed that economic growth has been pro-poor, and has led to a decrease in the poverty incidence.

Given the conclusion that the debt deal had *some* impact on economic growth, it may also have an (indirect) effect on poverty reduction *via* this economic growth. The high agricultural growth rate suggests that there has been some income poverty reduction, as poverty has proven to be strongly correlated with having a rural occupation (World Bank, 2007). However, there is also evidence that growth in the recent past (1999-2008) has not been accompanied by increases in formal employment.

Regional figures show that between 2004 and 2007, income poverty decreased in the North and in the South West of the country but not in the South South and the South East (see Table 9). The recent reduction in violence in the South following the amnesty agreement in 2009 may imply that growth will now also be accompanied by some poverty reduction in the South. On balance, given that growth was somewhat enhanced by debt relief, it can be concluded that debt relief also contributed modestly to income poverty reduction in Nigeria.

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Zones	Gini Coefficient 1996*	Gini Coefficient 2004**	Poverty incidence 2004**	Poverty incidence 2007***
North East	0.47	0.46	72.2	67.3
North West	0.30	0.37	71.2	63.9
North Central	0.53	0.39	66.9	63.3
South East	0.55	0.45	26.7	34.2
South West	0.57	0.55	43.0	20.9 (Oyo state)
South South	0.60	0.51	35.1	59.3
National	0.53	0.49	54.4	54.7
Male	0.52	-	-	-
Female	0.55	-	-	-
Rural	-	0.51	63.3	63.8
Urban	-	0.54	43.2	43.1

Source: \* Computed from Aigbokhan, (2000) *Poverty, Growth and Inequity in Nigeria – A Case Study*. AERC. Research Paper 102. \*\*Akande et al (2009) *Impacts of price change on poverty: The Nigerian Experience*, NISER. \*\*\*World Bank (2007) *Nigeria Poverty Assessment, based on 2004 poverty survey*.

## 7.4 Direct impact on income and non-income poverty

Several non-income poverty indicators have improved between 2003 and 2008, such as literacy rates, infant mortality rates and maternal mortality rates. These improvements can be attributed to improved poverty alleviation policies since the beginning of the decade, partly as a result of the anticipation of debt reduction, and to a limited extent to the VPF, which was established as part of the debt deal in 2006. Income poverty indicators for the period after the debt deal are not available yet, so no definite conclusions with regard to income poverty can be drawn. However, we can conclude that the outputs of the VPF (including the institutional changes it induced) are likely to have an effect on both income and non-poverty outcome and impact indicators in the future.

## 7.5 Sustainability

The debt relief agreement has made the external debt more sustainable and eliminated the debt overhang that reinforced the volatility of the economy, which negatively impacted economic growth. These positive effects will certainly be sustained over the next three to five years.

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Most key stakeholders identified a slow down in reforms after 2007 (see section 5.3). It can be concluded that the effect of the conditionality on macroeconomic and other policies is gradually waning, although some of the achievements are resilient. This includes the important oil price based fiscal rule which has been maintained, although it has been implemented much less rigorously in recent years.

The VPF has also proved resilient. It will probably be sustained over the medium term as vested interests have been created among a broad group of stakeholders: state and local governments, members of parliament, and civil society. The institutional changes promoted by the VPF in other federal agencies and in state and local governments could become more visible over time and may lead to a greater achievement of the MDGs in the future.

In general, the sustainability of the results depends on the extent to which overall political and economic stability in the country can be maintained.

## 7.6 Lessons learnt

This study confirms the validity and appropriateness of the intervention theory of debt relief, more than has been found in other evaluation studies of debt relief. The somewhat more positive results for Nigeria can be explained by the fact that in this case the debt was eliminated completely. The conditionality channel was also more effective than in other cases. The *prospect* of debt relief provided the political leverage for policy reforms and the motivation to appoint an economic team with strong ownership of the reform package. The political leverage of the reform conditionality of the agreement itself was weaker than the

political leverage induced by the prospect of debt relief. However, the conditionality of the agreement had a positive influence on the timeliness of policy implementation. In addition, the VPF was established, which will have a lasting effect on poverty reduction in the country.

Finally, the question must be answered whether these positive findings justify the use of around US\$ 18 billion in aid money and the use of US\$ 12 billion of Nigerian resources in cancelling the debt. We think they do. The investment is substantial, but the potential benefits are also huge: Nigeria has a large population of which more than half was still below the poverty line in 2004. The debt deal not only removed Nigeria's debt overhang but also improved government policies, including poverty reduction policies. Even if not all of these policy changes can be sustained, there are already positive effects on the welfare of approximately 150 million people in Sub-Sahara Africa.

From the perspective of Nigeria, the spending of the US\$ 12 billion can be seen as an investment for achieving a fresh start in its relations with its bilateral creditors and private sector investors, both domestic and foreign. It also made an end to the accumulation of arrears and the annual payment of US\$ 1 billion of debt service, which would have continued to reduce available resources for poverty reduction, with particular harmful effects in years with lower oil revenues. In addition, there have been positive effects on debt management, debt sustainability and poverty reduction policies, especially via the funding and institutional contributions of the VPF.

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The agreement between the 15 creditors united in the Paris Club and Nigeria in 2005 was the second biggest debt cancellation deal ever. The IMF and the World Bank both played a key role. Nigeria repaid US\$ 12 billion and introduced economic reforms in return for debt cancellation to the tune of US\$ 18 billion. This evaluation, which was organised and funded by Belgium and the Netherlands, first explains how the deal came

about between 2000 and 2005. It goes on to reveal the consequences for the Nigerian economy, and the impact on poverty reduction in Nigeria, with more than 150 million inhabitants the country with the biggest population in Africa.

This summary of the main report is meant for the specialist reader.

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