CENTRAL BANK OF NIGERIA

PROCEEDINGS OF THE SEMINAR ON "Financing Government Programmes in Economic Downturn – The Role of Central Bank of Nigeria?", FOR CBN EXECUTIVE STAFF
AT GOLDEN TULIP HOTEL, LAGOS,
SEPTEMBER 05 - 08, 2016

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Governor, Central Bank of Nigeria

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Deputy Governor, Economic Policy, Central Bank of Nigeria

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Aims and Scope

The *Economic and Financial Review* is published four times a year in March, June, September and December by the Research Department of the Central Bank of Nigeria. The Review contains articles on research undertaken at the Bank, in particular, and Nigeria, in general, mainly on policy issues both at the macroeconomic and sectoral levels in the hope that the research would improve and enhance policy choices. Its main thrust is to promote studies and disseminate research findings, which could facilitate achievement of these objectives. Comments on or objective critiques of published articles are also featured in the review.

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Notes to Contributors

Information on manuscript submission is provided on the last and inside back cover of the Review.

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Keynote Address

Godwin I. Emefiele (CON)[*]

Deputy Governors,
Departmental Directors,
Branch Controllers,
Eminent Resource Persons,
Executive Staff of the CBN,
Distinguished Ladies and Gentlemen

Introduction

It is a great pleasure for me to present the Keynote Address at this year's Central Bank of Nigeria Executive Seminar. I commend the organisers for sustaining this thought-provoking forum meant to enhance the capacity of Executives of the Bank and also, create opportunity for interaction between them and other stakeholders on contemporary economic issues affecting the country. Let me also seize this opportunity to appreciate the Executives and staff of the Bank for their unflinching loyalty to and support for Management, especially in these trying times. Your diligence, commitment and high level of professionalism have contributed immensely towards the delivery of the Bank's mandate.

Distinguished Ladies and gentlemen, the theme of this year's seminar, **Financing Government Programmes in Economic Downturn - The Role of Central Bank of Nigeria**, is quite appropriate given the enormity of challenges confronting the Nigerian economy. As we all know, Nigeria has over the years depended largely on crude oil exports for its foreign exchange earnings and financing of government activities. The recent developments in the international oil market has shown that this pattern is no longer sustainable as financing of government programmes has become increasingly difficult with the attendant implications for macroeconomic stability and economic growth. The decline in the price of oil has not only resulted in lower foreign exchange earnings for the country, but also in the decline in accretion to external reserves and pressure on the foreign exchange market. Furthermore, the development has constrained government's ability to deliver on its mandate.

Role of Government in Economic Development

Ladies and gentlemen, permit me at this point to say that governments are generally saddled with the responsibility of ensuring sustenance of the trajectory of growth and development for their economies. In this regard, a government would usually harness domestic and external resources to finance projects and ventures that may otherwise not

[*] Mr Godwin I. Emefiele (CON) is the Governor, Central Bank of Nigeria

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be possible or profitable for the private sector to undertake. Thus, the challenge for governments is how to channel state resources into projects and programmes that make the greatest contribution towards the realisation of long-term growth and development objectives. Such projects include roads, railways, transportation, hospital, schools, power, etc. which are components of critical economic and social infrastructure.

For a developing economy like Nigeria, particularly at a time such as this, one can observe the urgency with which the rejuvenation of the economy, requires policy formulation focus on and sometimes direct participation in the provision of critical infrastructure. This is borne out of the vision to be among the first twenty developed economies by the year 2020. Obviously, such a task requires a great sense of urgency from those saddled with the affairs of government, and requires them to do it in the most efficient and effective way.

Nigerian Economy and the State of Critical Infrastructure

The availability of efficient and functional infrastructure is a sine-qua-non for rapid economic growth. In this respect, the provision of adequate electricity, efficient transportation infrastructure (road, rail, water and air) etc., is fundamental for progress. In fact, economic history is replete with instances of government strategic interventions in critical infrastructure as precursor to the economic and industrial take-off of today's advanced economies. This in fact, is at the centre of the growth miracle of the Asian-Tigers (Hong Kong, Taiwan, Singapore and South Korea) which resulted in their phenomenal transformation. It is also a recurring narrative in the history of the rapid economic progress being witnessed by China, India and Malaysia, among others.

Distinguished participants, same cannot be said with respect to Nigeria's infrastructure, which has suffered years of neglect, particularly in the face of dearth of financial resources for new investments. This is not to say, however, that one is oblivious of the many concerted efforts of past governments to fix the infrastructure quagmire. As observed by a World Bank report (2013), Nigeria would require over ₦2.0 trillion investment in infrastructure on annual basis for the next six (6) years to address the infrastructural gaps within the economy. That is, indeed, a tall order given the dwindling financial resources of government.

Financing Government Programmes in Nigeria

Distinguished ladies and gentlemen, the budget is the instrument through which the government executes its various projects and programmes within a specified time frame for the ultimate goal of improving the overall well-being of the citisens. To finance the budget in advanced economies such as the United States (USA), United Kingdom (UK), Japan etc., the respective government relies on taxes as the primary source, while borrowing from the financial market, both at home and abroad, serves to bridge any shortfalls. In emerging market economies like China and many of the east-Asian economies, the traditional method of budget financing is further complemented by specialised development justifications such as Bank of Agriculture, Bank of Communication, Bank of Industries and Manufacturing, as well as, Export-Import Bank. Developing countries such as Nigeria are, however, constrained by low tax revenue, weak domestic financial market and reliance on volatile sources of revenue such as proceeds

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from exports/sales of crude oil and other primary commodities. In Nigeria, specifically government programmes are usually financed from annual budgetary provisions with most of the funds coming from domestic sources. However, given the need to augment the limited domestic resources and ensure rapid transformation of the economy, the government often times, resorts to external borrowing.

CBN's financing of Government Programmes

Ladies and gentlemen, it is no longer news that the CBN has, over the years, been directly or indirectly involved in the financing of growth-enhancing programmes and projects of the Federal Government. The involvement is incidental to the Bank's core mandates and part of its development and corporate social responsibilities, to accelerate growth and development of the Nigerian economy. There are various schemes and programmes either implemented directly, in conjunction with the Federal Government or through specialised financial institutions.

In this regard, the Bank's intervention initiatives encompass real sector programmes, particularly, agriculture, small and medium enterprises, infrastructure and youth empowerment. Notable among them are: the Commercial Agriculture Credit Scheme; Real Sector Support Facility (RSSF); SME Credit Guarantee Scheme (SMECGS); SME Re-structuring and Refinancing Fund (SMERRF); Nigeria Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL); Power and Airline Intervention Fund (PAIF); Nigeria Electricity Market Stabilisation Fund (NEMSF); Anchor Borrowers' Programme (ABP); Nigeria Textile Intervention Fund; Non-oil Export Stimulation Facility; Youth Innovative Entrepreneurship Development Programme (YIEDP); and Export Credit Rediscounting and Refinancing Facility. These initiatives have continued to impact positively on employment, food security, and power generation, transmission and distribution. All these are in addition to CBN's Ways and Means Advances to the Federal Government.

In spite of the Bank's initiatives and other activities of the government, the economy seems to be heading into recession. Reversing this trend would require huge fiscal stimulus by the government. The question is where will the resources come from in view of the government's precarious financial condition? It is against this backdrop that this gathering is expected to come up with innovative ways of financing government programmes in this period of economic downturn, and, the role the CBN should play taking due cognisance of the existing legal and institutional framework under which it operates.

Distinguished participants, I am aware of the assemblage of eminent resource persons to lead discussions at this seminar. It is my sincere hope that at the end, there would be clear cut policy direction and financing blueprint to guide government programmes for the overall improvement of the economy.

On this note, I declare the Seminar open and wish you very rewarding and fruitful deliberations. Thank you for your attention.

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Special Remarks

Dr. (Mrs.) Sarah O. Alade*

The Governor, Central Bank of Nigeria,
Deputy Governors,
Departmental Directors,
Branch Controllers,
CBN Executives,
Distinguished Resource Persons,
Ladies and Gentlemen

It is my honour and pleasure to make these special remarks at the opening ceremony of the 2016 edition of the annual Executive Seminar for staff of the Bank.

As you may be aware, the Seminar provides a forum for brainstorming among staff in the executive cadre of the Bank and distinguished resource persons, on current policy issues confronting the Bank in particular, and the economy in general. I would like to use this opportunity to commend the Governor and Management of the Bank for making this year's event a reality, despite the current economic challenges.

The theme of this year's Seminar, **Financing Government Programmes in Economic Downturn – The Role of Central Bank of Nigeria**, is quite germane, given the continued dwindling revenue of all tiers of government following the repressed global oil market.

Ladies and gentlemen, let me briefly highlight some key macroeconomic indicators to bring to the fore, the current economic challenges of the country. In the face of the challenging global economic and financial conditions, characterised by slow growth, currency volatility, sluggish investment, prolonged weak demand and low commodity prices, domestic output contracted by 0.36 and 2.06 per cent in the first and second quarters of 2016, respectively, in contrast to output growth of 3.96 and 2.35 per cent in the same periods of 2015. The development was attributed to a number of factors, including: high cost of transportation due to the removal of subsidy on petroleum products; high electricity tariffs; inadequate supply of foreign exchange; weak consumer demand; shortages in energy supply due, in part, to oil infrastructure vandalism; and the slow implementation of the 2016 budget. I need to reiterate here that most of these factors that fueled contraction in output growth were, largely, outside the purview of the Monetary Authority.

On the heels of negative growth outcome in the first two quarters of 2016, inflation has remained at double-digits since February 2016. In July, 2016, headline inflation (Y-on-Y) stood at 17.1 per cent, up from 15.58 and 16.48 per cent in May and June 2016, respectively. The core and food components also rose from 16.2 and 15.3 per cent in June

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2016 to 16.9 and 15.8 per cent in July 2016, respectively. The mounting inflationary pressure reflected mainly structural factors such as high cost of production, high cost of transportation, and low productivity. Similarly, government revenues have been dwindling since mid-2014, arising from declining crude oil prices and low oil production due to the destruction of pipelines by militants in the Niger Delta region.

The CBN, on its part, has made efforts to address these challenges in line with its mandate. This is reflected in the various intervention initiatives for the real sector. The main aim of the initiatives was to enhance access to finance at a cheaper rate, for growth-enhancing projects. Furthermore, in May 2016, a more flexible exchange rate regime was introduced with a Naira-settled FMDQ-OTC (a two-way quote) trading platform at the inter-bank foreign exchange market. This was aimed at: improving liquidity and ensuring stability in the foreign exchange market; preserving the external reserves; curbing excessive demand for foreign exchange; and entrenching appropriate pricing of the naira. In addition, the sustained reforms in the banking sector are meant to reposition the banks to effectively play the role of financial intermediation.

Distinguished participants, it is important to reiterate that the Federal Government has resolved to diversify the Nigerian economy away from reliance on oil as a major source of revenue. However, the realisation of this goal would be in the medium-to-long-term. In the short-term, the need to fund the 2016 budget with a deficit of N2.25 trillion and reverse the negative output growth becomes a critical challenge. In this respect, some of the relevant questions include: what are the viable options available to finance government programmes? Does the CBN have a role to play? How could the negative growth trend be reversed? And what fiscal and monetary instruments are required to address these challenges?

Let me at this juncture state that the current budgetary pressures may not be completely abated unless structural issues, which have contributed largely to the current economic downturn, are addressed.

Distinguished participants, it is against this backdrop that I urge you all to actively participate and discuss the theme of this year's Seminar, and come up with implementable, innovative and sustainable financing options for effective delivery of government programmes. Our expectation is that this Seminar will provide clear guidance on: the role of the CBN in financing government programmes; how government programmes can be prioritised for effective financing in a period of economic slump; the options available for financing government programmes; and the lessons that could be learnt from other jurisdictions.

Furthermore, I urge you to come up with fresh and innovative ideas that would not only aid the monetary authority to fine-tune its strategy, but also articulate practicable and sustainable financing options, which would take the economy out of the current difficulties.

On this note, I welcome you all to this year's Seminar and thank you for attention.

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Financing Government Programmmes in Economic Downturn: Theoretical Issues and Perspectives

Akpan H. Ekpo*

I. Introduction

A primary goal of fiscal policy, defined briefly as government spending, transfers and tax decisions, is to equilibrate the public sector's financing requirement with the private sector's demand for investment. It is the centerpiece of public and economic policy with fiscal outcomes having far-reaching implications for other policies. Too often, fiscal policies fall short of their desired objectives reflecting, among other things, inappropriate expenditure programming and financing, with consequential problems of debt accumulation, debt overhang, and retarded growth. There is thus, a mismatch between theoretical expectations and practical performance in fiscal management.

Fiscal imbalance has been the experience of most developing countries since the 1970 and 1980 decades. Public spending overshot domestic revenues, resulting in fiscal crises and calls by the international community for adoption of stabilisation and adjustment programmes. While stabilisation function is concerned with the attainment of full employment of labour and capital at stable prices, balance of payments equilibrium and satisfactory rate of growth in per capita income and adjustment programmes seek to reconcile aggregate demand with aggregate supply of resources.

In an inflationary recession which currently grips the Nigerian economy, inflation is definitely not caused by excessive aggregate demand. Indeed, aggregate demand is projected to be inadequate in the face of rising unemployment rate. Public expenditures have to be properly managed as doing otherwise could create distortions which retard, rather than promote economic growth and development. Moreover, the mode of financing the expenditures need to be properly articulated as particular modes generate costs and risks which could make them sub-optimal, retarding economic growth. Thus, selectivity of choice of modes of financing government programmes is of the essence. However, it is important to assert that economic downturn and/or recession are unavoidable in a capitalist market economy. Recessions are inherent no matter how the economy is managed. If any economy would have averted recessions it would be the USA economy. The USA economy remains the best managed market capitalist economy in the world yet, she experiences periodic booms and busts. However, no two recessions are alike and managing an economy remains a daunting task given the global complexities.

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The purpose of this paper is to articulate the theoretical issues and perspectives which underscore the need for caution in financing government programmes whether in the recurrent outlay or capital programmes as individual financing modes have built in costs and risks that could inhibit the realisation of government objectives. It is also to present a vector of "optimum" choices of financing functions for possible end-uses/programmes, intuitively and qualitatively, without the implementation of an econometric model.

Consequently, the paper is divided into four parts. Besides this Introduction, the paper in Part II highlights some theoretical issues. Part III focuses on sources of financing and perspectives for choice of financing modes for particular government projects. Part IV highlights the dangers in the adoption of "wrong" financing modes, inadequate executive capacity and Part V concludes the paper. It is expected that discussion in this paper would shed more light on the subject matter and provide policy makers a menu of options required for financing government programmes in a recession.

II. Theoretical Issues

It may be interesting to begin the analysis of the theoretical issues by articulating, albeit algebraically, the sources of financing fiscal deficit, defined as the excess of total recurrent and capital expenditures over total revenue. This will be followed, by analysis of the perspectives government needs to take in mobilising funds for its programmes. Fiscal deficits may be financed internally and externally.

Internal sources of financing the fiscal deficit include:

- Borrowing from the central bank through the issue of debt instruments.
- Altering the supply of money in the economy through engaging in open market operations (OMO) involving buying and selling of treasury securities. This is often targeted at implementing monetary policy, and
- Offering short- to long-term debt instruments (bonds). This also helps deepen the financial sector. There are many financial institutions, such as savings or mortgage banks, insurance companies, pension funds and specialised lending agencies with vast amounts of funds that can be placed temporarily or indefinitely in government securities. In general, deficits must be financed either by borrowing or by a drawdown of cash balances.

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Externally, many countries have obtained credits on concessional terms from government and multilateral development institutions for many years, and have set up units in their central banks and ministries of finance or semi- autonomous offices to manage such debts. Countries have also contracted export credits (with little concessionalities) and developed policies and strategies to negotiate and administer these debts. In recent years, many countries have borrowed extensively on commercial terms (with zero concessionality) from international banks and capital markets (see Appendix).

Algebraically, a budget deficit or surplus involves stock/flow changes in public debt and stock of high powered money. That is,

$$CD_t = \Delta D_t + \Delta M_t \qquad (1)$$

$$\Delta D_t = D_t - D_{t-1} \qquad (2)$$

Where:

D_t = stock of public debt at the end of period t

D_{t-1} = stock of public debt at the end of period t-1
CD_t = conventional/overall budget deficit
ΔM_t = variation in the stock of high-powered money during time t

Since the stock of public debt at the end of period t can be expressed as:

$$D_t = D_{t-1} + \Delta D_t \quad (3)$$

It follows that:

$$D_t = D_{t-1} + CD_t - \Delta M_t \quad (4)$$

Decomposing the overall budget deficit into primary surplus and interest payment expenditure.

$$D_t = D_{t-1} - SP_t + i_t D_{t-1} - \Delta M_t \quad (5)$$

It follows that:

$$D_t = (1 + i_t) D_{t-1} - SP_t - \Delta M_t \quad (6)$$

Where

i_t = (average) nominal interest rate
SP_t = primary balance (surplus excl. interest payments)

Or $$D_t = (1 + i_t)\, D_{t-1} - B_t - \Delta M \quad (7)$$

Where

B = primary balance;
B>0 = primary surplus;
B<0 = primary deficit
M = monetary base or reserve money or high-powered money
Δ = change operator

Re-arranging equation (7) gives

$$D_t = D_{t-1} - \underbrace{(B_t - i_t D_{t-1})}_{\text{Overall balance}} - \underbrace{BM_t}_{\text{Seignorage}} \quad (8)$$

Equation (7) always holds ex-post. It states that the government meets its debt obligations, and that any gap, Bt < 0, must either be financed by new debt or monetised, or a mix of the two. In contrast, Bt > 0, can be used to reduce the stock of existing debt.

Normalise equation (7) by dividing it by nominal GDP, $P_t\, Y_t$

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$$\frac{D_t}{P_t Y_t} = \frac{(1 + {}_t)^{D}{}_{t-1}}{P_t \quad Y_t} - \frac{B_t}{P_t \quad Y_t} - \frac{M\Delta}{P_t \; Y_t} \qquad (9)$$

$$= \frac{(1 + i_t)}{(1 + g_i)\,(1 + \eta_t)} \left(\frac{D_{t-1}}{P_{t-1} \quad Y_{t-1}} \right) - \frac{B_t}{P_t \; Y_t} - \frac{\Delta M_t}{P_t \, Y_t} \qquad (10)$$

Where

g_t = real growth area

η_t = inflation rate (measured as the rate of change of GDP deflator, p. Usinglower case symbols to denote ratios to GDP and ΔM_t for seignorage, to rewrite (Eq. 10) and obtain the **Law of motion** of the government debt to GDP ratio, we have:

$$d_t = \frac{(1 + i_t)\, d_{t-1} - (b_t + \Delta m_t)}{(1 + g_i)\,(1 + \eta_t)} \qquad (11)$$

$$= \left(\frac{1 + r_t}{1 + g_r} \right) d_{t-1} \;\; - (b_t + \;\; \Delta M_t) \qquad (12)$$

Where:

$$d_t = a\, d_{t-1} \;\; - (b_t + \Delta M_t)y \qquad (13)$$

r_t = real interest rate

a_t = is a discount factor defined as at = $(1+r_t)/(1 + g_t)$

Equation (13) is the fundamental fiscal sustainability identity based on the static budget constraint condition. From the above relationships, it is clear that a change in government expenditure must be financed by a change in government debt, change in primary surplus or the monetary base. Budget deficit, however, cannot be financed by tax changes; hence recourse must be made to money creation and debt creation. Money is created when the central bank purchases either existing privately owned or newly issued public debt.

When fiscal deficit is financed by money creation, the money supply expands either directly if the borrowing is from the central bank or indirectly, if it is through the deposit money banks. This process is easily dramatised in terms of the Polak Model:

$$\Delta M = \Delta NFA + \Delta Cg + \Delta Cp + \Delta OA(net) - \Delta QM \qquad (14)$$

Where

ΔM = Change in money supply

ΔNFA = Change in net foreign assets

ΔCg = Change in credit to government

ΔCp = Change in credit to the private sector

$\Delta OA(net)$ = Change in other assets less other liabilities of the banking system

ΔQM = Change in quasi money (time and savings deposits)

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Δ = Change operator

Pundits reckon that on the average, about half of budget deficits in developing countries are financed in this way (Little et al., 1993). There are a variety of theories and/or perspectives relating to what may be deemed as the "optimal" mode of financing government programmes. Put differently, are there theories on how public funds can and should best be raised to promote economic growth, especially in a recession?

Choice Between Domestic and External Borrowing

On the domestic front, government may issue bonds for the purpose of financing general or specific budget expenditures. This is significantly more cost-effective compared with bank loans as it involves a one-off issuance cost without any ongoing management fee. The use of bond augurs well for better budgetary control, enabling government flexibility to spread its repayment obligations over a longer (medium to long-term) period at relatively lower costs than bank finance. Even so, the full advantage of this financing mode cannot be taken if the bond market is not developed. In this regard, there are two major pre-requisites namely, the existence of macro-economic stability and a liberalised and stable financial system.

External financing, on the other hand, has been the major source of financing especially, for developing countries as domestic debt markets started featuring significantly only within the last decade. External financing has come in the form of aid (defined as concessional loans plus grants). There has been project and programme aid which includes general budget support, which leaves the recipient government completely free over its use and also, sectoral aid where the donor specifies the sector (such as education or transport), but leaves the recipient to decide on the use of the aid within that category. There is also bilateral and multilateral aid. While the bilateral relates to aid from one country's government to another's, multilateral aid is largely financed by Development Assistance Committee (DAC) members. However, the downside is that aid can be source-tied and source un-tied. Again, the commercial objectives of the donors are not always explicit and they seem to play a larger part in the motivation of some countries' aid than in that of others (Ekpo and Afangideh, 2012).

However, the relatively minimal interest rate cost has been a major attraction. Aid has a grant element of 86.0 per cent as the norm but any loan with a grant element of 25.0 per cent and above is deemed concessional. The current grant element adopted by most developing economies, including Nigeria and Ghana is 35.0 per cent.

Concessionality Issue

A concessional loan is one with a grant element[1] of at least 25.0 per cent. However, it is argued that government need not shy away completely from a non-concessional loan provided that the end-use of the loan is deemed to be very profitable such as investment in

[1] Grant Element (GE) measures the Concessionality of an official loan:

GE = face value of loan (stock) – sum of present discounted value of loan service (flow)divided by the face value of loan X 100 (%)

= ((face value - ∑PV (loan service)/face value of loan) X 100

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the oil/energy sector. Such investments have the potentiality of high return. Thus, borrowing from the hard windows to finance such investment is advisable.

Inflation – inducing Factor

Some financing modes are more inflationary than others. For example, borrowing through bond issuance is less inflationary than borrowing from the deposit money banks, or even central bank. Borrowing from the deposit money banks is less inflationary than borrowing from the central bank because central bank financing in high powered money, a direct injection of funds in the economy.

Cost and Risk Considerations

Some financing modes are riskier and costlier than others. For example, financing projects through foreign direct investment (FDI) is good but fraught with capital flow reversal risk. Dividends payment on such FDI projects may be cumulatively significant enough to put pressure on the exchange rate, depleting the external reserves. Real exchange rate appreciation is a major risk associated with huge capital inflow through FDI or international remittances, especially where the central bank does not have instrument autonomy to sterilise the inflow[2]. Government loan portfolio should be composed of loans with minimum cost-risk combination.

Counterpart Funding

Too often, donors require recipient governments to provide a proportion of loan commitment as condition precedent to draw down on such loans. The risk attached to this financing mode is that recipient government might not have provided for it in its budget during budget preparation. Such fund could be highly concessional but remain unavailable due to the non-provision of counterpart funds.

Timing of Issuance of International or Offshore Bonds

For this mode of financing to be significantly realisable, some pre-conditions need to be fulfilled. Government must be certain of international market conditions for the effort to go beyond mere bench-marking anchor for other domestic securities. International bonds issued when the international community is facing crisis from macro-economic shocks, domestic or external, may not yield desirable outcomes.

Choice from among Generic Loans Offers

For official loans, the grant element is a decisive factor. But in the case of private or commercial loans, a lot of considerations need to be made in deciding which loan to take. Critical factors have included real interest rate, the maturity of the loan, disbursement pattern, issues of raw material ties, and other qualitative factors. For commercial loans with complex terms, there is need to compute what is popularly called the "all in cost" and relate it to the London Interbank Offered Rate (LIBOR), choosing the loan with the highest basis point above the LIBOR (Omoruyi, 2016).

Government Programmes in Economic Downturn

[2] To sterilise here is meant taking actions to prevent the capital inflow from increasing money supply.

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In extant literature, there is a perspective that financing concrete development projects exerts a greater positive impact on economic growth than the financing of consumption goods involving capital spending on the infrastructure needs of workers (capital projects in consumption programmes). Government may, therefore, need to re-examine its capital expenditure programmes with a view to giving adequate priority to concrete development projects in recession. This will surely boost the recovery potentials of the doses of funds for financing.

If economic downturn is strictly defined as when an economy is in a declining phase then, expenditure on capital projects would impact on economic growth resulting in recovery, all things being equal. However, if the economy is in recession, then spending on both recurrent and capital becomes useful. For example, the present recession in Nigeria is due both to inadequate demand and supply (structural) challenges. Hence, putting money in the hands of households and their families would boost aggregate demand. In addition, spending on capital projects would enhance private investment.

Financing government programmes through debt would theoretically crowd out private investment. Depending on the financing mix, the crowding out could be partial or complete. Nonetheless, the outcome of the crowding-out hypothesis remains an empirical issue particularly, if government programmes are decomposed into sectors.

III. Financing by End-Use – A Rationalisation

III.1 Methodology

The above sources of financing indicated early in the preceding section involve costs and risks, making the choice of the "optimum" sources of financing for specific end-use problematic. This section is targeted at considerations governing the choice of optimum financing sources for particular end–uses. Although analysis such as this would require the construction of a quantitative probit model, the paper elects to be qualitative at this point, relying largely on pragmatism and assumed notions of costs and risks associated with financing end-use vis-à-vis a vector of financing modes/options.

There are challenges/constraints involved in the choice of one financing option rather than another in the lead up to mobilisation of a pool of financing sources, at least, theoretically deemed optimal or feasible vis-à-vis the end-use. Discussions would revolve round eight end-use financing choice functions formulated from the perspectives of developing countries such as Nigeria and under some simplifying assumptions, which include:

a. no time constraint in the mobilisation of the optimal sources;
b. no undue political interference; and
c. existence of resource gaps: investment gap (1-S) and government deficit gap (G – T) to be financed by the current account gap, M-X.

III.2 Sources of Financing

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Debt and non-debt sources constitute the source of financing in resource-deficit low income countries.

Debt Sources	Non-debt Sources
• Concessional loans and grants o Multilateral sources/creditors o Bilateral donors • Non-concessional sources o Export credits ▪ Suppliers' credit ▪ Buyers credit ▪ Official export credit o Multilateral bank loans and bonds (domestic and external) o Bank overdraft facilities o International Capital Markets (market finance)	• Foreign direct investment (FDI) • Equity • Privatisation receipts • Public-Private-Partnership (PPP) • Monetary base: o currency outside banks (COB) + bank reserves o $\Delta Cg + \Delta Cp + \Delta OA$ (net) $+ \Delta NFA$ or $NDA + NFA$ Where: NFA = Net foreign assets NDA = Net domestic assets Other variables are as defined previously.

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III.3 Possible End-use and Financing Options

In articulating the optimum combination of financing issues for end-use, the paper first outlines the end-uses vis-à-vis their possible financing options, in the form of end-use financing choice functions:

Optimum Choice of Financing (OCF)

OCF = f(end-use, constraint, country circumstances) (15)

End-use = f(constraints, country circumstances) (16)

Possible End-uses

Economic project

Financing = f(FDI, loans, bonds, PPP, privatisation receipts) (17)

Infrastructure/social safety nets = f(PPP, concessional loans, bonds, FDI, Privatisation receipts, grants) (18)

Bridging finance = f(overdrafts/loans/short-term) (19)

BoP support = f(IMF facilities, SDR) (20)

Equations (17) – (20) relate end-uses to possible financing modes. Which is the possible combination of financing modes for an end-use having regard to costs, risks, legal and exigency of end-use? As indicated in equation (15), the optimum financing source for an end-use is governed largely by constraint of financing mode and country circumstances. The underlay of these determinants of choice of financing for an end-use is broken down into costs, risks, legal and exigency of end-use.

In reviewing particular end-uses vis-à-vis its possible financing sources, the paper argues as follows:

Financing of Economic Projects

Equation (17) relates an end-use economic project to possible sources of its financing, namely FDI, loans, bonds, PPP, privatisation receipts, etc. These financing sources have their characteristics. FDI is non-debt creating but it requires the need to repatriate dividends in the future. In the process of repatriation, pressure could be placed on available resources of the country as well as on the exchange rate. These are costs to the economy although, inflow of FDI could momentarily appreciate the exchange rate, and could create opportunities for financing investment project.

However, loans, even if non-concessional and costly, could be an optimal choice for financing economic projects of strong viability where concessional loans with string attached are hardly suitable. Bonds, especially those issued for the international capital market, could adequately serve to finance economic projects and even do so better than non-concessional loans which may have relatively shorter maturity. PPP is good but its availability hinges on private sector perception of the credibility of government including the latter's governance rating. Even so, PPP approach could engender the creation of contingent liabilities with great potential to balloon the debt stock. This is a hidden cost which must be recognised in this financing mode. It may be argued that for economic projects, the optimum sources of financing include, bonds, loans, PPP, FDI and privatisation receipt, in that order.

Infrastructure/Social Safety nets

Equation (18) relates infrastructure/social safety nets to the following financing modes: PPP, concessional loans, bonds, FDI, privatisation receipts and grants. Considering that concessional loans are characterised by high grant element and long maturity, it is the financing mode to occupy second best position after grants for infrastructure projects. Although PPP is a good source for financing infrastructure, the hidden cost manifesting in emergence of contingent liabilities, places this financing mode in the third position after grants and concessional loans, as optimum sources of financing infrastructure/social safety nets. For PPP, government must have the capacity to negotiate and make it a win-win situation.

Bridging Finance

This is a form of short-term loan from banks available to government to "bridge" the period until government obtains expected revenue inflow or a medium or long-term loan to replace it. For example, an overdraft is a good source. For individuals, bridging loan features also in the housing market to enable them to finance the purchase of new houses while arranging long-term mortgage finance.

BOP Support

The IMF provides support through its concessional window in the form of the Poverty Reduction and Growth Facility (PRGF) and also, through its non-concessional facilities such

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as the Stand-By Arrangements (SBA), Extended Fund Facility (EPF), Supplemental Reserve Facility (SRF), etc.

III.4 Constraints to Choice of Financing Options

In the lead up to an optimum envelope of financing options for specific end-uses, the debt manager is faced with a variety of constraints. Some of the constraints are general in nature regardless of the nature of end-use. These include the legal framework, foreign policy/international economic-relations, level of government and global economic conditions.

Legal Framework

Most developing countries have in place the basic element of a legal framework for public debt management. However, changes in the legal framework are often crucial to enabling countries to manage their debt liabilities, especially market borrowing, actively and flexibly. The changes could include the extent to which the roles and responsibilities of officials are specified in legislation which may also constrain their activities in those roles. Primary legislation for debt management that includes debt ratios as a fiscal stability tool can be problematic. If they are too low, they may constrain responses at the time of financial stress, given the time lags involved in passing new legislation. If too high, debt ratios may not be meaningful. Thus, it is imperative to have a clear awareness of the legal framework and issues prior to resource mobilisation.

In the particular case of sub-national borrowing, for instance, concerns may be reflected in the debt legislation:

(i) that the aggregate of sub-national borrowing does not undermine the government macroeconomic policy stance.

(ii) that borrowing is properly appraised; and does not constrain central government's own borrowing. (Ekpo, 2012)

Foreign Policy/International Economic Relations

Foreign policy could also pose challenges to effective funds mobilisation. In some cases, policy may preclude borrowing from specific country jurisdictions for strategic reasons regardless of the merits of some financing source. However, this type of constraint is few and far between.

Level of Government

Central government would impose borrowing restrictions on the sub-national jurisdictions in order to maintain macroeconomic stability.

Global Economic Conditions

As exemplified by the global economic crisis of 2008/9, restrictions to borrowing often affects recovery effort of governments in deep financing needs.

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Country Circumstances

Individual developing country circumstances vary and could pose financing constraints. Such constraints may include: the current stage of development, especially with respect to financial markets and economic policies, the level and composition of the country's debt portfolio which may constrain further borrowing however attractive the loan terms, and the exchange rate regime maintained. Other constraints are the degree of capital account liberalisation, which could inhibit capital inflow, and the country's credit rating which may inhibit its effective negotiation of loans, political instability, availability of counterpart funding as condition precedent to loan disbursement and above all perceptions about the governance processes.

IV. Effects of "Wrong" Financing Modes

The effects of application of "wrong" financing modes for government projects are legion. The most notable include: cost overruns; debt servicing difficulties; project failure; debt overhang; and economic decline. The theoretical prescriptions of debt overhang which stand in bold relief among the effects are listed below:

- **Debt overhang induces a decline in investment:** Studies have shown that the poor investment and growth performance of highly indebted countries in the recent years is frequently attributed to the burden of their foreign debt – a high ratio of external debt to GDP – a phenomenon known as debt overhang. According to this hypothesis, the accumulated debts act as a tax on future output, discouraging productive investment by the private sector. This is because an increase in the production or export of the indebted country generates revenues that must be used to repay current debt obligation. In other words, creditors receive a significant portion of future returns on investment (Borensztein and Kumar, 1991; Omoruyi, 1995).

- **Unduly large debt size creates problems for effective debt management:** For effective debt management, the debt/GDP ratio is often at a low level, not exceeding the critical levels set by the World Bank. Recently, the World Bank has put in place different debt sustainability thresholds reflecting the quality of countries' policies, debtor countries' policies and institutions. This is because a high debt/GDP ratio suggests that the debtor country is at a great risk. Thus, for large values of the debt/GDP ratio, increased reliance on foreign borrowings may lower the growth rate of GDP even if the marginal product of capital exceeds the world interest rate. Moreover, an excessive rise in debt/GDP ratio may increase the perceived probability of future debt-servicing difficulties, thus raising expectations about increased taxation, inflation, currency depreciation or capital flight. However, it should be noted that revenues pay for debt and not GDP.

- **Monetary and economic instability:** Granted that large amounts of capital inflow notably foreign borrowing, grants and direct foreign investment may lead to an accumulation of foreign exchange reserves, the impact of this development on the financial system may be seen through an analysis of the monetary survey as follows:

$$M = NDA^b + NFA^b \quad \text{(i)}$$

$$NDA^b = C_g + C_p \quad \text{(ii)}$$

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M	=	$C_g + C_p + NFA^b$	(iii)
But $G - T$	=	$\Delta C_g - \Delta NFA_g$	(iv)
ΔC_g	=	$-(G\text{-}T) - \Delta NFA_g$	(v)
ΔC_g	=	$(G\text{-}T) + \Delta NFA$	(vi)

Substitute (vi) in (iii)

$$M = (G\text{-}T) + \Delta NFA^g + \Delta C_p + \Delta NFA^b$$

This accounting identity can be used to analyse the effects on the money supply of borrowing abroad by the government to finance a deficit, arising from debt overhang.

Where

M	=	money supply (M1): narrow measure of the money stock
C_g	=	credit to government
C_p	=	credit to private sector
NFA^g	=	net foreign assets of government (central bank)
NFA^b	=	net foreign assets of the private sector (banks)
Δ	=	change operator

Given the widened fiscal deficit arising from heavy debt service payment, government has to finance it both from domestic credit to government (ΔC_g) and change in foreign assets (NFA^g). When the government borrows from the external credit market, so that there is a decline in NFA^g, and transfers the proceeds of the borrowing to the banking system, then the net effect will be an increase in net foreign assets of the private sector (banks) and an equivalent increase in money supply (M) associated with the foreign financing of the government deficit.

However, this theoretical prognosis may not fully hold. The actual size of increase in money supply depends on movements in credit to government and private sector response to funds availability. Thus, it depends on whether the sectors absorb more credit or keeps more of the funds away in term deposit accounts.

V. Conclusion

This paper has reviewed the various sources of financing of government programmes during economic downtown, articulating both internal and external sources. It has also rationalised the financing modes for particular programmes on the basis of some assumed notions of costs, risks and country circumstances, perspectives and theories characterising such financing vehicles. This is aimed at ensuring that, as much as possible, the financing of government programmes (end-uses) is governed by some "optimal" considerations even without implementing the rigorous probit econometric analysis often germane to such binary choice situations.

The end-uses have included financing of economic projects, infrastructure/social safety nets, bridging finance and BOP support, in the lead up to the determination of the optimal sources of financing. Each end-use or programme is related in a financing function to a

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vector of financing modes, taking into consideration inherent costs, risks, exigency situation, country circumstances etc. and a vector of other limiting constraints. Thus, economic project financing is related to loans (non-concessional), bonds, PPP, FDI and privatisation receipts in that order. Infrastructure/social safety net financing is related to grants, concessional loans, PPP, bonds, FDI, and privatisation receipts. Overdrafts/loans – short-term financing from the banks, are the optimal sources for bridging finance. Finally, it may be argued that BOP support can be related to IMF facilities and SDR as its feasible sources of financing.

Of importance, is the theoretical analysis, of the possible effects of application of unsuitable financing modes, in terms of costs/risks considerations. The analysis of the effects of debt overhang stands in bold relief.

It is important to state that there is no primrose path to the financing of government programmes. It behooves officials engaged in mobilisation and negotiation of financing modes to be thoroughly acquainted with the rules, principles, practices or conventions and workings of the markets as well as the peculiarities of individual financing modes. It is also essential to constitute negotiation teams made up of experts versed in concessional loans, export credits and market finance. The teams should include lawyers who will monitor hidden clauses in loan agreement that may derail the effective execution of the programmes or projects. Finally, experts must be familiar with the techniques of choosing between financing sources as well as possess a deep, thorough knowledge or understanding of the projects to be financed. It is a truism that there are no primrose paths to financing of government programmes; hence the panoply of theories and perspectives invoked by debt managers involved in funds mobilisation. The need to recover from the current recession and resume growth calls for discipline, dedication, skills and pragmatism in the application of the identified theories and perspectives in funds mobilisation for programme financing.

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APPENDIX

Sources of External Borrowing

1. Official Development Finance (ODF)
   - Official Development Assistance (ODA); and
   - Other official Development Flows (ODF).

ODA

- Grants/loans by governments to promote economic development/ welfare cooperation;
- Excludes military assistance and official exports credits;
- 25 per cent or more grant element qualifies a loan as ODA; however, norm for ODA is 86 per cent and
- Grants component of ODA has risen through the years.

ODF

- ODF loans have title or no concessionality; it includes:
  - Disbursement from regional development banks
  - IBRD loans
  - Bilateral components arising from debt restructuring agreements;
  - Interest on World Bank loans must cover interest cost + 50 basis point (or ½ per cent)

2. Export Credits (ECs)

- Non-concessional loans to finance purchase of goods;
- Disbursement occur when goods are received by the importer
  - Types
    - When export credits are extended directly by an exporter (suppliers credits)
    - When export credits extended by exporter's commercial bank – (buyers credits).
    - When extended by specialised agencies of exporter's government (official export credits).

Types of ECs may be grouped into

- Private Export credits
  - Suppliers' credits
  - Buyers' Export Credits
- Official Export Credits

Suppliers' Credits

- Extended by private firms in developed countries to governments in developing countries;
- Credits in form of commodities or technical cooperation.

Buyers' Credits

- More common than suppliers' credits as they are extended through commercial banks; and

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- Maturities are short: 3 – 7years

Note

Most private export credits are insured by national export insurance agencies. When insured, private export credits are negotiated through the Paris Club Protocol.

Official Export Credits

- Insured by specialised export credit agencies (ECA); examples US Export-Import Bank (EXIM), France (Coface); Italy (SACE), Germany (Hermes), United Kingdom (ECGD) etc,
- Paris Club debts are covered by these export credit agencies;
- Interest rate is market related; and
- Maturities are much longer than can be provided by private lenders

Export Credits Agencies

- Purpose promotion of domestic export industry in ECA country
- Loans, guarantees and insurance to support sales to buyers in developing countries
- State – controlled (OPIC, Exim Banks, ECGD, Hermes, KfW, SACE, Coface, etc.…)
- Financers, guarantors and/or insurers
- Trade distortions through mixed financings (aid and export credit)
- Regulation via OECD Consensus/Arrangement
    - ECA financing limited to 85 per cent of value of total transaction
    - Minimum interest rate chargeable to borrowers
    - Maximum repayments terms
    - Minimum grant element in tied aid
- Concerns on competition between ECAs and resulting lack of social and environmental safeguards of projects supported.

Export Credit Agencies - Methods of financing

- Direct lending: ECA loan to buyer in developing country to finance purchase from exporter in ECA country.
- Intermediate lending: ECA loan to commercial bank which in turn lends to buyer in a developing country.
- Interest rate equalisation: ECA compensation to commercial lender which loans funds to buyers at below – market interest rate.

Structure of transactions:

- Buyer's credit: loan to purchaser of goods as borrower
- Supplier's credit: loan to exporter of goods as borrower, issuance of promissory notes by buyers against remittance of goods; recourse against buyer of notes not paid on maturity.

3. Private Flows

- Consist of
    - International bank loans
    - Bonds

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With the debt crisis of 1982, private lending shifted from commercial bank lending to bond and equity portfolio flows. Bond issues of developing countries were mainly in US dollars; but Latin American borrowers began to issue bonds denominated in ECUs (now Euros) and pesetas. Major borrowers issuing bonds were in Korea, Mexico, Brazil, Hungry, and Argentina.

Sources and Costs of Concessional Flows

The main sources of concessional flows for most developing countries are official that is, multilateral donors and creditors.

- Many multilateral institutions and bilateral governments have two financing windows: a concessional window for aid finance and a non-concessional window for export credits or market-related loans.
- Aid flows are also provided by non-governmental organisations (NGOs), charities and religious, scientific, educational and cultural organisations.

Multilateral Donors/Creditors

The main multilateral institutions providing grants and concessional loans include:

- The **European Union**, which provides both grants and concessional loans to developing countries. The European Investment Bank (EIB), a development bank, provides long-term loans to both public and private sectors. The European Development Fund (EDF) provides resources, mainly, grants to cover planned macro-economic support, programmes and projects. In addition, resources can be used for debt relief or to help with unforeseen shocks.

- The **International Monetary Fund (IMF)**, provides concessional loans to low income countries through its Poverty Reduction and Growth Facility (PRGF). Non-concessional loans are provided through the Fund's five main facilities: Stand-by Arrangements (SBA), Extended Fund Facility (EFF), Supplemental Reserve Facility (SRF), Contingent Credit Lines (CCL) and Compensatory Financing Facility (CFF).

- The **Islamic Development Bank**, provides long-term finance for development projects, mainly, agriculture and infrastructure in the least developed countries.

- The **United Nations and its main agencies**, such as the United Nations Development Programme (UNDP), United Nations Conference for Trade and Development (UNCTAD), United Nations Children's Fund (UNICEF) and the World Food Programme (WFP), provide most of their assistance in the form of grants.

- The **World Bank**, has three lending arms. The International Development Agency (IDA) provides highly concessional loans and some grants to low income countries, with per capita income of less than US$885. The International Bank for Reconstruction and Development (IBRD) provides non-concessional loans to middle income and creditworthy poorer countries. The International Finance Corporation (IFC) provides loan and equity finance for private sector projects in developing countries.

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There are also regional development banks and institutions providing external assistance to geographical regions. The main regional providers are:

- The **African Development Bank**, provides external assistance through its concessional window, the African Development Fund (AFDF) and non-concessional lending, through the African Development Bank (AFDB).

- The **Arab Bank for Economic Development in Africa** (BADEA) provides concessional loans for projects financing and technical assistance grants.

- The **Asian Development Bank** (ADB) provides both concessional (its OCR facility), non-concessional loans and exceptional assistance via its Special Programme Loans (SPL).

- The **European Bank for Reconstruction and Development** (EBRD) provides market-related loans to governments and private enterprise in the countries of Central and Eastern Europe and the Commonwealth of Independent States.

- The **Inter-American Development Bank** provides both concessional finance through its FSO window, and non-concessional loans (Ordinary Capital) to member states.

In addition, there are **Sub-regional institutions** providing external assistance including the:

- Arab Fund for Economic and Social Development (AFESD).
- Caribbean Development Bank (CDB) and CARICOM Multilateral Clearing Facility (CMCF).
- Central Bank of West African States (BCEAO), West African Development Bank (WADB), ECOWAS Fund.
- East African Development Bank (EADB)
- Central America Bank for Economic Integration (CABEI), Ardean Development Corporation (CAP) and Financial Fund for the Development of the River Plate Basin (FONPLATA).
- Nordic Development Bank (NDB) and Nordic Development Fund (NDF).
- Organisation of Petroleum Exporting Countries (OPEC).

Bilateral Donors/Creditors

Bilateral donors/creditors are sovereign governments or their agencies provide external assistance. The donors/creditors include developed and developing country-governments and agencies. The developed country-governments, which are members of the OECD, are sometimes referred to as OECD donors/creditors, with the others being called non-OECD donors/creditors. Another classification of bilateral donors/creditors refers to those governments, which are participating creditors at the Paris Club, referred to as Paris Club Donors/Creditors, and those which are not, called non-Paris Club Donors/Creditors. Most developed country-governments provide grants and concessional loans.

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Financing Government Programmes in Economic Downturn: A Comparative Analysis

Temitope Oshikoya[*]

I. Introduction

This paper examines the experience of Nigeria and other oil exporting countries in adjusting to lower oil prices and financing government programmes during economic downturn. The remainder of the paper is structured as follows. Section 2 discusses oil price shocks since 2014 and its impact on oil-dependent countries. Section 3 outlines government programmes and examines specific policy adjustments related to draw-down on reserves, oil revenue savings and sovereign wealth fund, exchange rate depreciation, and expenditure adjustment including oil subsidy reduction or removal. Section 4 discusses domestic budget financing sources including revenue generation, domestic debt issuance via treasury bills and bonds, and explores external financing sources such as private sector, bilateral, and multilateral. Section 5 concludes the paper.

II. Lower Oil Prices and Economic Downturn

Oil prices declined by more than 70.0 per cent from about US$115 in June 2014 to US$27 in February 2016, before recovering to the current US$42-52 price range per barrel in mid-2016. Since 1973, this level of negative oil price shock could only be comparable to those of the 1980s, when oil prices fell below US$10; and in 2008-2009, when it fell from around US$147 to about US$40. According to the IMF, futures markets predict only a modest recovery in oil prices from about US$45 a barrel at present to about US$50–US$55 a barrel by 2020. The prospect of lower oil prices for longer period is considerably influenced by a slowdown in global economic growth on the demand side, and the U.S. shale supply and Iran's return to the world oil market, on the supply side (IMF, 2016c).

The Economy and Lower Oil Prices

In oil-dependent countries, macroeconomic and financial developments are closely linked with the price of oil. Figure 1 provides a schematic view of the channels through which oil prices affect the economy. In oil-dependent countries, public sector expenditures are negatively impacted by low oil prices as fiscal revenues from oil decline. Economic activities in the non-oil sector slow down indirectly, as lower foreign exchange inflows reduce imports for household consumption and business investment and private sector confidence weakens. In the financial sector, credit and liquidity from the banking sector are tightened as banks' balance sheets weaken due to rising non-performing loans.

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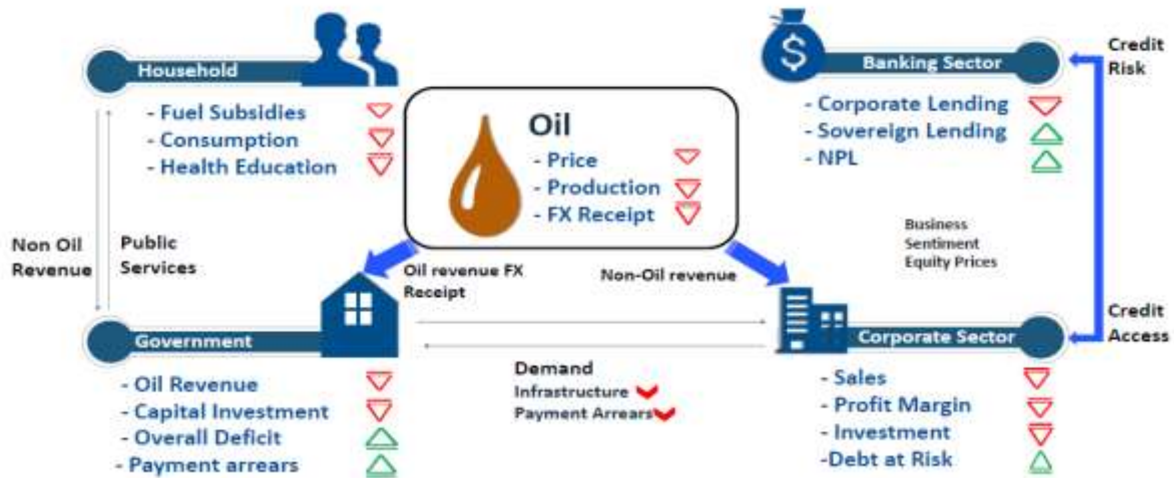
Figure 1

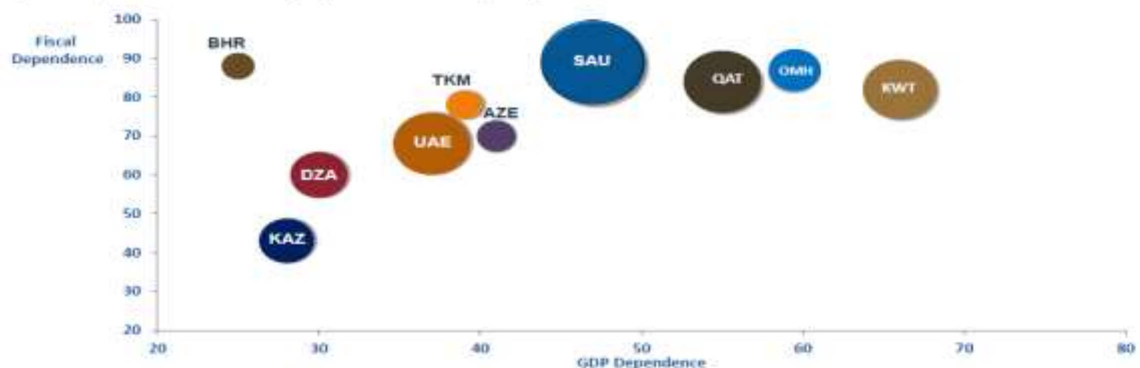


Source: Author

Jurisdictional Experiences of the MENA and CCA

Over half of the world's oil exporters are based in the Middle East and North Africa (MENA) countries (Algeria, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates), and Caucasus and Central Asia (CCA) countries (Azerbaijan, Kazakhstan, Turkmenistan). As shown in Figure 2, the fiscal revenues and gross domestic product of these countries are highly dependent on oil and other hydrocarbon resources. According to the IMF (2016c), lower oil prices reduced hydrocarbon budget receipts by more than 10.0 per cent of GDP in all Gulf Cooperation Council (GCC) countries, Algeria, and Azerbaijan between 2014 and 2015. Kuwait was one of the hardest hit, with fiscal revenue declining by a third, given that the oil sector contributes more than two-thirds to its GDP and 80.0 per cent of its fiscal revenue. In Nigeria, while the non-oil sector accounts for significant part of GDP, the oil sector plays a central role in the economy, by contributing over 70.0 per cent of government revenues until recently.

Figure 2



Source: IMF

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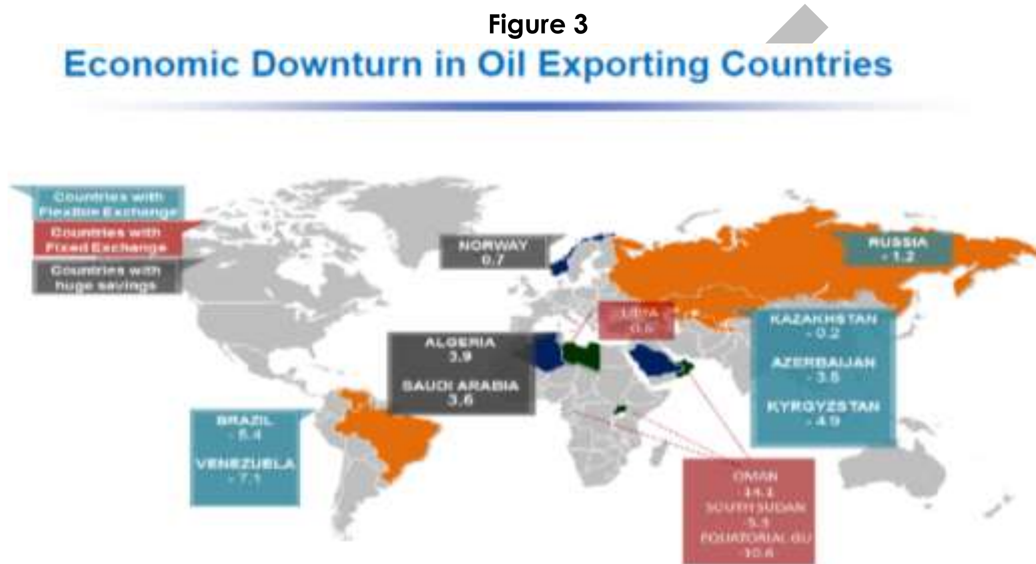
Economic Slowdown

Several oil-exporting countries registered negative growth rates in 2015 (Figure 3). There is no discernible empirical evidence to suggest that operating a free floating market exchange rate or a rigid fixed exchange rate would have prevented a recession in oil-exporting countries. The following countries have not depreciated their exchange rates by much and some even maintained fixed exchange rates, but still have negative GDP growth rates according to trading economics(2015), Kuwait (-1.6 per cent), South Sudan (-5.3 per cent), Libya (-6.0 per cent), Oman (-14.1 per cent), and Equatorial Guinea (-10.6 per cent).

Figure 3



Russia (-1.2 per cent), Brazil (-5.4 per cent), Venezuela (-7.1 per cent), Kazakhstan (-0.2 per cent), Azerbaijan (-3.5 per cent), and Kyrgyzstan (-4.9 per cent) have significantly depreciated their currencies, but still have negative GDP growth rates year on year. With the Russian economy declining by 3.7 per cent in 2015, Sergei Guriev, an economic advisor to a former President of Russia noted on CNBC that "the Russian economy is still very dependent on oil prices. Even though Russia's central bank has moved to a floating-exchange-rate framework, Russia could not avoid the recession, given the 50.0 per cent drop in oil prices. The ruble depreciation buffered the shock but could not have shielded the economy completely" (Ellyatt, 2014). Some countries with large oil savings relative to GDP that pursued counter-cyclical policies have managed so far, to avoid a recession irrespective of their exchange rates regime. These include: Norway (0.7 per cent) with a free floating exchange rate; Saudi Arabia (3.6 per cent) with fixed exchange rate; and Algeria (3.9 per cent) with managed floating exchange rate.

Nigeria achieved a decade of robust growth, with annual real GDP growth rate averaging 6.8 per cent a year up to 2014, driven by robust oil prices, which reached a high of US$115 in July of that year, fueling high consumer demand and encouraging capital flows, as well as the rise of the services sector. From 6.3 per cent in 2014, economic growth declined significantly to 2.8 per cent in 2015; and contracted further by 0.4 per cent in the first quarter and by 2.06 per cent in the second quarter of 2016. This was due to declining oil prices which reached a low of US$27 in February, 2016, cut in oil production by more than a

quarter as a result of vandalism of oil pipelines, energy and electricity shortages, and foreign exchange scarcity. Nigeria is already in a recession but is expected to reach a trough in the third quarter of 2016, with a projected positive growth in the fourth quarter. As a result, the economy is expected to register a decline of -1.3 per cent in 2016, according to the Medium-Term Expenditure Framework (MTEF) 2016-2020. The economy is expected to pick up in the first half of 2017, growing at 3.0 per cent.

Inflation reached a high of 17.1 per cent in July, 2016, eroding consumers real purchasing power. The rising inflationary pressure is due to structural and cost-push factors, low industrial activities, high electricity tariffs, and the pass-through effects of the depreciation of the naira. Government's fiscal balances moved from surpluses of 2.0 – 6.0 per cent of GDP in the past decade to -1.8 per cent in 2014, and further widened to -3.7 per cent in 2015. The 2016 budget sets expenditure at ₦6.08 trillion, with capital expenditure accounting for 30.0 per cent of the total budgeted expenditure, from 10.0 per cent in 2015, with ₦1.36 trillion for debt servicing, with a revenue projection of ₦3.86 trillion and deficit of ₦2.22 trillion. Fiscal deficits widened due to lower oil and non-oil revenues, huge fuel subsidy payments, and high debt service ratio. In 2015, export fell by 40.0 per cent and is projected to fall further by 20.0 per cent in 2016. The current account balance turned negative at -2.4 per cent in 2015. Gross international reserves declined from US$34.0 billion in 2014 to US$26.4 billion in June 2016, enough to cover 5 months of imports.

III. Adjustment as Financing Instruments

Drawdown of Reserves, Sovereign Wealth Fund (SWF) and Fiscal Buffers

Several oil exporters with fiscal buffers in oil savings and SWF used them to absorb the initial oil price shock and smoothen policy adjustment (Figure 4). The first line of defence has been to draw-down on foreign reserves, oil savings and sovereign wealth funds. The GCC countries and Algeria have a combined total of US$2.5 trillion in their sovereign wealth funds and other savings vehicles based on estimates from the Sovereign Wealth Fund Institute (SWFI). According to the IMF (2016c), several GCC and CCA oil exporters have substantial fiscal space, with financial savings plus debt capacity exceeding 10 years' worth of projected fiscal deficits. In some other countries such as Kazakhstan, Kuwait, Qatar, the United Arab Emirates, and Turkmenistan, the estimated fiscal buffers can finance more than 20–30 years of projected deficits. Their oil savings are more than 50.0 per cent of their GDP, while that of Nigeria are less than 1.0 per cent of GDP.

Exchange Rate Policy Options in Oil Exporting Countries

The exchange rate regimes of oil exporters vary from fixed, managed, and floating. The fixed exchange rate regime has been maintained by the GCC countries, and has provided a useful nominal anchor in most of the undiversified economies. This has been helped by the large fiscal buffers of these countries. However, fiscal adjustment measures via direct spending reduction and non-oil revenue increases will be needed to maintain the pegs in the face of a persistent adverse external shock.

Flexible exchange rate regime, allows for depreciation of the exchange rates, and can help smoothen fiscal and external adjustment, especially in countries with more diversified

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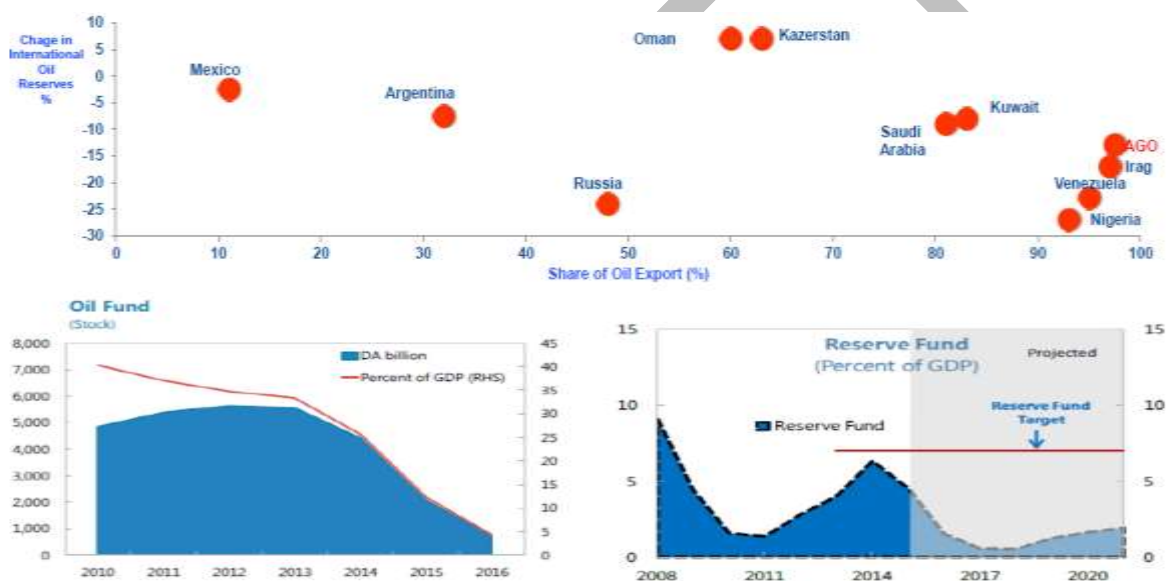
economies. However, there are adverse effects associated with higher inflation and financial stability risks due to currency mismatches and unhedged borrowers especially in the context of dollarised economies. While Algeria has adopted a managed exchange rate and Kazakhstan has introduced substantially more foreign exchange flexibility, Turkmenistan and Uzbekistan have managed their currencies more tightly through interventions and administrative controls. With a flexible exchange rate, currency depreciation raises the local-currency value of oil and other exports and thereby boost short-term fiscal revenues. However, these revenue gains can be negated by a proportional rise in government spending, especially public wages. Nominal depreciation can also be offset by inflationary pressures, which have been observed in Azerbaijan and Kazakhstan. Overall, the losses of foreign exchange reserves have been smaller in the CCA region than in the GCC and Algeria, which allowed flexible exchange rates as shock absorbers (IMF, 2016c).

Figure 4



Source: IMF Algeria, Angola and Russia Article 4 Consultation Report
Note: 1st Line: Fiscal Buffers: Drawdown your reserves, oil savings and SWF; Nigeria's SWF 0.5% of GDP Vs. 40% in Algeria (GCC have $2.5 Trillion in Savings > $1 Trillion of Projected Deficits)

The CBN had used various instruments in an attempt to meet multiple objectives. The Bank has used both quantitative measures and exchange rate adjustment in response to foreign exchange scarcity following the fall in oil price since 2014. Some of the measures include restrictions on commercial banks' FX trading, closing of the official FX auction window, and banning of 41 items from the official window. In September 2015, J.P. Morgan excluded Nigerian domestic bonds from its local currency government bond indexes due to FX liquidity issue. In order to stimulate the slowing economy, the CBN expanded special intervention schemes while easing monetary policy rate and the cash reserve ratios implemented in November 2014 and May 2015 (IMF, 2016a).

In essence within the monetary policy trilemma, the CBN sacrificed inflation and price stability for liquidity and growth, and exchange rate stability for capital flows. As a result, foreign capital flows dried up and inflation rates rose to 17.1 per cent. At its July 2016 MPC

Meetings, the CBN made a 360-degree change towards favouring capital flows while sacrificing growth with greater exchange rate flexibility, hike in interest, and short-term interest rate measured by the yields on Treasury Bills rising above 20.0 per cent.

Nigeria had devalued the naira twice in this oil down cycle, but has maintained an official exchange rate since the first half of 2015. Following the adoption of a flexible exchange rate by the Central Bank Nigeria (CBN) in June 2016, the inter-bank rate of the naira depreciated by two-thirds from ₦197 to US$1 to ₦316 to US$1 and stood at US$384 at the parallel market as at 2nd August, 2016. Demand for foreign exchange at about US$5.0 billion per month far outstripped by five times the supply of only US$1.0 billion.

Will a further devaluation by itself address the recession and current account gap? The IMF estimates that Nigeria faces a current account gap of 1.5 to 2 per cent of GDP and a real exchange rate gap of about 15.0 - 20.0 per cent. According to the IMF (2016), over half of the gaps could have been closed if other macroeconomic policies, other than exchange rate adjustment, had been at their desirable settings. "This provides a measure of the component of the estimated overvaluation that would ideally be addressed by other policy levers, leaving the remainder to be addressed through real exchange rate adjustment, or, in the medium term, structural policies to improve competitiveness. These dynamics are illustrated by the inability of the 2014-15 devaluations to significantly alter the real effective exchange rate, which points to the need for a package of supportive macroeconomic policies to restore external sustainability" (IMF, 2016).

IV. Government Ambitious Programmes and Limited Fiscal Space

In 2014, most MENA and CCA countries implemented fiscal stimulus measures, including through off-budget vehicles. In 2015, fiscal expenditures slowed substantially, and with sizable fiscal adjustment plans of 4-6 per cent of non-oil GDP for 2016. Over time, all MENA and CCA oil exporters are expected to adjust to the new reality of lower oil prices for longer, with fiscal adjustment of 5-7.5 per cent of GDP (IMF, 2016c). In terms of balancing fiscal budgets, GCC countries and Algeria, on average, require spending cutbacks by about one-third, while CCA oil exporters need about one-quarter.

Expenditure reduction is an important part of fiscal consolidation in several oil exporting countries partly due to prior pro-cyclical policies with significant increases during the episode of high oil prices. Algeria, Azerbaijan, and Saudi Arabia have announced sizable cuts in public investment spending, while Qatar continues to spend on key infrastructure ahead of the FIFA 2022 World Cup (IMF, 2016c). The United Arab Emirates has reduced transfers to public sector entities, subsidies, and grants. Kuwait is cutting recurrent expenditure, while maintaining capital spending. Protecting public employment and wages remains a major priority in most countries.

Subsidy and Energy Price reforms

Several oil exporters have adopted subsidy and energy price reform, with increases in fuel and electricity charges from very low levels in these countries. Saudi Arabia plans further price increases over time. the United Arab Emirates, Oman, Qatar went further by introducing energy price adjustment mechanisms that will align movement in domestic prices with international benchmarks.

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Non-oil Revenues

GCC countries do not have personal income taxes and are not planning to introduce them any time soon. However, a GCC-wide value added tax (VAT) has been announced and other fees, charges, and excises have been introduced. Bahrain has started increasing a number of fees including healthcare services while Oman has increased corporate taxes and fees.

Government delayed policy responses, especially those relating to adjustment to the low oil price, which should have started from the fourth quarter of 2014. The oil and gas sector has been marred by corruption, inefficiencies, and fuel scarcity with long queues at petrol stations all over the country. An announcement on subsidy removal was made in May of 2016. The 2015 budget was submitted within the electoral cycle and did not achieve much. The Federal Government provided some fiscal relief for the state governments. The 2016 budget was delayed by more than six months, although it has the goal of stimulating the economy, while laying the foundations for sustainable growth and development. The 2016 Budget proposals of the Federal Government had ₦6.08 trillion in spending, with a revenue projection of ₦3.86 trillion, resulting in a deficit of ₦2.22 trillion. A sum of ₦300 billion was budgeted for Special Intervention Programmes (FGN 2016 Budget Speech).

Capital expenditure: In 2016, capital expenditure was allocated 30.0 per cent (₦1.8 trillion) of the budget, compared to less than 15.0 per cent (₦557.0 billion) in 2015, but implementation take off has been slow, starting essentially from the second half of the year. Significant resources have been committed to critical sectors such as Works, Power and Housing – ₦433.4 billion; Transport – ₦202.0 billion; Special Intervention Programmes – ₦200.0 billion; Defence – ₦134.6 billion; and Interior – ₦53.1 billion. (FGN 2016 Budget Speech)

Recurrent Expenditure: The budget proposed a 9.0 per cent reduction in non-debt recurrent expenditure, from ₦2.59 trillion in the 2015 Budget to ₦2.35 trillion in 2016, while budgeting ₦300 billion for Special Intervention Programmes. The Efficiency Unit was set up, which along with the effective implementation of Government Integrated Financial Management Information Systems (GIFMIS) and Integrated Payroll and Personnel Information System (IPPIS), is expected to reduce overheads by at least 7.0 per cent, personnel costs by 8.0 per cent and other service wide votes by 19.0 per cent.

The MTEF and Budget: An average growth rate of 4.37 per cent was envisaged for the economy in 2016, and was expected to increase to 4.8 per cent in 2017 and 5.2 per cent in 2018. The GDP growth rate was predicated on an oil price benchmark of US$38 in 2016, and an average of US$49 in 2017-2018, as well as oil production of 2.2 million barrel per day (mbpd) in 2016 and an average of 2.27 mbpd for 2017-2018. The GDP growth rate was expected to come from the non-oil sector with agriculture, including agro-allied business, growing by 8.0 - 15.0 per cent over the period. In light of the weak macroeconomic outturns described above, the GDP growth rate was revised in the new MTEF to -1.3 per cent for 2016 and 3.0 per cent in 2017, with an average growth of 4.4 per cent during 2018-2020. The new MTEF Oil price benchmark of US$38 was maintained for 2016, but revised for 2017 and 2018 from US$42 and US$48 to US$48 and US$50, respectively. Oil output was revised down to 1.7 mbpd for 2016 and 2.2 mbpd for 2017.

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VI. Domestic and External Financing

Debt issuance: In several oil exporting countries, budget deficits are being financed with a mix of asset drawdowns and debt issuance. Many governments withdrew some of their deposits from the local banking system, central bank, or sovereign wealth funds. In some cases, governments also borrowed from local banks. The use of international bonds (for instance, in Bahrain, Kazakhstan, Qatar, and the United Arab Emirates—Abu Dhabi) and syndicated loans (Oman, Qatar, and Saudi Arabia) have been less frequent until recently.

After significant withdrawal of financial savings last year, some countries may issue more debt this year. The exact composition of financing is highly uncertain, but if policymakers decided to finance half of their deficits by issuing debt, the total issuance would reach close to US$100.0 billion, given the sizable projected deficits (IMF, 2016c).

The Sovereign Credit Ratings (SCR): The SCR of several oil exporters, including Bahrain, Kazakhstan, Oman, and Saudi Arabia have been revised down by credit rating agencies, although most GCC countries still have ratings similar to those of the best performing advanced economies, while their debt ratios are typically below advanced economy peers. Azerbaijan and Kazakhstan also have low debt ratios. In spite of rating downgrade, banks in most countries have tapped foreign sources of funds. According to the IMF (2016), in the GCC countries (excluding Saudi Arabia) and CCA oil exporters, the increase in net foreign liabilities was about 5.0 per cent of GDP in 2015. In Qatar, the increase was almost 10.0 per cent of GDP. Several countries, notably Saudi Arabia, are also exploring partial privatisation of government holding of public corporate assets as a temporary source of financing during adjustment. Oman has raised US$1.0 billion loan and US$2.5 billion Eurobond in spite of its fixed exchange rate and negative GDP growth of 14.0 per cent, while Qatar has raised US$9.0 billion triple-tranche bond.

Nigeria's fiscal deficit, equivalent to 2.16 per cent of GDP, brings the overall debt to GDP ratio to 14.0 per cent of our GDP, well within acceptable fiscal limits, but debt servicing at one-third of revenue is quite high. Government is targeting fiscal deficits to GDP ratio of 1.3 per cent by 2018, with revenue increases and overheads reduction. The 2016 deficit is planned to be financed by domestic borrowing of ₦984 billion, and foreign borrowing of ₦900 billion totalling ₦1.84 trillion.

In 2016, oil and gas revenues are estimated at ₦820 billion. Non-oil revenues would bring in ₦1.45 trillion. Non-oil revenues, which include Income Tax (CIT), Value Added Tax (VAT), Customs and Excise duties, and Federation Account levies, have been below peers at about 30.0 per cent of total revenues and 5.0 per cent of GDP. The efficiency ratio of VAT collection is also below peers (Figure 5). The contributions of independent revenues from MDAs are projected up to ₦1.51 trillion. The NNPC is exploring alternate funding models that will enable it honour its obligations in Joint Ventures (JVs) and deep offshore fields and to lower the burden that the traditional cash calls have imposed on fiscal budget and foreign currency cash flows.

Figure 5

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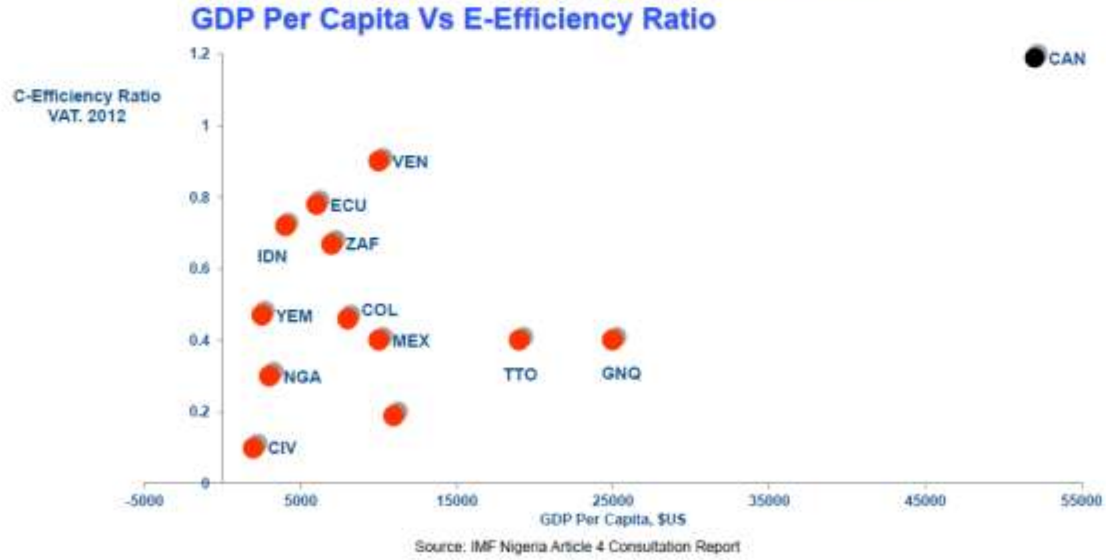

Figure 6 presents the cost and risk profile of existing public debt of the Federal Government of Nigeria (FGN) as at the end of 2015. Figures 7, 8 and 9 show the composition of domestic debt in terms of instruments and the sources of external financing and their respective percentage share as at the end of 2015. According to the DMO (2016), the implied interest rate (i.e., weighted average cost of debt) was high at 10.77 per cent, due mainly to the higher interest cost on domestic debt. The portfolio is further characterised by a relatively high share of domestic debt falling due within the next one year.

Figure 6

Policy Trade-Offs in Devising Deficit-Financing Strategies
- Drawdown of Own Resources

Options	Cost and Risk	Benefits	Policy Issues
Sovereign wealth funds	❑ If large deficits persist, buffers could diminish, investor sentiment could shift, and borrowing costs could increase. ❑ Losses could be incurred if assets are liquidated in unfavourable market conditions.	❑ Could ease pressures on domestic liquidity. ❑ Funds are readily available, contingent on market conditions	❑ Need a decision-making structure to determine how much when and what assets to sell. ❑ Fiscal rules governing sovereign wealth funds.
Bank Deposit	❑ Could tighten liquidity in the banking system and exert pressures on interest rates. ❑ Contingent on the surplus liquidity in the banking system the government could crowd out the private sector. ❑ Net costs could be very high if government deposits are small in relation to financing need.	❑ Financing costs for the government are low, particularly since the deposits likely yield low interest. ❑ Funding is readily available because it is not constrained by investor appetite for risky assets	❑ Coherent in monetary and fiscal operations is needed to minimise liquidity shock

Source: IMF

Interest rate risk is high, since maturing debt will have to be refinanced at market rates, which could be higher than interest rates on existing debt. The foreign exchange risk is relatively low given the predominance of domestic debt in the portfolio. A rise in short-term interest rates would increase the cost of domestic debt, while further pressure in the foreign exchange market and the resultant volatility would threaten the prospects of external financing and capital inflows in the immediate term (DMO, 2016).

Figure 7

- Domestic Borrowing

Options	Cost and Risk	Benefits	Policy Issues
Treasury Bills	❑ Exposes government to rollover risks given the short duration	❑ Instruments are denominated in domestic currency, so there is to currency risk. ❑ Could attract capital inflows from foreign investors wishing to participate. ❑ Provide s banks with short-term liquid assets and facilitate their liquidity management.	❑ Ensure infrastructure for issuance and calendar.
Treasury Bonds	❑ If domestic liquidity conditions tighten, the domestic cost of borrowing could be higher than in international capital markets. ❑ In tight liquidity conditions could crowd out private sector. ❑ Islamic banks, which account for a significant market share of banking system in the GCC, cannot participate	❑ Medium-to long term instruments issued in domestic currency, so reduces rollover and currency risk. ❑ Can facilitate domestic debt market development and provides a reference benchmark for private sector issuance. ❑ Provides alternative investment opportunities for financial institutions and for banks the zero-risk weight can improve the capital adequacy ration. ❑ Could attract capital inflows from foreign investors wishing to participate.	❑ Ensure infrastructure for issuance and calendar. ❑ Develop medium-term debt management strategy.

Source: IMF

Figure 8

- External Borrowing

Options	Cost and Risk	Benefits	Policy Issues
Issuance of Sovereign Bonds	❑ Cost of borrowing can be high if market sentiment shifts due to uncertainties about the trajectory of oil prices and if the sovereigns bond is downgraded. ❑ Access is contingent on market sentiment and liquidity conditions in the global market. ❑ Increases currency exposure and exchange rate vulnerability for countries with flexible exchange rates. ❑ Large financing needs could lead to re-emergence of debt vulnerabilities.	❑ Eases pressure on domestic conditions. ❑ Debt is marketable and can be in a secondary market so appetite might be higher for domestic bonds. ❑ Can attract investors seeking to their portfolios. Given the countries have not been in markets regularly. ❑ Pre-financing when market are favourable could borrowing costs.	❑ Need to develop debt management strategy ❑ Need legal and financial advisory services necessary to achieve a successful issuance ❑ Need to monitor issuance by sovereigns with similar credit ratings and establish effective investor-relations programs
Sovereign Bond Issuance for on-lending to government-related entities	❑ Central Govt. assumes the counterparty risks of government-related entities	❑ Could reduce borrowing costs for the government related entities	❑ Legal framework is needed to govern the transaction
Multilateral Lending (IMF, ADB, World Bank)	❑ Devaluation inevitable ❑ Backlash from populists	❑ Longer tenure, lower interest rates, lower fees, direct budget support and project financing for infrastructure	❑ Policy Conditionalities, Devaluation
Commercial Bank loans, including syndicated loans	❑ Market for loans not as developed as that of international bonds	❑ Eases pressure on domestic liquidity conditions ❑ Greater flexibility to influence terms depending on negotiating power	
Bilateral Loans, Including project loans	❑ Project loans tied to specific project use thus less funfible ❑ Disbursement highly dependent on progress of project	❑ Could finance public investment programs	❑ Institutional framework for monitoring projects is needed

Source: IMF

Figure 9

- Domestic & External Borrowing

Options	Cost and Risk	Benefits	Policy Issues
Sukuk	❑Could require complex structuring if it is to be used for budgetary purposes since an underlying asset is required	❑Provides investment opportunities for Islamic banks and facilitate s liquidity management in the Islamic banking segment.	❑Need a legal framework to issue Sukuk and to identify permissible assets.
Diaspora Bonds	❑Administrative or market rates ❑Could crowd out banks in funding market ❑More costly distribution arrangements	❑Could tap into high-net-worth clients. ❑Widens investor base for the government	❑Need an institutional framework for issuance
Infrastructure Funds	❑Long-term commitment ❑High risk for infrastructure projects	❑Bring a wide pool of investors ❑Bring in institutional investors including Asset Managers, Pension Funds, SWF	❑Need an Institutional framework

Source: IMF

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The newly approved Debt Management Strategy prepared by the DMO and approved by the Federal Executive Council (FEC) plans to introduce new debt instruments. Retail bond, inflation-linked bond and Domestic Sukuk are planned for the Domestic Bond Market, while Diaspora Bonds and International Sukuk are envisaged for the International Capital Market.

The Debt Strategy for 2016 to 2019 period favours rebalancing the public debt portfolio in favour of long-term external financing with the objective of reducing debt service cost and extending the maturity profile of debts. The debt portfolio composition is, therefore, targeting a ratio of 60:40 for domestic debt and external debt, as against the 84:16 as at end 2015. The foreign exchange rate risks that may arise will be mitigated by prioritising long-term concessional borrowing for infrastructure projects. The debt strategy is also aiming at a domestic debt mix of 75:25 for long and short-term debts from the current 69:31 as at end 2015 to reduce the cost of debt service and roll-over risk (DMO, 2016).

V. Conclusions

The economies of Nigeria and other oil exporters have been hit by lower oil prices with serious consequences for fiscal and current account balances, economic growth and financing of government programmes. This paper examined the experiences of other oil exporters in adjusting and financing government ambitious programmes. These experiences were compared and contrasted with the experience of Nigeria.

Oil exporters in the MENA and CCA regions have used a variety of instruments to adjust to major oil shocks and to financing their government programmes. The first line of defence for major oil exporters was to partially drawdown their oil savings and sovereign wealth funds to stabilise their economy and finance government programmes. In contrast to Nigeria with oil

savings funds of only about 0.5 per cent of GDP, some of these countries had oil savings in excess of 50 per cent of GDP, and that could finance up to 10 years and even 20 years of projected fiscal deficits.

The second line of defence has been to adjust exchange rate policies with flexible and managed floating exchange rates, which serve as shock absorbers. While most GCC countries have fixed their exchange rates, CCA countries allowed their exchange rates to depreciate faster than Nigeria has done. As part of the adjustment processes, government in oil exporting countries have also adjusted expenditure on energy subsidy to conserve fiscal resources. Some countries have also announced privatisation programmes to raise revenues. GCC countries do not have personal income taxes; and are not planning to introduce them any time soon, although a GCC-wide value added tax (VAT) has been announced, and other fees, charges, and excises have been introduced. Beyond these monetary and fiscal measures, governments in oil exporting countries are borrowing both domestically and externally from commercial sources, via Euro-bonds and other sources to finance public sector programmes.

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An Overview of CBN Interventions in the Nigerian Economy (2009 – Date)

Mudashir A. Olaitan [*]

It is a pleasure to be with you at this 2016 Annual Central Bank of Nigeria (CBN) Executive Seminar. This year's Seminar and the topics to be discussed are of great importance to us all, because we share a common goal in ensuring quicker economic recovery and a return to strong growth.

In view of the limited fiscal space, the monetary authority has a definitive role in promoting sustainable economic development. Evans (2010) once noted that the United States Federal Reserve (Fed) had a dual mandate to promote maximum employment and price stability even in more normal times. This dual mandate of promoting sustainable economic development and price stability also applies to the CBN. There have been heightened interests in the Bank's interventions over the past few years from the stakeholders on whether the developmental objective of the CBN conflicts with the stability objective.

Epstein (2006) identified two schools of thought on central banking in this debate. The first is the historically dominant theory and practice of central banking which involves financing governments, managing exchange rates, and supporting economic sectors by using "direct methods" of intervention. These, according to him, are the most important tasks of central banking and, indeed the essence of their establishment. The other is the "neo-liberal approach. The main components are (i) Central Bank independence (ii) controlling inflation and (iii) the use of indirect methods of monetary policy i.e. short-term interest rates as opposed to direct methods. This is deemed 'best practices' and prescribed by the international financial institutions such as International Monetary Fund (IMF) and other prominent economists.

The 2007/2009 global financial crisis, however, seriously undermined the essence of the orthodox approach promoted by IMF and the multilateral agencies. The developments in the past decade renewed the need for central banks to look beyond price stability mandate and include the promotion of sustainable economic development as a major task to be accomplished. The apologists of this school opined that widening the mandates of the central banks will promote sustainable economic development, inclusive growth and greening of the financial system, among others (German Development Institute GDI, 2015).

The growth of the economies of east Asia, particularly Japan, Korea and China also strengthened the view that central banks can facilitate the attainment of certain developmental goals, by directly supporting or subsidising lending to priority sectors. The Bank of Japan supported government's industrial policy through credit allocation policies. The central banks of France, Italy and Belgium have also devised different methods to support desired sectors such as manufacturing. Similarly, the Bank of England (BOE) and the

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Fed have also supported economic sectors using direct methods, particularly to enhance the international role of their financial service industries in the global financial system.

There is consensus that central banks, particularly in developing economies have to develop policies not only to address price stability, but also to have a major role in the political, institutional, and economic environment. It was on this premise that the Governor, CBN in his maiden speech, noted that the Bank would pursue both price and financial system stability as well as provide complementary developmental functions by creating an environment for Nigerians to live better and more fulfilled lives and these will include policies to enhance financial access and reduce borrower cost of credit. (Emefiele, 2014).

Historically, the Bank had been involved in development financing since 1962. The focus of policies were on improving access to credit by preferred sectors (agriculture, manufacturing, MSMEs, and infrastructure) and the establishment and strengthening of development finance institutions. These included: the Commercial Bill Financing Scheme (1962); Bank of Industry 1964 (formerly Nigeria Industrial Development Bank); regional commodity boards (later called national commodity boards, 1977); Rural Banking Programme (1977); Agricultural Credit Guarantee Scheme (1978); and Export Financing and Rediscount Facility (1987). Others were the Bank of Agriculture (formerly Nigeria Agricultural and Co-operative Bank Ltd) 1972; Export Guarantee Scheme (1987); People's Bank of Nigeria (1989); Community Banking (1990); Export Rediscounting and Refinancing Facility (1991); Sectoral Allocation of Credit and Concessional Interest (1996); Small and Medium Industry Equity Investment Scheme (2001); and Agricultural Credit Support Scheme (2006).

In 2009, there was a paradigm shift in the focus of the Bank's intervention. It was now being used as an instrument of quantitative easing in 2010 to address the "persisting tight credit conditions and the continuing under-performance of key monetary aggregates". The twin focus of the interventions became stimulating growth through the development of identified weak private sector and strengthening of the financial system. Monetary policy now reflects the imperative to maintain the growth trajectory of the economy and ensure that lending rates are not placed under further upward pressure. The interventions now provide "direct support" to industries that have high job-creating capacity and other vital economic infrastructure such as power projects. For instance, the Commercial Agricultural Credit Scheme (2009) is dedicated to fast-tracking the development and access to credit facilities by large commercial agricultural enterprises to increase output and create jobs. The SME Restructuring and Refinancing Facility (SMERFF) and Power and Airline Intervention Facility (PAIF) were introduced to restructure/refinance DMBs' exposures to the manufacturing sector and SMEs, boost electricity production, especially within industrial clusters, ensure the smooth flow of credit to the real sector of the economy, promote private sector/foreign investment as well as energise reforms in the power and other economic infrastructure sectors, and bring about growth in employment-generation. In the same vein, the Nigeria Electricity Market Stabilisation Facility (NEMSF) is to promote investment in the power sector to achieve sustainable growth, while the MSME Development Fund and the Youth Entrepreneurship Development Programme (YEDP) are to facilitate access to affordable credit by micro and small businesses, particularly women and youth enterprises. The Anchor Borrowers' Programme (ABP) also provides resources for small-holder farmers who are the bedrock of Nigeria's agricultural sector.

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The broad policy deliverables of the interventions can, therefore, be categorised as follows:

- improve access to affordable finance to promote long-term investment in the real sector;
- diversify the economy;
- create jobs; and
- promote inclusive growth.

The question is to what extent has these been achieved? Have the interventions delivered on the intended benefits? In developing and emerging economies like Nigeria, the achievement of a central bank's mandate of monetary and price stability is positively correlated with and driven largely, by the dynamics in the productive sectors of the economy. The effectiveness and ability of the financial sector to meet the needs of the productive sectors, to a large extent, determines the output levels and tempo of development. Increased production of goods and services enhances price and financial stability.

For the purposes of this discourse, the Bank's interventions will be evaluated on the results, achieved since the commencement of each of the intervention as shown in table 1. The interventions have been able to fund the industrial sector to a large extent with affordable long-term finance and created jobs. For instance, the Commercial Agricultural Credit Scheme (CACS) and SMEs Restructuring and Refinancing Facility (SMERRF) had financed 460 and 604 projects, respectively. Others have also improved access to credit by MSMEs resulting in over 6.2 million jobs created. There is also an increase in the level of credit to the agricultural sector to over 3.0 per cent from 1.3 per cent in 2010.

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Table 1: Performance Evaluation of CBN Interventions in the Nigerian Economy (2009 – Date)

INTERVENTION	OBJECTIVES	MODALITIES	FUNDING SOURCE	EXIT DATE	IMPACT/ACHIEVEMENT as at July, 2016	CHALLENGES
₦200 Billion Commercial Agriculture Credit Scheme (CACS)	To fast-track the development of the agricultural sector of the Nigerian economy by providing credit facilities to commercial agricultural enterprises at a single digit interest rate, enhance national food security, increase output, generate employment as well as diversify the revenue base.	DMBs are granted facilities to be disbursed to clients (both private and state governments) at a maximum interest rate (all inclusive) of 9.0 per cent. CBN earns 2.0 per cent as interest from the 9.0 per cent	₦200 billion FGN Bond for 7 years tenor, floated by the Debt Management Office (DMO)	The scheme which was initially meant to terminate in September, 2016 was extended to September 2025	₦373.73 billion disbursed in favour of 460 projects. Contributed to the creation of 1,132,260 jobs created along the various agricultural value chains. Increased capacity utilisation of agro-allied companies.	Underutilisation of installed capacity due to inadequate raw materials as a result of low agricultural productivity. Infrastructural constraints (transport and electricity) are increasing the cost of production of beneficiaries
₦200 Billion Small and Medium Enterprises Restructuring and Refinancing Facility (SMERRF)	To re-finance and restructure banks' existing loan portfolio to manufacturers to improve access to finance as well as improve the financial position of DMBs	Administered at 7.0 per cent per annum payable on quarterly basis. The Managing agent (BOI) is entitled to a 1.0 per cent management fee and the Banks, a spread of 6.0 per cent. Loans shall have a maximum tenor of15 years and or working	₦200 billion debenture issued by Bank of Industry (BOI) to fund SMEs and manufacturing sector	Scheme has been discontinued while repayment is still ongoing.	₦381.99 billion disbursed to 604 projects. Contributed to the creation of 89,860 direct jobs. Increased productivity and turnover of firms. Restoration of 905 MW of electricity to the National grid. ₦6.9 billion estimated as interest savings to beneficiaries.	Quest for cheap imported goods. Cost of power supply is significantly increasing beneficiaries cost of production.

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		capital facility of one year with provision for roll over				
Small and Medium Enterprises Credit Guarantee Scheme (SMECGS)	To fast-track the development of the manufacturing SME sub-sector of the Nigerian Economy	Provide guarantee cover of 80.0 per cent of principal and interest on term loans for SMEs	Contingent liability		87 projects valued at ₦4.21 billion in favour of 9 financial institutions	Apathy of banks to fund SME projects from their balance sheet. 80.0 per cent guarantee not considered as adequate incentive by financial institutions to lend to SMEs
Power and Airline Intervention Fund (PAIF)	To stimulate and sustain private sector investment in the power and airline sectors as well as fast track development in both sectors of the economy	Administered at a rate of not more than 7.0 per cent per annum. The Managing agent (BOI) is entitled to a 1.0 per cent management fee and the banks, a spread of 6.0 per cent. Effective May 2016, new projects charged at 9.0 per cent (BOI at 1.0 per cent, CBN at 3.0 per cent, DMB at	₦300 billion debenture issued by Bank of Industry (BOI)	2025	40 power projects valued at ₦140.442 billion; and 16 airline projects valued at ₦120.762 billion were financed. 840 MW of power generated and 120 km of gas pipeline constructed. Resuscitation of a number of aircrafts, captive and embedded power projects to complement the national grid	Pricing of electricity. Wanton destruction of pipelines and increasing cost of aviation fuel has hindered repayment by beneficiaries.

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		5.0 per cent).				
Nigerian Incentive Based Risk Sharing System for Agricultural Lending (NIRSAL)	Creates access to finance by integrating end-to-end agriculture value chains with financing value chains. It seeks to de-risk agricultural finance value chain, build long-term capacity and institutionalise incentives for agricultural lending	Guarantee banks' exposure to agricultural sector and provide cascaded interest rebates to farmers.	NIRSAL created as a Special Purpose Vehicle (SPV) and fully funded by CBN			NIRSAL has taken off fully as a SPV and reports to its Governing board.
₦220 Micro Small and Medium Enterprises Development Fund (MSMEDF)	The Fund seeks to enhance access by MSMEs to financial services, increase productivity and output of microenterprises; increase employment and create wealth, and to engender inclusive growth	Administered at 2.0 per cent per annum to PFIs for on-lending to beneficiaries at 9.0 per cent. Maximum loan tenor of 1 and 5 years for micro and SMEs, respectively.	Funded by CBN		478 projects funded by PFIs valued at N74.797 billion	Low uptake by PFIs due to low lending margins that is considered not commensurate with the risk of lending to MSMEs and startups. Poor capacity of PFIs to monitor micro entrepreneurs.
Nigeria Electricity Market Stabilisation Fund (NEMSF):	The NEMSF is aimed at putting the Nigerian Electricity Supply Industry (NESI) on a route to economic viability and sustainability by facilitating the settlement	Funds to be disbursed at 10.0 per cent per annum with a ten-year tenor. 6.0 per cent CBN; 2.0 per cent NESI SS Ltd;	Funded by CBN		₦106.64 billion disbursed to 23 market participants. ₦8.67 billion earned by beneficiaries as interest savings on funds received.	Court judgment against the take-off of Transitional Electricity Market (TEM). Wanton destruction of gas pipelines.

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	of Legacy Gas Debts and payment of outstanding obligations due to market participants, service providers and gas suppliers that accrued during the Interim Rules Period (IRP Debts)	2.0 per cent Participating Mandate Banks				
₦300 Billion Real Sector Support Fund (RSSF)	Established to stimulate output growth, enhance value addition and engender productivity in the economy. The Facility will concentrate on increasing credit to priority sectors of the economy with sufficient employment capabilities, high growth potentials, increase accretion to foreign reserves, expand the industrial base and consequently, enhance the diversification of the economy	Interest at 9.0 per cent (all-inclusive) and CBN to earn 1 per cent.	Special Intervention Reserve (SIR) of DMBs		4 projects valued at ₦4.6 billion approved. Contributed to the creation of 17,000 direct and indirect jobs.	Apathy of DMBs to fund real sector projects from their SIR
Anchor Borrowers' Programme (ABP)	Designed to create an ecosystem that links small holder farmers to local processors; improve productivity in identified commodities with high domestic production potential; and also build	Administered at 2.0 per cent per annum to PFIs for on-lending to beneficiaries at 9.0 per cent	CBN MSMEDF		₦15.77 billion disbursed to 76,251 small holder farmers through 5 private anchors in 3 states. 26 states have expressed interest in participation under the wet season farming	Fragmentation of farm holdings by small holder farmers have limited the use of mechanisation and hence hindered the

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	capacity of small holder farmers					optimisation of potentials
Secured Transaction and National Collateral Registry (ST and NCR)	A collaborative effort between the Central Bank of Nigeria (CBN) and the International Finance Corporation (IFC) as a financial infrastructure to deepen credit delivery to the micro, small and medium enterprises (MSMEs). The Secured Transaction and National Collateral Registry (ST and NCR) seeks to specifically, address the constraints posed by lack of collaterals as a hindrance to credit by MSMEs	The NCR is a public data base of ownership of assets, allowing borrowers to prove their creditworthiness and potential lenders to assess their ranking priority in potential claims against particular collateral.	Counterpart funding for the provision Registry on-line platform		27 Financial Institutions have registered their administrators on the NCR platform	Delayed passage of the ST and CR Bill. Poor capacity of financial institutions on asset based lending
₦50 Billion Textile Intervention Facility:	A one-off special intervention with a seed fund of ₦50 billion to resuscitate the textiles industry in Nigeria. The Facility will be used to restructure existing loans and provision of additional credit to cotton, textile and garment (CTG) companies in Nigeria as part of its efforts to	Long-term loans for acquisition of plant and machinery. All-Inclusive rate of 4.5 per cent; 3.5 per cent to CBN and 1.0 per cent to BOI Fund Management by BOI	CBN. To be funded by repayments from other Interventions.	31st December, 2025		

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	promote the development of the textile and garment sector					
₦500 Billion Export Stimulation Facility (ESF)	Established to Broaden the scope of export financing instruments. It seeks to improve access of exporters to concessionary finance to expand and diversify the non-oil export baskets; attract new investments and encourage re-investments in value-added non-oil exports production and non-traditional exports; shore up productivity and create more jobs within the non-oil exports value-chain of Nigeria etc. among other deliverables	All-inclusive interest of 7.5 per cent for facilities ≤ 3 years and 9.0 per cent for facilities > 3 years: (PFI – 4.5 per cent - 6.0 per cent; NEXIM – 1.0 per cent; CBN – 2.0 per cent). Managed by NEXIM	To be funded by CBN	28th February, 2026	Stakeholders' engagement ongoing.	
₦50 Billion Export Rediscounting and Refinancing Facility (RRF)	To encourage and support DMBs to provide short-term pre- and post-shipment finance in support of exports by providing a discount window to exports financing banks and, therefore, improving their	All-inclusive rate of a maximum of 6.0 per cent per annum with the pricing structure as follows; CBN/NEXIM would provide the RRF at a rate of 3.0 per	Funded by CBN		Disbursement yet to commence.	

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	liquidity and exporters' access to export credit. To also provide moderation and indirect influence on the cost of export credits to the non-oil sector in order to enhance competitiveness of Nigeria's exports and thereby assist in export production and marketing	cent per annum Participating banks shall have a maximum spread of 3.0 per cent per annum NEXIM as the Managing Agent				
Youth Empowerment Development Programme (YEDP)	Established to improve access to finance by youths to develop their entrepreneurial skills using a well-structured business model; stimulate job creation through the development of small and medium enterprises among Nigerian youths; harness the entrepreneurial capacity of Nigerian youths; and increase the contribution of the non-oil sector to the nation's GDP	NYSC Certificate, Tertiary Institution Certificate, 3rd Party Guarantors as collaterals. Registration of Collaterals (movables) and financed equipment with the National Collateral Registry. Loan at max 9.0 per cent interest rate (all-inclusive)	Funded from CBN MSMEDF		11,000 applications received and about 3,000 processed by lending bank. 1,211 prospective entrepreneurs trained nationwide in the 1st training.	Unwillingness of DMBs to fund startups and their lack of readiness to accept movable assets as collaterals for loans.

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The Bank has a major role to play in the socio- economic development of the country. To avoid conflict between price stability objectives and policies that promote sustainable development, interventions should be initiated under the larger framework of enhancing growth and development. More intensive study should be done in future as to when, how and the quantum of resources to be dedicated to such interventions. It is also imperative that continual performance tracking and intensive periodic impact assessment be undertaken to institute a clear exit strategy when an intervention has attained its policy objectives.

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Financing Government Deficit during Economic Downturn: Options for Consideration

Olu Ajakaiye[*]

I. Introduction

Economic downturn is said to commence when the rate of economic growth is slowing down. If economic downturn, continues up to a point where the growth rate turns negative for two consecutive quarters, the economy is generally deemed to be in recession. The immediate cause of economic downturn can be a reduction in expenditure by households, firms, government, reduction in export earnings or a combination of these causes. The root cause of recession is, however, a reduction in income of households, firms, government and the major trading partners or a combination.

An economic downturn triggered by a reduction in export earnings, for example, will result in loss of income by firms. Firms respond by retrenching workers resulting in rising unemployment and dwindling household incomes (wage and non-wage incomes). During economic downturn, therefore, government revenue falls. A passive government may reduce its expenditure on goods and services, while transfers component of its expenditure relating to unemployment benefits, pension and other social protection programmes may have to rise. Accordingly, during recession, government budget, invariably, runs into non-discretionary deficit.

An active government that seeks to pursue counter-cyclical fiscal policy may also embark on discretionary budget deficit thus, magnifying the budget deficit. In such situation, government discretionary budget deficit arises from government investment (capital) expenditure. Passive governments (like EU and UK until recently) tend to adopt austerity measures thereby avoiding discretionary budget deficit.

The upshot of the foregoing is that during economic downturn or outright recession, non-discretionary budget deficit is inescapable. Experience, however, suggests that during economic downturn, most governments tend to pursue counter-cyclical fiscal policy requiring a discretionary budget deficit.

The conventional approaches to financing budget deficit are the issuance of government bonds. In this paper, we examine the efficacy of the conventional approach to financing budget deficit during economic downturn in Nigeria. We also consider other (unconventional) options for financing budget deficits during economic downturn in Nigeria.

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The rest of the paper is, therefore, organised as follows. Section II presents key features of the current economic downturn in Nigeria. This is followed, in Section III, by a review of the current methods of financing budget deficit in Nigeria. Section IV presents additional options for financing budget deficit that can be considered in the contemporary Nigerian situation.

II. Features of Current Economic Downturn in Nigeria

As mentioned earlier, economic downturn manifests when GDP growth rate starts to decline. A look at Figure 1 shows that the current economic downturn in Nigeria actually commenced from the second quarter of 2014 and by the first quarter of 2016, the growth rate had turned to negative (-0.36 per cent). The second quarter GDP growth rate of -2.06 per cent along with a double digit inflation rate since June 2016 suggests that the Nigerian economy is in a recession accompanied by rising inflation, unemployment, interest rates on loans and government debts.

Meanwhile, it is significant to note that the downturn started immediately the international price of crude oil decelerating from June 2014 (see Figure 2). Specifically, the root cause of the current economic downturn in Nigeria is the reduction in export earnings, occasioned by the deceleration in international crude oil prices. This has been accentuated by the disruption in oil production by the various groups in the Niger Delta Region.

In the Nigerian context, therefore, the immediate effect of reduction in export earnings is reduction in oil revenue (government income) and reduced inflow of foreign exchange. The associated reduction in capacity to import also affects a major component of revenue, namely customs duties. Given the high import dependence of production and consumption activities in Nigeria, the VAT, CIT and payroll taxes would eventually decline. In sum, the reduction in export earnings arising from the fall in international crude oil prices and reduction in oil output had a ramifying immediate effect on all components of government revenues leading to escalated non-discretionary budget deficit in the economy.

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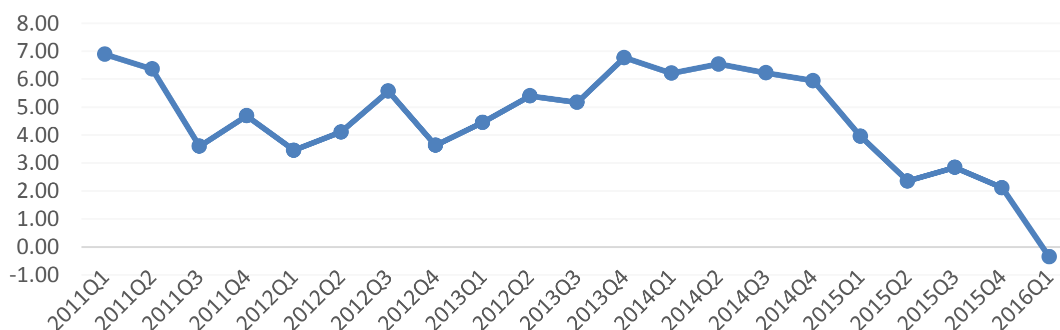
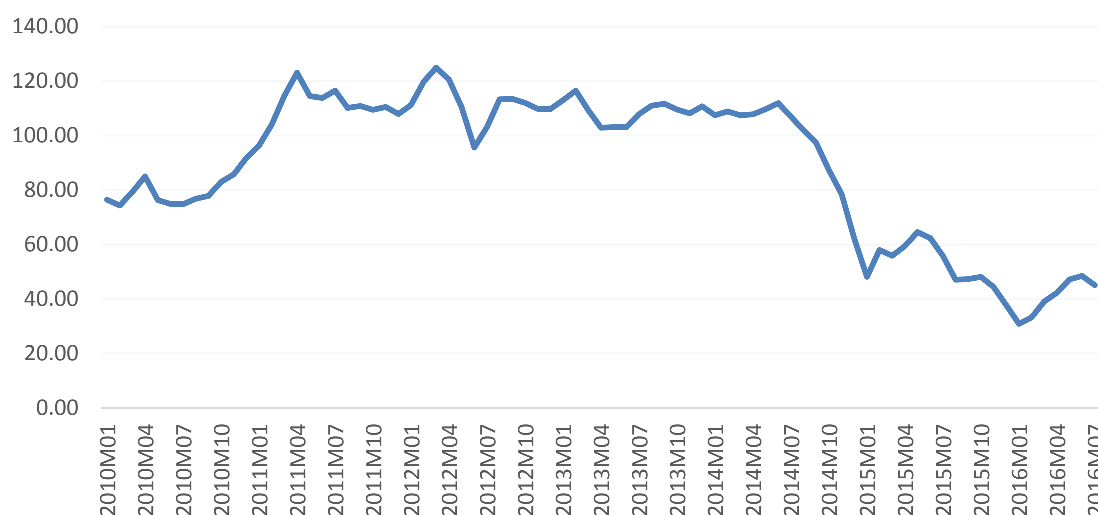
Figure 1: Quarterly GDP Growth Rate, 2011Q1-2016Q1



Source: National Bureau of Statistics (2016) National Accounts of Nigeria (NBS, Abuja)

Figure 2: Monthly Brent Crude Oil Price US$/Barrel, 2010-2016



Source: World Bank (2016) Global Economic Monitor (World Bank, Washington DC)

Another pertinent feature of the current economic downturn is that the government budget has been in deficit for some time. For example, a look at Table 1 showed that prior to the onset of economic downturn, government has been running budget deficit. It seems reasonable to consider the deficits prior to 2015 to be largely discretionary, while the 2015 budget deficit is a combination of discretionary and non-discretionary deficits [3]. Clearly, the 2016 Federal Budget is a combination of discretionary and non-discretionary deficits [4].

Table 1: Federal Government Fiscal Balances 2011-2015

Budget Heads/Ratios	**2011**	**2012**	**2013**	**2014**	**2015**
Federal Government Retained Revenue (N' billion)	3348.12	3154.86	3362.19	2518.84	3602.96
Total Expenditure (N' billions)	4484.74	4130.58	4522.15	3030.29	4357.96
Budget Deficit (N' billion	-1136.62	-975.72	-1159.90	-511.45	-755.00
Primary Deficit (N'Billion)	-641.52	-296.44	-325.33	191.38	188.00
Total Fiscal Deficit (per cent) of Revenue	-42.80	-30.93	-25.29	-20.30	-20.95
Primary Deficit (per cent) of Revenue	-19.16	-9.40	-9.68	7.60	5.22
Total Fiscal Deficit/GDP per cent	-3.09	-2.85	-1.85	-0.64	-0.79
Primary Deficit or surplus /GDP per cent	-1.7	0.74	0.70	0.2	0.2
GDP (N'Billions)	37543.70	39904.30	46714.30	80,222.13*	95843.16

Source: National Institute of Legislative Studies (2016) Review of 2016 Appropriation Bill (NILS. Abuja)

A related issue is the rather high debt service payments. For example, as shown in Table 1, between 2011 and 2015, an average of 25.0 per cent of Federal Government revenue has

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[3] When the difference between revenue and recurrent expenditure is positive (negative), i.e., development budget is non-zero (negative) the budget deficit can be deemed to be discretionary (non-discretionary).

[4] For 2016, the federal government retained revenue is N3.85 trillion, recurrent expenditure is N 4.6trillion implying that up to 50% of the total deficit of N2.2trillion can be considered non-discretionary.

been devoted to debt service. Moreover, Table 2 revealed that actual debt service has always exceeded the budget in recent times. Now that the economy is in recession, it is pertinent to manage debt service payment with a view to releasing the much needed government revenue for use in addressing the burning social and economic development challenges which the economic recession would have accentuated. Accordingly, the next section is devoted to examining the efficacy of the conventional approaches to financing budget deficit in a recession.

Table 2: Budget and Actual Debt Service Payments, 2013-2015

Items	Jan-Dec, 2013			Jan-Dec, 2014			Jan-Sep 2015		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
Debt Service Payments	591.76	834.56	242.79 (41.03 per cent)	712.00	941.67	229.67 (32.2 per cent)	715.21	908.91	193.7 (27.0 per cent)

Source: National Institute of Legislative Studies (2016) Review of 2016 Appropriation Bill (NILS. Abuja), *Notes: The values in parentheses show the percentage of variations of Actual from Budgeted* values. *the actual values for personnel cost, pensions and gratuities and overhead costs and service wide votes in 2014 are as at October.

III. A Review of the Current Approaches to Deficit Financing in Nigeria

The conventional approach to financing government budget deficit is through domestic and/or external borrowing. Domestic borrowing is typically effected through issuance of interest-bearing government debt instruments like treasury bills and bonds. These instruments can be purchased by the central bank, deposit money banks, other financial institutions, pension funds and the non-bank public. An accumulation of these instruments results in rising public debt. Also, financing budget deficit through interest-bearing domestic debt can cause interest rates to rise leading to rising debt service as well as the familiar crowding-out effect and possible Ricardian equivalence.

Table 3: FGN's Domestic Debt by Holder Category as at end-December, 2015 (₦' Billion)

Instruments	Central Bank	Banks	Non-Bank Public	Sinking Fund	Amount Outstanding
FGN Bond	550.66	2,237.14	3,020.34	-	5,808.14
Treasury Bonds	93.79	-	-	162.20	255.99
NTBs	232.85	1,046.87	1,493.15	-	2,772.87
TOTAL	**877.30**	**3,284.01**	**4,513.49**	**162.20**	**8,837.00**
Per cent of Total	9.93	37.16	51.07	1.84	100.00

Source: Annual Report and Statement of Accounts, 2015 (DMO, Abuja)

Available data from Debt Management Office presented in plotted Figures 3 and 4 showed that Nigeria's total debt stock and debt service have been rising. Figure 3 showed that the increase in total debt stock has been driven, mainly, by domestic debt, indicating that the bulk of the deficit has been funded through domestic borrowing.

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Table 3 showing the distribution of domestic debt by category of holders revealed that over half of the total debt stock at end-December 2015 was held by non-bank public, while the banks held about 37.0 per cent. The relatively small holding by the Central Bank is consistent with the twin objective of the domestic debt management strategy of DMO, namely, to finance budget deficit and also deepen the bond market (DMO, 2015:11).

As shown in Figure 3, Nigeria's external debt stock is relatively small, but rising. Figure 4 also showed that external debt service is quite small. It is also noted that 82.2 per cent of the external debt stock is made up of concessional loans. It is encouraging to note that Nigeria has been meeting its debt service obligations promptly such that it received a waiver in 2015. These explained the relatively low external debt service. During recession, it is important to maintain these attributes to prevent the stock and debt service payments from escalating.

Figure 3: Composition Nigeria's Debts Stock, 2011-2015

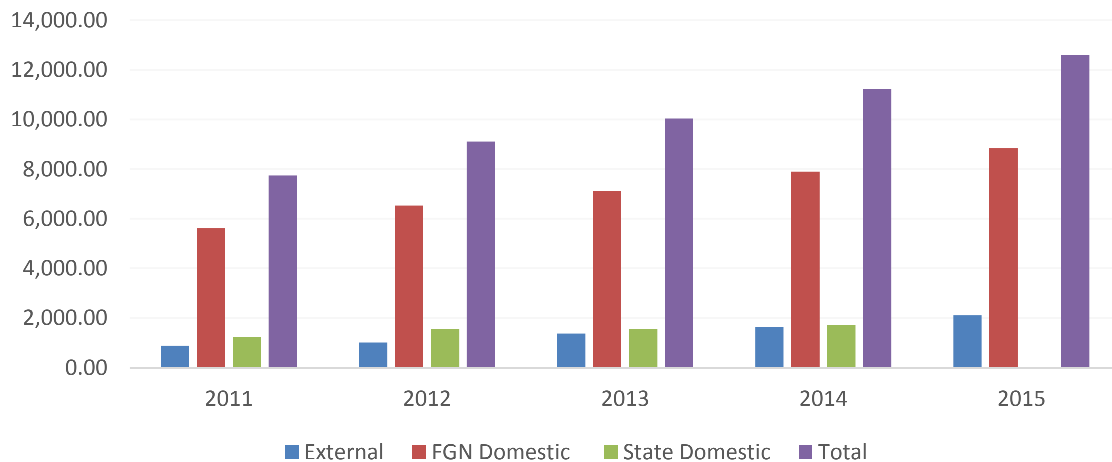
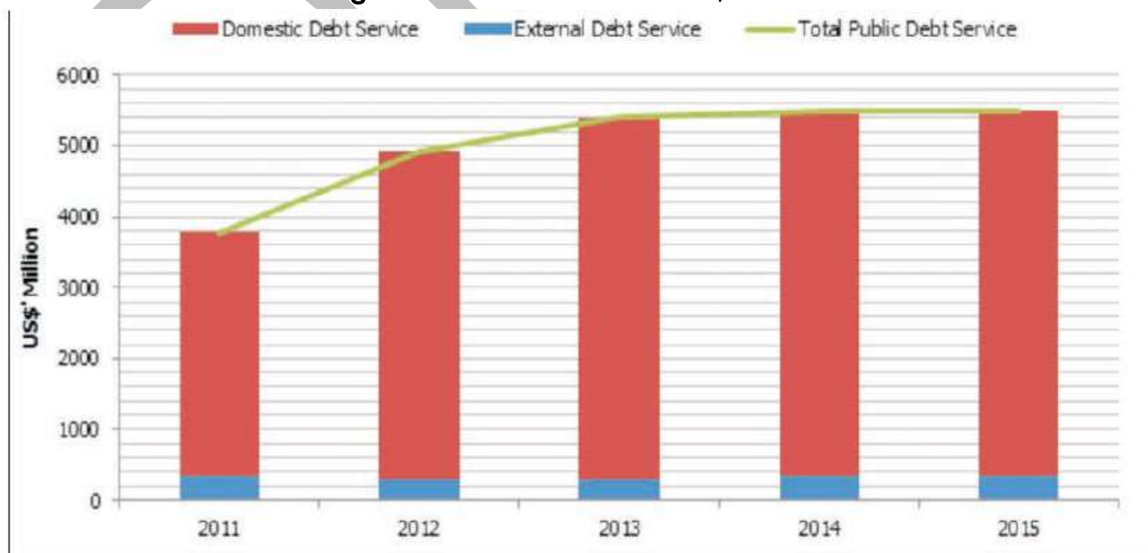


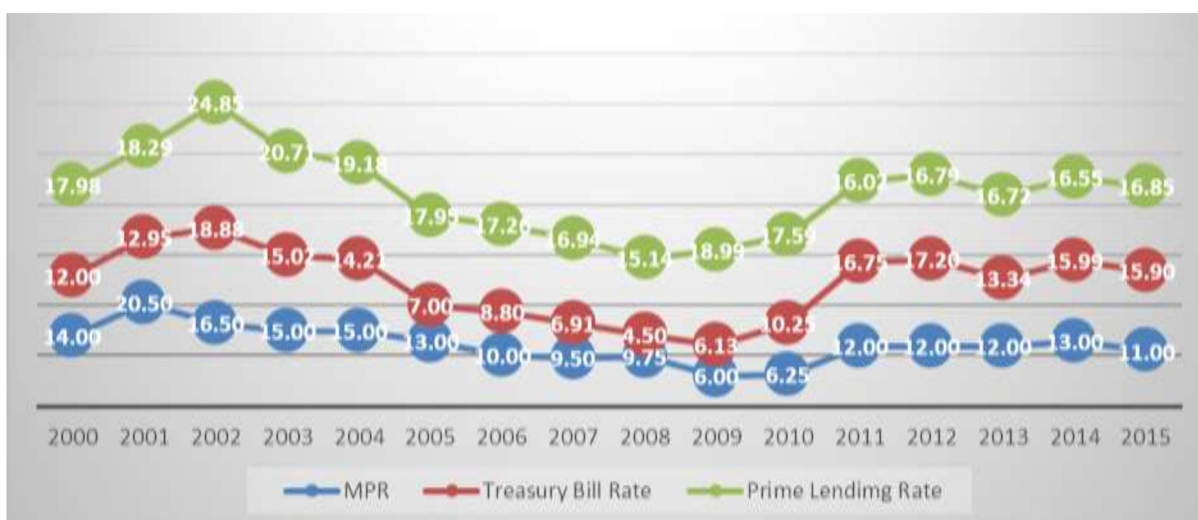
Figure 4: Trend in Debt Service, 2011-2015



Source: DMO

Figure 5 showed clearly that TBR and Prime lending rate tracked remarkably. Causality test also suggested that the causality runs from TB rate to prime lending rate implying that raising the TBR in order to attract investors to patronise government interest-bearing debt instruments crowds out the private sector and stokes cost-push inflation. See Ajakaiye and Babatunde (2015) for further analysis of the relationship between lending rate and inflation in Nigeria.

Figure 5: Trends in MPR, TBR and Prime Lending Rate, 2000-2015



Source: CBN

It would be recalled that most of the external debt overhang from which Nigeria managed to extricate itself in 2006 were accumulated during the economic downturns of the 1980s and 1990s. The commercial debts have a way of starting small, but growing very fast. Also, there is always pressure by the commercial loan 'merchants' to encourage developing country governments to take their loans, especially during a recession. It is important to avoid these temptations during this recession so as to prevent a re-emergence of debt overhang in the future.

It is noted that so far, a large proportion of external debts are allocated to economic sectors (see DMO, 2015:28). During economic recession, government may be tempted to contract non-concessional and commercial external debt for social protection programmes, especially in view of the massive needs for resettlement of the internally displaced persons. The prevailing strategy of patronising concessional loans for this purpose should be sustained. If commercial loans must be contracted, they should be allocated to projects that will generate foreign exchange high enough to meet the interest and capital payment obligations.

Evidently, Nigeria has adopted the conventional approach to deficit financing from domestic sources, namely issuance of government debt instruments. In keeping with the text books (Krugman and Wells, 2009 Ch. 13) and in recent literature (Wood, 2012; Ajakaiye, 2002; and Ajakaiye and Babatunde, 2015; Turner, 2015; and McCulley and Pozsar, 2013), this

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conventional approach tends to raise interest rates, crowd-out the private sector from the credit market and could stoke inflation.

A review of the Nigerian experience prior to the onset of economic downturn revealed that domestic public debt stock and debt service have been rising very fast, and an average of 25.0 per cent of government revenue has been devoted to debt service between 2011 and 2015 and evidence suggest that the rising TB rates contributes to rising bank lending rate, thus, contributing to cost-push inflation in Nigeria. Meanwhile, the domestic debt management strategy is apparently aimed at achieving the twin objective of financing budget deficit and deepening the bond market in Nigeria.

The Nigerian experience also showed that the external debt management strategy aims at maximising low-cost concessional external debt while minimising non-concessional and commercial debts. Evidence suggests that this strategy has been successful such that over 80.0 per cent of total external debt stock is concessional and external debt service remains quite small.

Now that the Nigerian economy is in recession triggered, mainly, by falling crude oil revenue and characterised by high inflation, high unemployment, and depreciating exchange rate in an import dependent production and consumption system, it is imperative to reconsider exclusive reliance on the conventional approach to deficit financing and explore options that are unlikely to raise interest rates, raise debt service and stoke cost-push inflation. The next section therefore explores these options.

IV. Additional Options for Financing Nigerian Government Budget Deficit during Economic Downturn

IV.1 Monetary Financing of Budget Deficit

Evidently, continuing the exclusive reliance on issuance of interest-bearing debt instruments as a strategy for deficit financing from domestic sources in Nigeria will escalate debt service, cause interest rates to rise and crowd-out the private sector. Moreover, pursuing the other objective of deepening the bond market in Nigeria during economic recession may be unaffordable. Data showed that at end-2015, CBN held less than 10.0 per cent of total interest-bearing domestic debt stock. Therefore, financing budget deficit by issuing irredeemable fiat non-interest bearing monetary liabilities of government by the CBN should be seriously considered (Wood, 2012; Citi Economic 2012; and Turner, 2015).

This approach, which has been dubbed Overt Money Finance, has the benefit of stimulating the economy without raising interest rates and crowding out the private sector as well as stoking cost-push inflation. The approach, however, requires the CBN and Ministry of Finance to coordinate their activities and work in concert to stimulate the economy at lower direct costs (Turner, 2015; Wood, 2014). In this regard, the monetary authorities may have to give greater consideration to economic revival (growth and employment revival) and be ready to accept higher inflation while the recession lasts. The risks of abusing this

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approach have been significantly reduced as the fiscal authorities comply with the Fiscal Responsibility Act which prescribed 3.0 per cent deficit GDP ratio.

IV.2 Co-Financing Arrangements with Pension Funds

At the moment, Pension Funds regulation discourages the PFAs from investing in long-term risky projects. Therefore, they patronise treasury bills and minimise long-term bonds in their portfolio. However, if capital projects are packaged in ways that they will yield reasonable returns, Pension Funds could be encouraged to enter into co-financing arrangement with government. Examples could be highway projects with tolls similar to those in Lagos State. This way, the countercyclical development enhancing capital projects could be financed without issuing interest-bearing instruments and, indeed, non-interest bearing government bonds.

IV.3 Issuance of Project-Tied Bonds

It has been mentioned that the external debt management strategy aimed at minimising the external debts stock and debt service is suitable for an economy in recession and should be sustained. It is quite possible that concessional external loans may be insufficient to meet the external components of budget deficit. In such case, government, in concert with the Central Bank, should consider issuing project-tied bonds and market them among the Nigerians in Diaspora. Experience of countries that successfully issued such bonds suggests that an appropriate Diaspora Policy guaranteeing participation of the diaspora in political, social and economic development of their home country is a pre-requisite. The Diaspora Policy of Ethiopia can be a useful guide in this regard. Successful diaspora bonds can be instrumental in formalising remittances and making them available to fund capital projects.

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The Role of Central Banks during Economic Downturn: Lessons and Options for Financing Government Programmes in Nigeria

Charles N. O. Mordi*

I. Introduction

Central banks by their very nature are unique institutions and therefore, play a very important role in all economies—whether in advanced, emerging markets and developing economies. This role is often derived from their mandate(s), as enshrined in the laws establishing them and have tended to evolve as the economy processes. In discerning the role played by central banks, it is observed that there is role that is generally common, irrespective of whether the economy is advanced, emerging or developing while some roles tend to be economy specific. For example, while the stabilisation role appears to be common across economies; in modern times, the developmental role tends to be more closely associated with emerging markets and developing countries—largely because these economies are more or less still evolving.

Economic history has taught us that even some central banks in the advanced economies played an important role in the financing of government programmes/projects in their early days, for example, the Deutsche Bundesbank of Germany in rebuilding the country after the world war 2. Other countries include: the UK (1694), the US in the 19th century, France (1800), Belgium (1850), and Spain (1874) (see Epstein, 2006). Two central banks that are known to have been actively involved in financing government programmes/projects in recent times are Banco Central Do Brazil (Central Bank of Brazil) and Bank Negara Malaysia (Central Bank of Malaysia).

The financing of government programmes/projects by central banks seemed to have lost some of its popularity even among emerging markets and developing economies during the period leading to the 2007-2009 global financial crisis and its attendant economic downturn. The crisis and the associated economic downturn has apparently opened up another wave of debate among economists on the role of central banks during economic crisis.

In the period leading to the 2007/2009 global financial and economic (GFE) crises, a consensus seemed to have emerged that the stabilisation role of central banks—maintaining price stability, should be the centerpiece of central banks' monetary policy. Indeed, in some economies, it is the sole objective of monetary policy. This seeming consensus emanated from the apparent "success" of central banks that adopted inflation-targeting (IT) as a monetary policy framework from the early 1990s, in stabilising their economies—that is, taming inflation.

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The "dismal" performance of most of the IT countries during the crisis has raised concerns as to the universal applicability of this paradigm—pursuing price stability as the sole objective of monetary policy during economic crisis. Undeniably, the GFE crises have brought to the fore the need for central banks to always pay serious attention to what is happening in the macro-economy and how it impacts on the banking system as well as the financial system as a whole.

The theme of this executive seminar, and indeed, the topic for this session, raises some fundamental issues/questions with regard to the role of Central Bank of Nigeria during economic downturn.

The issues are of particular relevance to the Nigerian economy of today and include the following:

- What is(are) the traditional role(s) of central banks?
- Should this(these) role(s) change in economic downturn?
- Should central banks really be involved in financing government programmes at all, particularly during economic downturn?
- If the answer to the preceding question is yes, what are the likely implications and does the initial conditions matter in that regard?
- What lessons can we draw from central banks' experiences during the recent global financial and economic crises?
- Since financing government programmes by the CBN is not new, how successful has the Bank been in this area?
- Can these lessons help shape the future direction of CBN's role in the economy, particularly against the backdrop of the current economic recession in the country?

II. Traditional Roles of Central Banks in the Economy

The role that a central bank perform in an economy derives principally from the mandate(s), as set out in the laws establishing that central bank. Traditionally, in most countries the central bank serves as the principal authority for the nation's financial matters, in addition to being a key partner in economic policy issues.

Overall, the roles that virtually all central banks routinely perform include:

- Implementing monetary policy geared toward delivering robust and consistent growth and employment;
- Determining interest rates that facilitate the effective mobilisation and efficient utilisation of scarce financial resources to support productive investment, growth and development;
- Controlling a country's money supply to ensure a non-inflationary growth trajectory;
- Promoting the stability of the country's financial system through the effective regulation and supervision of the banking industry;
- Managing the country's foreign reserves and gold reserves;

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- "Lender of Last Resort" role—to maintain liquidity in the economy to prevent the financial system from collapsing; and
- Promoting the development of the payment system infrastructure and safeguarding its smooth functioning.

Perhaps, it is important to stress that these roles evolved gradually over the years. In the specific case of the Central Bank of Nigeria, in addition to the roles listed above, the Bank has also been assigned a developmental role, as stated in Section 31, of the CBN Act 2007. This role aims at promoting and developing not only the capital markets, but also supporting financial/economic growth and development.

Of all these roles, perhaps the ones that bear a direct link to the theme of this seminar and the subject of the session are those related to the conduct of monetary policy—interest rate and lender-of-last resort, and developmental functions.

III. Selected Country Experiences of Central Banks' Role during the 2007-2009 Global Financial and Economic Crisis

The 2007-2009 global financial crisis and the ensuing economic slump witnessed an unprecedented direct intervention by central banks in economic activities and financing of government programmes aimed at mitigating the adverse impact of the crises.

Indeed, central banks all over the world unleashed their "lender-of-last resort" role by adopting non-traditional measures through massive injection of liquidity to stem the collapse of their financial systems and to stimulate the real economy in the wake of the economic recession that accompanied the financial turmoil. These non-traditional measures have been termed "Quantitative Easing" (QE for short) in the economics lexicon and involved the large-scale purchase of assets that central banks would normally not touch and the unlimited supply of reserves to shore-up base money.

III.1 Advanced Economies

According to Fawley and Neely (2013), the QEs programmes of the Federal Reserve (Fed), Bank of England (BoE), European Central Bank (ECB) and Bank of Japan (BoJ) were initially targeted at alleviating financial market distress, but this was later broadened to include achieving inflation targets, stimulating the real economy, and containing the European sovereign debt crisis. They noted further that the ECB and BoJ focused their programmes on direct lending to banks - reflecting the bank-centric structure of their financial systems - while the Fed and BoE expanded their respective monetary bases by purchasing bonds.

In reality, although the four central banks announced outright asset purchases their approaches differed:

- The Fed and BoE targeted large amounts of assets to purchase;

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- The ECB and BoJ chose to ease their monetary policy stance primarily by supplying amount of loans to banks, as they required;

- The ECB and BoJ outright asset purchases were generally small and targeted specific assets.

A summary of the QE programmes of the Fed, ECB, BoE, and BoJ are contained in the tables below culled from Fawley and Neely (2013).

The abbreviations used in the tables include:

- Federal Open Market Committee (FOMC)
- Mortgage-backed security (MBS)
- The Covered Bonds Purchase Programme (CBPP)
- Securities Market Programme (SMP),
- Outright Monetary Transactions (OMT)
- Long-term refinancing Operation (LTRO)
- Fixed rate full allotment (FRFA)
- Growth-Supporting Funding Facility (GSFF)
- Fixed-rate Operations (FROs)
- Exchange-traded funds (ETFs)
- Japanese real estate investment trusts (J-REITs)
- Japanese government bonds (JGBs)
- Corporate finance instruments (CFI)

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Table 1A

Important Announcements by the Federal Reserve

Date	Program	Event	Brief description	Interest rate news
11/25/2008	QE1	FOMC statement	LSAPs announced: Fed will purchase $100 billion in GSE debt and $500 billion in MBS.	
12/1/2008	QE1	Bernanke speech	First suggestion of extending QE to Treasuries.	
12/16/2008	QE1	FOMC statement	First suggestion of extending QE to Treasuries by FOMC.	The Fed cuts the federal funds rate from 1% to 0.00-0.25%; expects low rates "for some time."
1/28/2009	QE1	FOMC statement	Fed stands ready to expand QE and buy Treasuries.	
3/18/2009	QE1	FOMC statement	LSAPs expanded: Fed will purchase $300 billion in long-term Treasuries and an additional $750 and $100 billion in MBS and GSE debt, respectively.	Fed expects low rates for "an extended period."
8/12/2009	QE1	FOMC statement	LSAPs slowed: All purchases will finish by the end of October, not mid-September.	
9/23/2009	QE1	FOMC statement	LSAPs slowed: Agency debt and MBS purchases will finish at the end of 2010:Q1.	
11/4/2009	QE1	FOMC statement	LSAPs downsized: Agency debt purchases will finish at $175 billion.	
8/10/2010	QE1	FOMC statement	Balance sheet maintained: The Fed will reinvest principal payments from LSAPs in Treasuries.	
8/27/2010	QE2	Bernanke speech	Bernanke suggests role for additional QE "should further action prove necessary."	
9/21/2010	QE2	FOMC statement	FOMC emphasizes low inflation, which "is likely to remain subdued for some time before rising to levels the Committee considers consistent with its mandate."	
10/12/2010	QE2	FOMC minutes released	FOMC members' "sense" is that "[additional] accommodation may be appropriate before long."	
10/15/2010	QE2	Bernanke speech	Bernanke reiterates that Fed stands ready to further ease policy.	
11/3/2010	QE2	FOMC statement	QE2 announced: Fed will purchase $600 billion in Treasuries.	
6/22/2011	QE2	FOMC statement	QE2 finishes: Treasury purchases will wrap up at the end of month, as scheduled; principal payments will continue to be reinvested.	
9/21/2011	Maturity Extension Program	FOMC statement	Maturity Extension Program ("Operation Twist") announced: The Fed will purchase $400 billion of Treasuries with remaining maturities of 6 to 30 years and sell an equal amount with remaining maturities of 3 years or less; MBS and agency debt principal payments will no longer be reinvested in Treasuries, but instead in MBS.	
6/20/2012	Maturity Extension Program	FOMC statement	Maturity Extension Program extended: The Fed will continue to purchase long-term securities and sell short-term securities through the end of 2012. Purchases/sales will continue at the current pace, about $45 billion/month.	
8/22/2012	QE3	FOMC minutes released	FOMC members "judged that additional monetary accommodation would likely be warranted fairly soon..."	
9/13/2012	QE3	FOMC statement	QE3 announced: The Fed will purchase $40 billion of MBS per month as long as "the outlook for the labor market does not improve substantially...in the context of price stability."	Fed expects low rates "at least through mid-2015."
12/12/2012	QE3	FOMC statement	QE3 expanded: The Fed will continue to purchase $45 billion of long-term Treasuries per month but will no longer sterilize purchases through the sale of short-term Treasuries.	The Fed expects low rates to be appropriate while unemployment is above 6.5 percent and inflation is forecasted below 2.5 percent.

NOTE: The appendix provides URLs for the official policy statements included in Tables 1A-1D and those discussed in the text.

Table 1B

Important Announcements by the European Central Bank

Date	Program	Event	Brief description	Interest rate news
3/28/2008	LTRO	Governing Council press release	LTRO expanded: 6-month LTROs are announced.	
10/15/2008	FRFA	Governing Council press release	Refinancing operations expanded: All refinancing operations will be conducted with fixed-rate tenders and full allotment; the list of assets eligible as collateral in credit operations with the Bank is expanded to included lower-rated (with the exception of asset-backed securities) and non-euro-denominated assets.	
5/7/2009	CBPP/LTRO	Governing Council press release	CBPP announced/LTRO expanded: The ECB will purchase €60 billion in euro-denominated covered bonds; 12-month LTROs are announced.	ECB lowers the main refinancing rate by 0.25% to 1% and the rate on the marginal lending facility by 0.50% to 1.75%.
5/10/2010	SMP	Governing Council press release	SMP announced: The ECB will conduct interventions in the euro area public and private debt securities markets; purchases will be sterilized.	
6/30/2010	CBPP	Governing Council press release	CBPP finished: Purchases finish on schedule; bonds purchased will be held through maturity.	
10/6/2011	CBPP2	Governing Council press release	CBPP2 announced: The ECB will purchase €40 billion in euro-denominated covered bonds.	
12/8/2011	LTRO	Governing Council press release	LTRO expanded: 36-month LTROs are announced; eligible collateral is expanded.	ECB lowers the main refinancing rate by 0.25% to 1%, and the rate on the marginal lending facility by 0.25% to 1.75%.
8/2/2012	OMT	ECB press conference	ECB President Mario Draghi indicates that the ECB will expand sovereign debt purchases. He proclaims that "the euro is irreversible."	
9/6/2012	OMT	Governing Council press release	OMTs announced: Countries that apply to the European Stabilization Mechanism (ESM) for aid and abide by the ESM's terms and conditions will be eligible to have their debt purchased in unlimited amounts on the secondary market by the ECB.	

Table 1C

Important Announcements by the Bank of England

Date	Program	Event	Brief description	Interest rate news
1/19/2009	APF	HM Treasury statement	APF established: The BOE will purchase up to £50 billion of "high quality private sector assets" financed by Treasury issuance.	
2/11/2009	APF	BOE Inflation Report released	The BOE views a slight downside risk to meeting the inflation target, reiterates APF as a potential policy instrument.	
3/5/2009	APF	MPC statement	QE announced: The BOE will purchase up to £75 billion in assets, now financed by reserve issuance; medium- and long-term gilts will comprise the "majority" of new purchases.	The BOE cuts policy rate from 1% to 0.5%; the ECB cuts policy rate from 2% to 1.5%.
5/7/2009	APF	MPC statement	QE expanded: The BOE will purchase up to £125 billion in assets.	
8/6/2009	APF	MPC statement	QE expanded: The BOE will purchase up to £175 billion in assets; to accommodate the increased size, the BOE will expand purchases into gilts with remaining maturity of 3 years or more.	
11/5/2009	APF	MPC statement	QE expanded: The BOE will purchase up to £200 billion in assets.	
2/4/2010	APF	MPC statement	QE maintained: The BOE maintains the stock of asset purchases financed by the issuance of reserves at £200 billion; new purchases of private assets will be financed by Treasury issuance.	
10/6/2011	APF	MPC statement	QE expanded: The BOE will purchase up to £275 billion in assets financed by reserve issuance; the ceiling on private assets held remains £50 billion.	
11/29/2011	APF	HM Treasury decision	Maximum private asset purchases reduced: HM Treasury lowers the ceiling on APF private asset holdings from £50 billion to £10 billion.	
2/9/2012	APF	MPC statement	QE expanded: The BOE will purchase up to £325 billion in assets.	
7/5/2012	APF	MPC statement	QE expanded: The BOE will purchase up to £375 billion in assets.	

NOTE: MPC, Monetary Policy Committee.

Table 1D

Important Announcements by the Bank of Japan

Date	Program	Event	Brief description	Interest rate news
12/2/2008	SFSOs	Unscheduled monetary policy meeting	The BOJ will operate a facility through the end of April to lend an unlimited amount to banks at the uncollateralized overnight call rate and collateralized by corporate debt.	
12/19/2008	Outright JGB/CFI purchases	Statement on monetary policy	Outright purchases expanded: The BOJ increases monthly JGB purchases (last increased October 2002) from ¥1.2 trillion to ¥1.4 trillion; they will also look into purchasing commercial paper.	The BOJ lowers the target for the uncollateralized overnight call rate from 0.3% to 0.1%.
1/22/2009	Outright CFI purchases	Statement on monetary policy	Outright purchases announced: The BOJ will purchase up to ¥3 trillion in commercial paper and ABCP and is investigating outright purchases of corporate bonds.	
2/19/2009	Outright CFI purchases	Statement on monetary policy	Outright purchases expanded: The BOJ will extend commercial paper purchases and the SFSOs through the end of September (previously end of March) and will purchase up to ¥1 trillion in corporate bonds.	
3/18/2009	Outright JGB purchases	Statement on monetary policy	Outright purchases expanded: The BOJ increases monthly JGB purchases from ¥1.4 trillion to ¥1.8 trillion.	
7/15/2009	Outright CFI purchases/SFSOs	Statement on monetary policy	Programs extended: The BOJ extends the SFSOs and outright purchases of corporate paper and bonds through the end of the year.	
10/30/2009	Outright CFI purchases/SFSOs	Statement on monetary policy	Status of programs: Outright purchases of corporate finance instruments will expire at the end of 2009 as expected, but the SFSOs will be extended through 2010:Q1; ample liquidity provision past 2010:Q1 will occur through funds-supplying operations against pooled collateral, which will accept a larger range of collateral.	
12/1/2009	FROs	Statement on monetary policy	Facility announcement: The BOJ will offer ¥10 trillion in 3-month loans against the full menu of eligible collateral at the uncollateralized overnight call rate.	
3/17/2010	FROs	Statement on monetary policy	Facility expansion: The BOJ expands the size of the FROs to ¥20 trillion.	
5/21/2010	GSFF	Statement on monetary policy	GSFF announcement: The BOJ will offer ¥3 trillion in 1-year loans to private financial institutions with project proposals for "strengthening the foundations for economic growth."	
8/30/2010	FROs	Unscheduled monetary policy meeting	Facility expansion: The BOJ adds ¥10 trillion in 6-month loans to the FROs.	
10/5/2010	CME	Statement on monetary policy	APP established: The BOJ will purchase ¥5 trillion in assets (¥3.5 trillion in JGBs and Treasury discount bills, ¥1 trillion in commercial paper and corporate bonds, and ¥0.5 trillion in ETFs and J-REITs).	The BOJ sets the target for the uncollateralized overnight call rate at around 0 to 0.1%.

Table 1D, cont'd

Important Announcements by the Bank of Japan

Date	Program	Event	Brief description	Interest rate news
3/14/2011	CME	Statement on monetary policy	APP expanded: The BOJ will purchase an additional ¥5 trillion in assets (¥0.5 trillion in JGBs, ¥1 trillion in Treasury discount bills, ¥1.5 trillion in commercial paper, ¥1.5 trillion in corporate bonds, ¥0.45 trillion in ETFs, and ¥0.05 trillion in J-REITs).	
6/14/2011	GSFF	Statement on monetary policy	GSFF expanded: The BOJ makes available another ¥0.5 trillion in loans to private financial institutions for the purpose of investing in equity and extending asset-based loans.	
8/4/2011	CME	Statement on monetary policy	APP/FROs expanded: The BOJ will purchase an additional ¥5 trillion in assets (¥2 trillion in JGBs, ¥1.5 trillion in Treasury discount bills, ¥0.1 trillion in commercial paper, ¥0.9 trillion in corporate bonds, ¥0.5 trillion in ETFs, and ¥0.01 trillion in J-REITs); 6-month collateralized loans through the FROs are expanded by ¥5 trillion.	
10/27/2011	CME	Statement on monetary policy	APP expanded: The BOJ will purchase an additional ¥5 trillion in JGBs.	
2/14/2012	CME	Statement on monetary policy	APP expanded: The BOJ will purchase an additional ¥10 trillion in JGBs.	
3/13/2012	GSFF	Statement on monetary policy	GSFF expanded: The BOJ makes available another ¥2 trillion in loans to private financial institutions, including ¥1 trillion in U.S.-dollar-denominated loans and ¥0.5 trillion in smaller-sized (¥1 million-¥10 million) loans.	
4/27/2012	CME	Statement on monetary policy	APP expanded/FROs reduced: The BOJ will purchase an additional ¥10 trillion in JGBs, ¥0.2 trillion in ETFs, and ¥0.01 in J-REITs. The BoJ also reduces the availability of 6-month FRO loans by ¥5 trillion.	
7/12/2012	CME	Statement on monetary policy	APP expanded/FROs reduced: The BOJ will purchase an additional ¥5 trillion in Treasury discount bills and reduces the availability of FRO loans by ¥5 trillion.	
9/19/2012	CME	Statement on monetary policy	APP expanded: The BOJ will purchase an additional ¥5 trillion in JGBs and ¥5 trillion in Treasury discount bills.	
10/30/2012	CME/SBLF	Statement on monetary policy	APP expanded/SBLF announced: The BOJ will purchase an additional ¥5 trillion in JGBs, ¥5 trillion in Treasury discount bills, ¥0.1 trillion in commercial paper, ¥0.3 trillion in corporate bonds, ¥0.5 trillion in ETFs, and ¥0.01 trillion in J-REITs. Through the SBLF it will fund up to 100 percent of depository institutions' net increase in lending to the nonfinancial sector.	
12/20/2012	CME	Statement on monetary policy	APP expanded: The BOJ will purchase an additional ¥5 trillion JGBs and ¥5 trillion in Treasury discount bills.	

NOTE: CFI, corporate finance instruments (corporate bonds plus commercial paper); CME, comprehensive monetary easing.

III.2 Developing Economies

In the case of **Bank Negara Malaysia (BNM)**, bin Ibrahim (2010) stated that pre-emptive and precautionary measures were taken in response to the crises to preserve the stability of the financial system; and ensure the continuity of credit flows.

Table 2

Ensuring continued access to SME financing

Facility	Amount (USD)	Establi-shed	Objective	Remarks
SME Assistance Facility	200m	Aug 2008	To assist viable SMEs facing financial difficulties to manage temporary cash flow problems due to rising costs	Fully utilised
SME Modernisation Facility	142m	Aug 2008	To provide financing to SMEs to modernise their operations, in particular to purchase or upgrade machinery and equipment, as well as for energy-saving equipment	Fully utilised
Micro Enterprise Fund	57m	Nov 2008	To enhance access to microfinancing for micro enterprises with viable businesses	Partly utilised
SME Assistance Guarantee Scheme	600m	Jan 2009	To assist viable SMEs adversely impacted by the economic slowdown to continue obtaining access to adequate financing	Replacement of the SME Assistance and Modernisation Facilities
Working Capital Guarantee Scheme	1.4bn	Apr 2009	To assist viable companies with shareholder equity of below RM 20 million to gain access to financing in order to maintain their operations amid the challenging economic environment	Government guarantees 80% of working capital funding from banking institutions, which were fully utilised
Industry Restructuring Loan Guarantee Scheme	1.4bn	Apr 2009	To promote investments: • that increase productivity; • in high-value-added activities (such as research and development, and downstream agriculture activities); and to promote the greater application of green technology	Government guarantees 50–80% of funding of long-term investments obtained from banking institutions, depending on the size of shareholders' equity

Source: Bank Negara Malaysia.

This included specific and targeted measures to preserve confidence and address the highly vulnerable segments and potential areas of stress:

- Extending a blanket guarantee on all ringgit and foreign currency deposits with commercial, Islamic and investment banks and deposit-taking development financial institutions regulated by the BNM through the Malaysia Deposit Insurance Corporation;
- Extending access to the BNM's liquidity facility to insurance companies and operators regulated and supervised by the BNM;
- Ensuring banks' accessibility to USD liquidity for trade financing purposes; and

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- Intensifying engagement with industry players, businesses and large corporate as well as trade bodies.
- In addition, efforts were mainly targeted towards ensuring that businesses and households continued to have adequate and uninterrupted access to financing, which measures encompass improving and broadening access to financing through:
    - Support to small- and medium-sized enterprises (SMEs)—see Table 2 below;
    - Deepening capital market activity;
    - Addressing potential borrower distress; and
    - Accommodative monetary policy.

The measures taken by the **CBN**, in response to the crises were broadly identical in nature to those taken by the selected central banks, but differed only in the case of the QE in term of the transmission vehicle through which the QE was implemented. While the other central banks actually provided liquidity/credit directly to the banks or other financial institutions—apparently to "repair" their balance sheets, the CBN on its part provided credit to specific sectors of the economy that were deemed to have the potential to enhance productivity and economic growth.

The CBN initially utilised a mixture of policies including:

- Stoppage of aggressive liquidity mop-up;
- Progressive reduction of monetary policy rate (MPR);
- Progressive reduction in the cash reserve requirement;
- Reduction of liquidity ratio requirement;
- introduction of expanded discount window (EDW) to increase DMB's access to facilities from the CBN; this was later replaced with the CBN guarantee of interbank money market transactions;
- Guarantee of letters of credit and/or foreign counterparties creditors to the DMBs;
- Limit on deposit money banks' (DMBs) foreign exchange net open positions;
- Rollover of margin loans that were extended to equity investors, amongst others; and
- Injection of ₦620 billion as tier 2 capital in 8 troubled banks.

The QE segment of the CBN intervention came later, in 2010, when the Bank by virtue of its developmental function, as contained in Section 31 of the CBN Act, 2007, decided to establish a ₦500 billion facility for investment in debenture stock of the Bank of Industry for long-term (10 – 15 years) lending to Deposit Money Banks (DMBs);

The facility was targeted to specific sectors of the economy, namely: The sum of ₦300bn was for financing of power projects and the refinancing of airlines' existing facilities with the DMBs; and ₦200bn was for the refinancing and restructuring of SME/manufacturing sector existing loan portfolio, and where necessary, to provide working capital.

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The facility was at a concessionary interest rate of 1.0 per cent to the DMBs for on-lending to their clients at a single-digit of 7.0 per cent. In the light of the foregoing review of how central banks responded to the 2007-2009 financial and economic crises, it is perhaps safe to draw the following conclusions:

- The crises did not materially alter the traditional role(s) of central banks particularly with regard to their stabilisation role;
- If anything it actually reinforced that role;
- The crises underscored the need for central banks not to be too rigid with respect to pursuing the price stability objective when economic slump occurs;
- Central banks should begin to pay greater attention to financial stability since price stability and financial stability are not mutually exclusive objectives;
- Central banks will need adequate direct powers as well as increase their capacity to undertake macro-prudential analyses; and
- Strengthening of governance structures, as more powers are given to central banks.

In addition, in spite of the massive injection of liquidity during the crises, the preponderance of evidence reveals the following downsides:

- Credit extension has not resumed as expected;
- Economic growth has remained sluggish;
- How to roll-back some of the measures in the face of substantial liquidity overhang;

However, there are some positives:

- Inflation has remained subdued in many countries;
- Interest rates have remained low, and in some cases near zero-bound;
- Stability has somewhat been restored in the financial system; and
- Macro-prudential environment has improved somewhat.

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IV. Lessons of Experience and Options for Financing Government Programmes in Nigeria

Central banks, particularly in developing countries intervened in the real economy in order to enhance the transmission mechanism of monetary policy actions and facilitated the development of the financial markets and created easy access to credit for investment and production. This is predicated on the existence of significant gaps between the demand for investment and the availability of domestic resources. Indeed, the philosophy behind central banks' interventions in the real economy is to indirectly influence cost of production for firms and affect prices positively.

In the UK, the Bank of England has a unit that administers its small and medium enterprises financing. In the United States, the Federal Reserve Bank identifies and addresses a broad spectrum of challenges confronting low and moderate income communities by developing their capacity through its Community Affairs Department, which is responsible for supporting economic growth at the lower end of the market. In Asia, central banks play vital

intermediation roles. For example, Bank Indonesia is involved in promoting priority sector lending primarily in favour of MSMEs, micro-credit project for the poor and self-help group linkage to banks.

The Philippines Central Bank, promotes appropriate financial market policies, implements specialised microfinance schemes, capacity building and other initiatives (rediscounting facility, Credit Bureau, rating agencies). The State Bank of Pakistan's Agricultural Credit and Microfinance Department is responsible for meeting the credit needs of the agricultural sector, a major foreign exchange earner. The Central Bank of Bangladesh is entrusted with the responsibilities of formulating and implementing national agricultural credit policy. It maintains two Departments, namely: Agricultural Credit and Financial Institutions Department and SME and Special Programmes Department to perform these roles.

Similarly, in Africa, the Central Bank of Mauritius sponsors credit scheme for sugarcane farmers who are the major foreign exchange earners in the country; the Bank of Uganda manages various lines of development programmes in the form of credit and term loans in collabouration with accredited financial development institutions; the Central Bank of The Gambia operates a microfinance supervisory department to take care of the peculiarities of its rural credit market; the National Bank of Ethiopia undertakes development finance activities by providing technical assistance and investment in micro financing businesses; the Bank of Ghana has been involved in rural credit support through its rural/community banking system; the Bank of Sierra Leone's Development Finance Division supervises the rural banking and rural export credit guarantee scheme of the country; and the Bank of Liberia actively participates in rural financing, manages a credit guarantee scheme and performs other developmental functions.

Central Bank of Nigeria

The legal basis for the CBN intervention in certain sectors of the economy is contained in Section 31 of the CBN Act, 2007 captioned "Developmental Function". The section provides that the Bank, under its developmental function, may subscribe to, hold and sell shares of any corporation or company or debentures thereof set up with the approval of or under the authority of the Federal Government for the purposes of promoting the development of money and capital markets in Nigeria or of stimulating financial or economic development.

The CBN intervention in financing government programmes in Nigerian has a long history. The Bank has, since its early years, been actively involved in the critical areas of the economy including Agricultural financing - the flagship and most visible of CBN's involvement in financing government programmes; establishment of Development Finance Institutions (DFIs); development of banking culture and networks; promotion of access to finance for small and medium-scale enterprises; and entrepreneurship development.

Table 3 below provides a list of the various CBN interventions in the real economy/government programmes in Nigeria.

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Table 3: List of various CBN Interventions in the Real Economy

S/N	Intervention program	Year Established
1	Agricultural Credit Guarantee Scheme (ACGS)	1977/78
2	Trust Fund Model (TFM)	2001
3	Agricultural Credit Support Scheme (ACSS)	2003
4	Entrepreneurship Development Centres (EDC)	2008
5	Commercial Agriculture Credit Scheme (CACS)	2009
6	Nigeria Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL)	2010
7	SME Restructuring/Refinancing Fund (RRF)	2010
8	Small and Medium Enterprise Credit Guarantee Scheme (SMECGS)	2010
9	Power and Airline Intervention Fund (PAIF)	2010
10	Micro Small and Medium Enterprises (MSME) Development Fund	2014
11	Nigeria Electricity Market Stabilisation Facility (NEMSF)	2014

Although, a comprehensive assessment of the impact of the various interventions are yet to be undertaken, but judging the state of the Nigerian economy today and the continued heavy reliance on oil, one can safely infer that the achievement is only modest.

In this regard, therefore, a fundamental question arises, as to whether there is still scope for continued intervention/financing of government programmes in Nigeria by the CBN, particularly during economic downturn. While a direct answer may not be readily given, one can make the following suggestions for the future:

- The Bank should as a matter of priority undertake a comprehensive evaluation of the various financing programmes with a view to determining their effectiveness in delivering on the set target(s);
- Following from this evaluation exercise, the Bank should determine whether it has reached the limit of its financing, as set out in Section 31 of the CBN Act 2007;
- A new framework for future intervention in the real economy or financing government programmes should be established.

Such a framework should detail the modalities/conditions precedent for intervention or financing, so that the Bank is not distracted from its traditional stabilisation role. The

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framework should identify specific sectors with very high potential of steering the economy in the desired direction and/or out of recession; this will obviate the current ad-hoc interventions that depend on the mood of the political authorities. The new framework should be backed by law and made publicly available and easily accessible to ensure that the Bank is held accountable;

Direct disbursement of funds to government should be avoided given our past experience with the huge leakages associated with the finances of government. Funds should be channelled through the financial system using guarantees and on-lending rather direct credit, conditional on putting in place a robust framework for monitoring to ensure that funds are not diverted and/or that the funds get to the intended beneficiaries or sectors. Within the confines of the enabling law, appropriate limits should be set for CBN financing of government programmes to check the potential for abuse and protect the credibility of the Bank.

Furthermore, future interventions in the real economy and/or financing of government programmes should take into consideration the initial economic conditions before the downturn such as liquidity condition; quantum of credit/rate of growth of credit; level of inflation; absorptive capacity of the economy; rate of growth and level of unemployment; level of investment and productivity in the economy; level of slack capacity in the economy; state/health of the financial system; etc.

V. Concluding Remarks

In conclusion, the following observations are necessary:

- Experience has shown that there are no compelling reasons for the CBN to abandon its traditional role of continuing to stabilise the economy during economic downturn;
- There is need for a comprehensive evaluation of its previous interventions/financing of government programmes with a view to refocusing such roles in future and avoid the current ad-hoc nature associated with the subsisting interventions; and
- Understanding of economic conditions precedent do matter for the CBN financing of government programmes during economic downturn to avoid any missteps capable of further exacerbating the already adverse environment.

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Non-Oil Exports, Economic Growth and Macroeconomic Stability

*T. Ademola Oyejide **

I. Introduction

The topic that I was asked to write about is "Stimulating Non- Oil Exports for Revenue Generation During Economic Downturn". In the process of preparing this paper, it became clear to me first that increased non-oil exports would not necessarily make up for the fall in government revenue arising from the oil price slump and second that increased non-oil exports would be critical for economic growth under all circumstances. Based on this assessment, I have chosen to examine the role of non-oil exports in promoting economic growth and development in the medium to long-term context, and in enhancing macroeconomic stability in the short-term context. In both cases, the Central Bank has important policy responsibilities to carry out. In addition, both cases should be jointly addressed for at least two reasons. First, the policy instruments required for both are either the same or are closely related. Second, the decisions taken for maintaining short-run macroeconomic balance typically have implications for the medium to long-term economic growth and development outcomes as well.

In the rest of this paper, Section 2, discusses the role of non-oil exports in the structural transformation and sectoral diversification processes which are inherently associated with sustainable growth and development. In Section 3, the focus of the analysis shifts to an examination of the role of non-oil exports in the context of short-term macroeconomic management. Effective and productive policy making over the short-, medium- and long-term must take account of the necessity for managing the inevitable policy trade-offs that will be confronted. This constitutes the focus of Section 4. The paper concludes in Section 5.

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II. Structural Transformation and Sectoral Diversification

Structural transformation of an economy occurs with the reallocation of resources across different sectors and products. The process of structural transformation is driven by differences in sectoral productivity. In particular, the structural transformation process is growth- and development-enhancing when it involves resource shifts from lower to higher productivity sectors or sub-sectors. In comparison, diversification represents the shift to a more varied structure manifested by the introduction of new products, higher quality products, or the expansion of existing ones. Diversification can occur in the forms of output and export. In the former case, it is called domestic sector output diversification or the production of a wider range of products. In the latter case of exports, diversification can

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occur either in the form of a wider range of products exported or in the form of exports to a larger number of export markets or trading partners. In general, countries achieve higher levels of export diversification when their export revenues are generated from a wide mix of export products and trading partners. In the early stages of a country's economic development, structural transformation and sectoral diversification are likely to be closely linked. Thus, the development process of the typical low-income country begins from specialisation in a narrow range of primary commodity activities, such as agriculture and mining. Structural transformation, from this base, through reallocation of resources would probably involve diversification into broader production and export structures.

Economic theory asserts and the historical experiences of many countries confirm that structural transformation and sectoral diversification are necessary for ensuring that economic growth is sustainable and inclusive. In particular, structural transformation and sectoral diversification play important roles in influencing the macroeconomic performance of developing countries. Diversification of domestic production exports facilitate faster growth and greater macroeconomic stability.

Many of the success stories of structural transformation and sectoral diversification processes that have generated rapid and sustained economic growth and development have been based on sectoral diversification in favour of manufacturing industry which exhibit many growth enhancing features. It is more productive than other sectors; tends to be labour-intensive, especially in the early stages of industrialisation and hence, can absorb the increasing labour supply shed by the agricultural sector. Manufacturing is associated with greater product sophistication which causes higher per capital growth in output; and the broader diversification potentials in the manufacturing sector that tend to cushion price volatility. As a result of these features, the economies of many of the countries that have successfully achieved sustainable economic growth and development based on structural transformation and sectoral diversification are associated with increasing share of the manufacturing sector in GDP as well as rising share of manufactured exports goods in total exports.

Nigeria aspired to achieve similar result between the 1960 and mid-1970s by adopting an import substitution industrialisation strategy (ISI) as a means of diversifying the economy away from agriculture. But there were two fatal policy errors. First, the success conditions associated with ISI were not met. These conditions include selection of the beneficiary industries on the basis of their specific features, granting of protection over a limited duration and subject to clear performance standards, and readiness to remove protection when the performance standards are not met. In actual practice, tariff protection was routinely granted to all indefinitely and without any analysis of their growth enhancing features. Second, the use of ISI strategy has an in-built weakness relating to its demand for foreign exchange. While protection from foreign competition which typically applies to the domestic production of final consumer products can save foreign exchange, the foreign exchange requirements for the import of raw materials, semi-processed inputs and capital goods (machinery, etc.) tend to increase with volume of production. This is why ISI must be export-oriented. In actual practice, Nigeria's manufacturing sector was not designed to be

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export-oriented. Its generous protection and other incentives focused on meeting domestic demand.

The emergence and immediate dominance of oil from the mid-1970s ultimately struck the final blow. Since it provided an immediate source of foreign exchange, it appeared to solve the problem of the manufacturing sector's increasing demand for foreign exchange to meet its raw materials and other input requirements. But due to the volatility of global oil prices, this problem continued to surface and to periodically cripple the manufacturing sector by drastically reducing its capacity utilisation. This has done serious damage to the dynamic growth of Nigeria's manufacturing sector. But it, in fact, represents a minor irritation compared to the second problem.

This second problem emanates from what the literature calls the "Dutch Disease". When an economy has a dominant and booming tradable sector (such as oil) which brings into the economy huge amounts of capital inflows, the economy's equilibrium real exchange rate tends to appreciate! This means that the external value (in terms of foreign currencies) of the domestic currency rises. This, in turn, means that the prices of tradable imports are lower in the domestic market, while the domestic exports are higher in price in foreign markets. As a result, the domestically produced goods find it more difficult to compete with imported products in the domestic market and virtually impossible to compete in export markets abroad. To some extent, increased tariff protection and import prohibition may enable domestic producers to survive in the domestic market, but only at the expense of domestic consumers whose welfare is reduced in the process.

As indicated earlier, the developing countries of the 1950s and 1960s which were successful in achieving sustainable economic growth and development through structural transformation and sectoral diversification are characterised by two important features: large and increasing share of manufacturing sector in GDP, and high and rising share of manufactured exports goods in total exports. By comparison, Nigeria's output and trade structures are deficient on both counts. More specifically, Nigeria's economy features both a small and falling manufacturing sector output share of GDP and a minimal and diminishing contribution of manufactured exports in total exports. In effect, while Nigeria experienced fairly rapid economic growth between 1995 and 2013, this performance was essentially driven by the oil boom associated with the commodity super cycle of that period. The growth episode was apparently not associated with structural transformation and sectoral diversification.

More specifically and as the rebased GDP series shows, the contribution of manufacturing sector to GDP remained in single digits at 6.6, 7.8, 7.8 and 9.3 per cent, in 2010, 2011, 2012 and 2013, respectively. In terms of structure, Nigeria's manufacturing sector's output is dominated by low-level technology. Over the period of 2010-2012, the food, beverages and tobacco (FBT) sub-sector accounted for an average of 66.8 per cent of total manufacturing sector's output.

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This was followed by textiles, apparel and footwear (TAF) sub-sector's average share of 14.3 per cent; and that of other manufacturing (OM) sub-sector's average contribution of 6.9 per cent over the same period. Thus, these three sub-
sectors accounted for an average of 88.0 per cent of total output of Nigeria's manufacturing sector. Furthermore, sugar's share of FBT's total output was 42.9 per cent over the period, while that of bread was 23.4 per cent. Thus, sugar and bread accounted for 66.3 per cent of the total output of FBT which, in turn, accounted for 66.8 per cent of the total output of Nigeria's manufacturing over the 2010-2012 period.

In the case of exports, the share of non-oil goods averaged 29.6 per cent over the same period. The poor performance of non-oil exports has its roots in the corresponding adverse production incentives that are generated by the effect of the capital inflows associated with the oil-boom which appreciated the equilibrium real exchange rate. Due to the repressive effect of this on non-oil tradables, Nigeria's manufacturing sector has generally been unable to take advantage of generous trade that Epstein (2006), associated with the European Union in the context of the series of Lome Convention and Cotonou Partnership Agreement since 1775, as well as that offered by the United States through its African Growth and Opportunity Act (AGOA). In the specific case of the AGOA whose preferential margins in the case of garments and apparels were generous and fully utilised by other African countries, Nigeria's own policies constituted the major constraint. By imposing very high import tariffs or prohibition of textiles, the incentive structure produced the result that textiles accounted for an average of 91.7 per cent of the TAF total output; with garments and apparel accounting for only an average of 1.6 per cent during the 2010-2012 period. The high tariff protection on textiles which induced this output performance also had a price in the form of the corresponding high cost of garments and apparel products that use textiles as inputs. The African countries which took advantage of the generous preference margins for garments and apparel succeeded because they also took advantage of AGOA's permission for them to use the cheapest textile inputs they could find. Nigeria's tariff policy closed this route to Nigeria's garment producers. Hence, while Nigeria was eligible to benefit from this trade preference, its own self-inflicted wound made it impossible to do so.

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This above analysis has several implications. First, the current industrial development strategy has clearly failed. Its application over half a century has produced a manufacturing sector which contributes little to GDP and exports. The economy has achieved neither structural transformation nor sectoral diversification without which sustainable growth and development cannot be achieved. Second, it is important to identify and understand the reasons why the current strategy is judged to have failed. It is easy to pinpoint at least two reasons. One relates to its bastardisation in the process of application through the sustained violations of virtually all of its success conditions. The other is that the strategy's principal tool, i.e, import control (through tariff or non-tariff measures) does not address the fundamental source of the problem, i.e the "Dutch Disease"- induced real exchange rate appreciation which persistently undermines the competitiveness of domestic production.

To the extent that this diagnosis is correct, a tempting recommendation would be to scrap the current industrial development strategy completely and immediately. But this will be "a bridge too far", and will amount to "throwing the baby out with the birth water". The more

logical way to go is probably a carefully re-designed and phased programme of ban, removal and tariff rate reductions over a suitable period of time that is established on the basis of more detailed analysis.

The more positive recommendation is to transfer the industrial protection mechanism from tariffs to the exchange rate. The exchange rate is a macro price whose use in this context does not require the kind of product specific selection that is associated with tariffs. This reduces its been captured by powerful individuals or groups of producers. By comparison, the use of the exchange rate tool requires that the exchange rate be market-determined in the context of a managed float arrangement; while the Central Bank reserves the right to intervene asymmetrically. That is, only when there is pressure (due to rising capital inflows) to appreciate the exchange rate. The system would assist in sustaining and enhancing the competitiveness of Nigerian non-oil exports. In this arrangement, the lower the external value of the naira, the more expensive will be Nigeria's imports, the cheaper will Nigeria's exports be abroad, and the higher will be the per unit revenue of exports to domestic producers. Yes, of course, the naira price of imported raw materials and other inputs required by domestic manufactures will be higher as well as the naira price of their output. But since these inputs constitute only a proportion of the total cost of final output, the per unit profitability needs not be reduced.

The use of the exchange rate tool in this system is not without cost, of course. It will, for example, require the Central Bank to accumulate and sterilise foreign exchange reserves; a process that forfeits the return that could otherwise have been earned if not sterilised.

III. Short-Term Macroeconomic Management

In the context of the basic analytical framework, the primary objectives of short- term macroeconomic management are to establish and continually maintain both sets of the internal and external balances of an economy. A significant oil price decline could pose serious challenges of short-term macroeconomic management for oil-exporting developing countries especially those that are heavily dependent on oil exports and whose economies are, to that extent, undiversified. One of these challenges emanates from the likelihood that, as a result of the oil price slump, oil-exporting countries will earn less oil export revenue and their budgets will be under pressure. Based on previous experience of large and unpredictable oil price declines, these events typically have major impact on fiscal balances of the affected countries. Even a small fall in oil price may generate a large increase in their financing needs, since their exports are not diversified and oil revenue accounts for a large proportion of total revenue. Thus, a mechanical effect of an oil price decline is likely to be a fiscal deficit for most oil-exporting developing countries.

The fiscal deficit may, in turn, necessitate abrupt macroeconomic adjustments in the short-term. But, in order to avoid the disruptive pains of such abrupt adjustments, the affected countries may try to smooth out the adjustment by not curtailing government expenditures immediately and to the extent required for re-establishing internal balance. But for countries

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that lack accumulated funds to finance the deficit, a larger real exchange rate depreciation would be required. This could become problematic because a strong monetary framework would be required to avoid the situation in which the depreciation leads to persistently higher inflation and further depreciation.

There exists a second challenge that is posed for macroeconomic management of oil-exporting developing economies by an oil price slump. This derives from the fact that the oil price slump which reduces government revenue also reduces export revenue which, in turn, may place external balances under pressure. In the event that this happens, financial stability risks would increase and significant pressure could be placed on the domestic currency. This is the mechanism through which falling oil prices typically lead to the depreciation of oil- exporters' currencies. If this depreciation is carefully and effectively controlled, it should assist the affected oil-exporting developing country to adjust smoothly and successfully. But things could go wrong for at least two reasons. First, financial problems could be exacerbated for the government and individual firms whose debts are denominated in foreign currencies such as dollars. Second, if inflation expectations are not well anchored, depreciations may become uncontrollable and thus lead quickly to very high inflation. The fact that the adjustment processes required for restoring both internal and external balances involve depreciation implies considerable interactions across both. It also reveals the critical importance of the exchange rate for the process of short-term macroeconomic management.

A number of initial conditions and certain features of the policy framework have been found to be helpful in ensuring an effective macroeconomic management of the consequences of an oil price decline. As discussed above, a major consequence of an oil price decline is an unanticipated cash-flow shock. The ability of a country to absorb such a shock depends on the strength and robustness of the government's financial position. If the position is strong, the government would have the room to manoeuvre and accommodate the cash-flow fluctuations through an appropriate mix of adjustment and financing. This would enable the country to implement short-run fiscal strategies which can be suitably focused at avoiding fiscal instability while insulating the domestic economy from oil revenue volatility. Many oil-exporting developing countries typically acquire this capacity by establishing policy cushions such as oil saving funds and fiscal rules which enable them to save during periods of high oil prices with a view to using such saving to sustain spending when lower oil prices occur. When successful, this strategy ensures the decoupling of current spending from current earnings.

Both theory and evidence also suggest that the exchange rate regime matters for the management of the adjustment associated with an oil price decline in oil-exporting developing countries. More specifically, countries with flexible exchange rate regimes can adjust through currency depreciations. This process yields a smaller and smoother output response due to large and immediate real exchange rate depreciation. In addition, there is less need for contractionary fiscal policy because the real depreciation tends to exert an adequate dampening role. In the case of fixed exchange rate regimes, however, monetary policy is typically constrained and the major burden of macroeconomic stabilisation falls upon fiscal policy. In effect, adjustment typically requires substantial fiscal spending

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reductions which may turn out to be particularly damaging for recovery and subsequent growth.

The patterns of oil price decline, impact on internal and external balances, policy responses and their consequences are largely mirrored by Nigeria's experience over the previous five oil price decline episodes. Several issues stand out, however. One of these is the continued inability of the country to tame its generally pro-cyclical fiscal policy posture. Going forward, therefore, the key policy imperatives should include the following elements:

- pursuit of fiscal policy strategy aimed at breaking the pro-cyclical response of expenditure to volatile oil prices
- elimination of expansionary fiscal policy bias during oil booms
- targeting prudent non-oil fiscal balances
- reduction of the non-oil fiscal deficit gradually and systematically over time.

These fiscal policy imperatives listed above are not new. In fact, they have always been recognised and they constitute the justification for the establishment of arrangements, laws and institutions such as the Excess Crude Account, the Fiscal Responsibility Act, and Nigeria Sovereign Investment Authority. If these had been allowed to work effectively, the era of pro-cyclical fiscal policy could have ended and Nigeria would have been in a strong financial and fiscal position to adjust to the current oil price slump more efficiently and with much less pain.

The second issue relates to the role of export diversification. As argued in section 2, structural transformation and sectoral diversification constitute key elements of a dynamic process for generating sustainable and inclusive economic growth. This process neither happens automatically nor does it necessarily produce the desirable kind and extent of structural transformation and sectoral diversification. Low-income countries of the 1950s and 1960s that have successfully created vibrant and export-oriented manufacturing sectors and, have achieved much higher levels of per capita income and economic development have done so largely by effectively deploying the exchange rate policy tool.

In the context of oil price and revenue volatilities which create difficult macroeconomic management problems for oil-dependent developing-country economies, a more diversified export structure obviously has a role in ameliorating these problems. While this amelioration would not necessarily apply to a full extent in the case of government revenue, it should do so in the case of strengthening the country's external balance position. Thus, an exchange rate policy which focuses effectively on sustaining the competitiveness of the domestic economy and, thus, promotes non-oil exports can be expected to reduce the volatility of total exports as well as the extent and cost of adjustment through contractionary fiscal policy.

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IV. Managing Policy Trade-Offs

In Sections 2 and 3 above the real exchange rate is recognised as the most important factor which shapes the economy's incentive structure through the movements of relative tradable and non-tradable product prices. In the context of an oil dominated economy such as Nigeria, the resource re-allocation effect of changes in the exchange rate can be particularly strong. For example, it is well established in the literature on the "Dutch Disease" that the exchange rate appreciates in response to surge in capital flows and that this reduces the competitiveness of the capital–receiving country's exports. The implication of this is that if Nigeria wishes to create and sustain a dynamic and export-oriented non-oil sector, an appropriate policy intervention strategy must be designed and implemented to effectively counteract this "natural" tendency of exchange rate appreciation. The design and implementation of such a policy intervention strategy must begin with the recognition that tradeoffs often exist between policies and that these trade–offs need to be understood so that they can be effectively managed. A very useful and simple analytical scheme for this purpose is the Impossible Trinity or Trilemma, a paradigm of open economy macroeconomics. In its simple form, this paradigm asserts that it is impossible for a country to have all three of the following at the same time:

- a stable foreign exchange rate
- free capital movement (or absence of capital controls)
- an independent monetary policy

When confronted with this Trilemma, policy makers have to select a combination of any two because all the three goals can be mutually inconsistent. For example, if a country chooses to maintain a fixed exchange regime and decides to raise the interest rate in order to control inflation, this will increase the difference between its own rate and the world interest rate. Given the emerging arbitrage opportunity in open capital markets and the underlying interest rate parity condition, such a move would attract capital inflows into the domestic economy, and results in an appreciating pressure on the fixed exchange. In order to eliminate this pressure and restore the fixed exchange, the country would have to intervene in the foreign exchange market to buy international reserves by selling domestic currency. This will end up defeating the original objective of controlling domestic inflation.

A review of country experiences shows that some developed countries and regions have tended to select the corner solution that the Trilemma implies. Thus, the United States allows its exchange rate to vary in the context of open capital markets while retaining an independent monetary policy as its control instrument. By comparison, the countries in the Euro-Zone component of the European Union have chosen to give up monetary policy independence in exchange for exchange rate stability and open capital markets.

Many other countries, including those of emerging markets, appear to have chosen to move away from the corner solutions and towards the middle ground. This seems to reflect the understanding that open capital markets are associated with significant costs and benefits. On the side of benefits, open capital markets permit capital flows which help to

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bridge the gap between domestic saving and investment as well as productivity-enhancing technology and skilled managerial capacity. On the cost side, unbridled capital inflows can fuel inflationary pressures, fan asset price bubbles and appreciate the exchange rate, thus reducing domestic competitiveness. In addition, sudden reversals in capital flows can lead to instability, including crises in financial and currency markets.

Thus, middle ground solutions tend to embrace gradual opening up of non-debt capital flows (principally foreign direct investment), while maintaining some control over debt and portfolio capital flows. An example of such middle-ground policy making is presented by the experience of the Reserve Bank of India (RBI). More specifically, the RBI intervenes in the foreign exchange market in an asymmetric way; it generally intervenes only when the exchange rate is appreciating, and adopts a "hands off" approach during times of depreciation. This approach is capable of achieving three different objectives. First, the depreciating currency assists in enhancing or restoring the competitiveness of exports. Second, the deprecating currency helps to ameliorate trends towards growing current account deficits. Third, it minimises the risk of losing foreign exchange reserves.

Like India, several other emerging market economies operate in an intermediate range of limited financial integration and managed floating exchange rate regimes. In this context, their central banks actively intervene in foreign exchange markets both to promote structural transformation and sectoral diversification in the medium to long-term, and using reserve management policies in the short-run to balance the trade–offs presented by the Trilemma. In this context, reserve accumulation gives the policy makers more flexibility in dealing with the short-run trade-offs between monetary policy independence and exchange rate stability for a given level of capital account openness. There is, of course, "no free lunch". This approach involves an inherent disadvantage in terms of rising fiscal cost of reserve sterilisation. In view of the multiple objectives of macroeconomic management such as maintaining a robust and sustainable economic growth rate, manageable current account deficit, competitive exchange rate, access to adequate external capital for domestic investment, moderate inflation, and adequate foreign exchange reserves, the process of macroeconomic management in the context of significant policy trade-offs remains inherently complex; there is unlikely to be a cost-less solution.

V. Concluding Comments

The current oil price slump and its immediate effects of reduced government revenue and export revenue will, no doubt, impose a costly and painful adjustment process on the Nigerian economy. The appropriate approach for an effective management of this process in order to minimise the cost and the pain will also continue to generate heated debate for quite a while, as current projections suggest that oil prices may not return to the level before the slump for roughly five years.

The volatility of oil prices is not new, and the current oil price fall will not be the last. In addition, based on the experience of the previous five episodes, a lot is known about the consequences of such oil price and revenue slumps. Based on this knowledge, appropriate

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countervailing institutions have been created and relevant policy packages designed. The real tragedy for Nigeria may be the inability to learn from experience and past mistakes so that adequate preparation can be made for the future. That future is now.

There are studies which suggest that difficult periods such as this actually provide both the challenge and opportunity to initiate and fast-track the processes of structural transformation, sectoral diversification as well as the enhanced capacity for a rational and effective management of the economy. Perhaps this opportunity can be seized upon now. If this succeeds, the mistakes of the previous five episodes could be forgotten and forgiven.

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Financing Government Programmes during Economic Downturn: Policy Options

Emmanuel M. Abolo*

"The Centre for Budget and Policy Priorities wants to explain a simple truth that a lot of people seem to have a hard time understanding. That simple truth is this: you don't cut government spending or raise taxes during a recession. Governments should run deficits during recessions to compensate for lack of private demand, and should then balance the budget during periods of strong economic growth and full employment. Right now, with 10 per cent unemployment and the economy still in a parlous state, insisting on short-term budget-balancing measures makes no sense". **(The Economist, 2010)**

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I. The Concept of Economic Downturn/Recession

A downturn is a slowdown in economic activity leading to inflation and an increase in uncertainty, as rising costs and prices are difficult to predict. In order to control demand when inflation is high, the government can increase taxes. In addition to this, the central bank can raise interest rates. These actions encourage savings and discourage spending. The result is that economic activity begins to decline.

There is no "official definition" of recession, but there is a general recognition that the term refers to a period of decline in economic activity. It is also a business cycle contraction which results in a general slowdown in economic activity. A downturn can lead to a recession which can be defined as "two successive quarters of negative economic growth". Very short periods of decline are not considered as recessions.

During a recession, demand in the economy is low and markets shrink. There are pressures for businesses to reduce costs, which can lead to increased unemployment as companies lay off workers. The resulting higher unemployment lowers aggregate demand, thus contributing to the downturn in the economy. Some businesses may have to close down. Macroeconomic indicators such as GDP (gross domestic product), investment, capacity utilisation, household income, business profits, and inflation fall.

Recessions generally occur when there is a widespread drop in spending (an adverse demand shock). This may be triggered by various events, such as a financial crisis, an external trade shock, an adverse supply shock or the bursting of an economic bubble. In a 1979 New York Times article, economic statistician Julius Shiskin suggested several rules of thumb for defining a recession, one of which was two consecutive quarterly declines in

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GDP. In time, the other rules of thumb were forgotten. Some economists prefer a definition of a 1.5-2 percentage points rise in unemployment within 12 months.

In the United States, the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) is generally, considered as the authority for dating US recessions. The NBER defines an economic recession as: "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales". Burns and Mitchell (1946,3) provide a somewhat vague but nonetheless useful description of a recession as a substantial prolonged decline in economic activity that occurs broadly across various sectors of the economy.

More recent working definitions used by business-cycle analysts refine these ideas and emphasise the “three Ds” for a slowdown to be a recession. It should be sufficiently long (duration), it should involve a substantial decline in economic activity (depth), and it should involve multiple sectors or all the sectors of the economy rather than simply reflecting an isolated decline in a single sector or region (diffusion).

II. Attributes of Economic Downturn

A recession has many attributes that can occur simultaneously and includes declines in component measures of economic activity (GDP) such as consumption, investment, government spending and, net export activity. These measures reflect underlying drivers such as employment levels and skills, household savings rates, corporate investment decisions, interest rates, demographics, and government policies.

A severe (GDP down by 10.0 per cent) or prolonged (three or four years) recession is referred to as an economic depression, although some scholars argue that their causes and cures can be different. As informal shorthand, economists sometimes refer to different recession shapes, such as V-shaped, U-shaped, L-shaped and W-shaped recessions. A focus on GDP alone is narrow, and it is often better to consider a wider set of measures of economic activity to determine whether a country is indeed, suffering from a recession. Using other indicators can also provide a timelier gauge of the state of an economy.

Consistent with this definition, it is more appropriate to focus on a comprehensive set of measures including employment, income, sales, and industrial production to analyse the trends in economic activity. Although, an economy can show signs of weakening months before a recession begins, the process of determining whether a country is in a true recession or not often takes time. For example, it took the NBER Committee a year to announce that the U.S. recession started in December 2007.

This is understandable, because the decision process involves establishing a broad decline in economic activity over an extended period of time, and which is done after compiling and sifting through many variables. In addition, different measures of activity may exhibit conflicting behavior, making it difficult to identify whether the country is indeed, suffering from a broad-based decline in economic activity. Recessions are infrequent but costly.

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Although each recession comes with unique features, there are common characteristics including:

- They typically last about a year and often result in a significant output cost. In particular, a recession is usually associated with a decline of 2 percent in GDP. In the case of severe recessions, the typical output cost is close to 5 percent;
- The fall in consumption is often small, but both industrial production and investment register much larger declines than that in GDP;
- They typically overlap with drops in international trade as exports and, especially, imports fall sharply during periods of slowdown;
- The unemployment rate almost always jumps and inflation falls slightly because overall demand for goods and services is curtailed; and
- Along with the erosion of home and equity values, recessions tend to be associated with turmoil in financial markets.

II.1 Key Pointers that the Nigerian Economy is In Recession

The Federal Government has confirmed recently that the country's economy was 'technically' in a recession. Nigeria's GDP growth contracted to -0.36 per cent in the first quarter of this year [2016], compared with 2.11 per cent in the fourth quarter of 2015. Several economists have already forecasted that the economy is likely to contract again in the second quarter of 2016.

The IMF has also stated that the Nigerian economy would now grow at a much slower pace than South Africa's, which is expected to grow at 0.1 percent in 2016. The IMF (2016) emphasised that the *Nigerian economy will contract for the first time in more than two decades* as the economy adjusts to foreign-currency shortages due to lower oil receipts, lower power generation and weaker investor confidence**.**

As the Nigerian economy slips further into recession, manufacturers in the country say their production level has dropped by 20.0 per cent, blaming dollar scarcity, declining purchasing power, fuel scarcity and infrastructure challenges for their woes. Key indicators that Nigeria's economy is in recession include:

- GDP Decline – Consecutive declines in quarterly real gross domestic product below zero. Year-on-Year GDP decline in 2015 was -15.3 per cent. South Africa overtakes Nigeria as Africa's biggest economy in dollar terms. The change in status of both countries was attributed to the appreciation of the rand and the devaluation of the naira;
- Decline in economic activity spread across the economy, in both the manufacturing and non-manufacturing sectors and lasting more than a few months. Capacity utilisation is now less than 20 per cent. The manufacturing sector is getting bleaker by

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the day as their earnings dim amidst the biting economic crunch. Recently, four major blue-chip Nigerian companies lost as much as N51.86 billion in the first half of 2016 as the economy continues to take a dip. Nestlé Nigeria Plc, Nigerian Breweries Plc, Dangote Cement Plc and Lafarge Africa all suffered combined profit losses to the tune of N51.86 billion in the first half of the year;

- Production level, business activity, new orders, employment level and raw material inventories have all declined at a faster rate ever.
- Decline in income and profits reported by businesses. Publicly quoted companies now mostly declare a drop in their revenues or profits;
- Dip in Government Revenue – We have seen government revenue dip so much that most states have to seek for a bailout to enable them pay for something as basic as salaries. Twenty-seven (27) states out of 36 cannot pay salaries of their staff. In spite of the bailout fund they received from the federal government, the states have failed to meet up with their obligations to their workers. The situation is so bad that some states are owing their workers up to a year and the state governors have constantly reminded everyone that there is no where they can source for funds;
- Job losses – There are massive layoffs as most companies cut cost to remain afloat. Since consumer and government spending has dropped, businesses can no longer produce at same level and, therefore, cut back to remain in business. There has been massive lay-off of workers in banks and financial institutions. The National Bureau of Statistics revealed a few months ago that over 600,000 jobs have so far been lost;
- Market capitalisation down to US$48.0 billion from US$84.0 billion in 2014;
- Foreign airlines exit the Nigerian aviation market. Fourteen (14) airlines have so far withdrawn their services from Nigeria due to low patronage. The airlines are among the 50 that operated the Nigerian routes some months ago. Some of those that have left are Spanish-owned Iberia Airlines, United Airlines and Air Gambia. Twenty Shipping firms are also confirmed to have left Nigeria over low businesses with 300 workers sacked; and
- Inflation rate gallops and is currently 16.5 per cent, the highest since 2005.

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III. The Case for Increased Government Spending in times of Recession

Government expenditures [programmes] are financed primarily in three ways. These include Government revenue such as taxes and non-tax revenue (revenue from government-owned corporations, sovereign wealth funds, sales of assets, or seigniorage);Government borrowing; and money creation. How a government chooses to finance its activities/programmes can have significant effects on the distribution of income and wealth (income redistribution) and on the efficiency of markets.

During a recession, the private sector spending drops for a variety of reasons. Demand for goods and services drop. Private investors tend to restrict their investments. Factories tend to drop production and lay off workers. Eventually, more and more businesses will continue to lay off more because of lower demand.

Revenues of government at federal, state and local governments will also fall leading to higher unemployment, bankruptcies, hunger, homelessness, desperation, and crime. In addition, there will be social issues such as loss of personal dignity. If this downward spiral continues, we can expect serious consequences for everyone including corporations, the rich, the middle class, and the poor.

To prevent the downward spiral there has to be spending. If the ailing private sector cannot provide enough spending, we will need someone else to resuscitate the economy during a recession. Economists recommend injecting government funds into the economy without increasing taxes. Recession may be one of the few exceptions in which economists can justify deficit financing. In order to do this right, the spending should be big enough to make an impact. Ideally, spending should be in labour-intensive projects that would benefit the the society as a whole. It can include spending on construction, education, communication networks, massive power-generation, and other major infrastructure projects.

For example, during the Great depression of the 1930s, the Tennessee Valley Authority [TVA] was created in the US. This not only created jobs, but it also helped in addressing the economic depression speedily. It improved the quality of life by providing cheap and clean electricity for millions. Industries that were heavily dependent on large amounts of energy thrived. TVA also helped the US during the Second World War by providing a huge amount of electricity needed to build the atomic bomb that stopped the war with Japan.

With an effective stimulus package, such job creation will start very quickly. With workers now having money, they will be able to create a demand for goods and services. Businesses with capital will now begin to invest in goods and services. This, in turn, creates more jobs and more demand for goods and services. More small business such as retail shops and restaurants will sprout within many communities. There will be ample opportunities for the masses to rise above subsistence. Self-esteem and consumer confidence of the masses will improve. Human hardships, homelessness, crime and other social issues will decrease.

Eventually, as the positive ripple effect continues, the tax revenues naturally will go up and government's deficit financing will not be needed at some point. Eventually, tax revenues will automatically rise due to higher economic activity. This rise in revenues should now be used to reduce the budget deficit. The justification for a budget deficit will not be there anymore after the recession. Then taxes, fiscal policies, and interest-rates should be adjusted to maintain the health of the economy and keep government budgets balanced.

Deficit financing by the government is appropriate during recession or depression. This is also considered to be a textbook solution by many economists. It has been the practice in many countries including China, Japan and parts of Europe and Asia. Japan was one of the first nations to successfully use deficit financing to reduce the impact of the economic depression during the 1930s. It was so effective that they were out of that depression as early as 1933.

Fiscal deficit can be financed in two ways. Firstly, through domestic and external borrowing by the government from the market, and Secondly, by borrowing from the central bank which issues new notes against government securities. Thus, borrowing from the central

bank results in expansion of high-powered money in the economy. It is in fact monetisation of fiscal deficit which may be inflationary.

There are four implications of fiscal deficit.

- Firstly, a good part of it is financed through borrowing from within and/or outside the country. This leads to increase in public debt and its burden;
- Secondly, if a part of fiscal deficit is financed through monetisation of fiscal deficits, it leads to the creation of new money and rise in prices or inflation. To check inflation and achieve price stability, the IMF and World Bank had recommended that fiscal deficit should not be more than 3.0 per cent of GDP;
- Thirdly, a large fiscal deficit adversely affects economic growth as a substantial part of borrowed funds is used to finance current consumption expenditure of the government; and
- Lastly, more borrowing by the government leaves fewer resources for private sector investment.

The 2016 national budget was expansionary, anchored on a deficit of ₦2.2 trillion. The entire capital component of the budget was ₦1.8 trillion. Thus, without borrowing and even if the 2016 revenue projections were fully achieved, the implementation of the capital expenditure component of the budget would be impossible. Indeed, less than ₦400 billion has so far been released for capital projects. In the light of this and with economy already contracting at a GDP of -0.36 per cent in the first quarter of 2016 and unemployment rate of 12.1 per cent, government would need to act fast in negotiating loans to support critical sectors that will reflate the economy and pull it out of recession and stagflation.

Deficit financing is the right thing to do given that our debt- to- GDP ratio is very low. What is important is optimum utilisation of the resources borrowed to ensure we do not unduly overburden future generations with debts.

Need to broaden the tax base

Value Added Tax (VAT) can be broadened by the Federal Government especially, against the backdrop that it is among the lowest in the world and, well below the rates in other ECOWAS member countries. Thus, some increment should be considered.

CBN Monetary Tools

The Central Bank of Nigeria in collaboration with other stakeholders has effective tools to reverse the current recession. The Bank's special interventions, including funds targeting lending to SMEs, agriculture, power and non-oil exports are important. Section 3.2.12(h) of the CBN Monetary Policy Circular No. 38 for 2010/2011 fiscal year noted that infrastructure development remains grossly inadequate relative to the nation's requirements due to lack of funds. As part of efforts to address this challenge, the Central Bank of Nigeria established the Infrastructure Finance Office on March 01, 2010 with a mandate to, among others,

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evolve a sustainable financing framework to stimulate long-term financing for infrastructure development in the country. A few of the interventions are as follows:

The N300 billion Power and Aviation Intervention Fund (PAIF)

The Bank provided ₦300 billion facility for investment in debentures to be issued by the Bank of Industry (BOI) in accordance with Section 31 of the CBN Act 2007, for investment in power and aviation projects. The funds were channeled through the BOI for on-lending to Deposit Money Banks [DMBs] at a maximum interest rate of 1.0 per cent for disbursement at concessionary interest rate of not more than 7.0 per cent and a tenor of 10 -15 years. The African Finance Corporation [AFC] served as technical adviser to the Fund.

Review of the Prudential Guidelines to recognise the peculiarities of Long-Term Financing

As part of measures by the CBN to further encourage banks to lend to the real sector of the economy, particularly SMEs, infrastructure and agriculture, the Bank approved the amendment of the prudential guidelines on loan loss provisioning, and rules and regulations on margin lending. The objective is to take cognisance of the current dynamics in the industry and provide guidance on the recognition and measurement of loans, establishment of loan loss allowances, credit risk disclosure and related matters. The reviewed prudential guidelines recognises the use of a time-based approach for specialised loans which established longer time lines for measuring asset quality, based on the gestation periods for projects in the target sectors.

In Nigeria, not much can be achieved by relying solely on traditional sources of revenue to finance its programmes in these times of grave economic crisis. The focus should be on innovative financing and that is the focus of the rest part of this paper.

IV. Innovative Financing: The Way out for Nigeria

The term 'innovative financing for development' was coined in the early 2000s and since then, its use has become commonplace in development discourse. As the UN Secretary-General's 2009 Progress Report on Innovative Sources of Finance for Development noted, "the concept of innovations now extends to such diverse forms as thematic global trust funds, public guarantees and insurance mechanisms, equity investments, growth-indexed bonds, countercyclical loans, distribution schemes for global environmental services, microfinance and mesofinance, and so on" (UN,2009 pp. 5).

The World Bank defines innovative financing for development as "those that depart from traditional approaches to mobilising development finance —that is, through budget outlays from established sovereign donors or bonds issued by multilateral and national development banks exclusively to achieve funding objectives". (UNDP, 2012 pp. 11)

Some of the innovative financing options that Nigeria could use to finance government programmes include the following:

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IV.1 Public-Private–Partnership Option

In the face of budgetary constraints, government can turn to the private sector as an alternative source of funding to meet the funding gap to deliver new and improved infrastructure projects from transport (roads, railways, bridges); education (schools and universities); healthcare (hospitals, clinics and treatment centres); waste management (collection, disposal, waste to energy plants); water (collection, treatment, distribution), government accommodation and defence.

One option is to leverage on public-private partnerships (PPPs) which are contracts between private sector entities and a government body, usually with the former expected to deliver desired services and assume the associated risks. The government is relieved of the financial and administrative burden of providing the service, but retains an important role in regulating and monitoring the performance of the private partner.

Employing PPP as a tool for meeting its obligations to citizens, governments have been able to avail themselves of the state of the art technology and private sector expertise, while avoiding excessive strains on already limited budgets.

Some of the objectives of a PPP programme are to:

- Increase financing available for infrastructure by making use of private sector investment resources;
- improve value for money in infrastructure projects by creating incentives for best-practice design, timely completion, and efficient operation by sharing project risk with the private sector;
- encourage innovation in the provision of infrastructure;
- improve the sustainability of infrastructure and infrastructure service;
- improve accountability in public expenditure If a government intends to increase the use of PPPs to provide infrastructure, then the main aim of developing the PPP framework is to make this happen.

Benefits of PPPs

- Infrastructure created through PPP can improve the quality and quantity of basic infrastructure such as the provision of water and its treatment, energy supply and transportation. In addition, the process can be widely applied to a variety of public services such as hospitals, schools, prisons and government accommodation;
- PPPs can assist the government develop a more disciplined and commercial approach to infrastructure development whilst allowing them to retain strategic control of the overall project and service;
- Under PPP arrangements, the risk of performance is transferred to the private sector. The private sector only realises its investment if the asset performs according to the contractual obligations. As the private sector will not receive payment until the

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facility is available for use, the PPP structure encourages efficient completion on budget without defects;

- There is evidence of better quality in design and construction than under traditional procurement. PPP focuses on the whole life cost of the project not simply on its initial construction cost. It identifies the long-term cost and assesses the sustainability of the project;
- The expertise and experience of the private sector encourages innovation, resulting in shorter delivery times and improvements in the construction and facility management processes. Developing these processes leads to best practice and adds value;
- The process helps to reduce government debt and to free up public capital to spend on other government services;
- The tax payer benefits by avoiding paying higher taxes to finance infrastructure investment development;
- The PPP process requires a full analysis of projects risks at the outset. This fuller examination of risks by both the government and lenders means that cost estimates are robust and investment decisions are based on better information; and
- PPPs create efficient and productive working relationships between the public and private sector.

Potential Risks of Public-Private-Partnerships

- Development, bidding and ongoing costs in PPP projects are likely to be greater than for traditional government procurement processes. The government should, therefore, determine whether the greater costs involved are justified. A number of the PPP and implementation units around the world have developed methods for analysing these costs and looking at value for money;
- Some projects may be more politically or socially challenging to introduce and implement than others, particularly, if there is an existing public sector workforce that fears being transferred to the private sector, if significant tariff increase is required to make the project viable, if there are signficant land or resettlement issues, etc.;
- There is no unlimited risk bearing – private firms (and their lenders) will be cautious about accepting major risks beyond their control, such as exchange rate risks/risk of existing assets. If they bear these risks, their price for the service will reflect these;
- Private firms will also want to know that the rules of the game are to be respected by government as regards undertakings to increase tariffs/fair regulation, etc. The Private sector will also expect a significant level of control over operations if it is to accept significant risks;
- The Private sector will do what it is paid to do and no more than that. Therefore, incentives and performance requirements need to be clearly set out in the contract. Focus should be on performance requirements that are out-put based and relatively easy to monitor;
- The private sector is likely to have more expertise and after a short time, have an advantage in the data relating to the project. It is important to ensure that there are clear and detailed reporting requirements imposed on the private operator to reduce this potential imbalance;

- Given the long-term nature of these projects and the complexity associated, it is difficult to identify all possible contingencies during project development. Events and issues may arise that were not anticipated in the documents or by the parties at the time of the contract. It is more likely than not that the parties will need to renegotiate the contract to accommodate these contingencies.

IV.2 The Pension Funds Option

Pension funds are a fast-growing and useful asset pool for funding infrastructure projects. The National Pension Commission (PENCOM) recently announced that the asset pool of contributor's funds and managed by Pension Fund Administrators (PFAs), is currently at N5.3 trillion. It has been suggested that the Federal Government of Nigeria (FGN) could use the pension funds to finance budget deficit.

The use of pension funds to finance infrastructure projects became more prominent in the past two decades. This was largely as a result of mandatory pension schemes to fund pay-as-you-go systems particularly, in the private sector to guarantee pensions. This trend was further fueled by the need to diversify risk and match assets to the liabilities of pension fund schemes. Infrastructure asset is a suitable vehicle that delivers strong long-term economic inflation-linked returns at an acceptable level of risk, while matching asset to liability tenor of pension schemes. Thus, it has attracted significant funding from pension schemes. Within the Organisation for Economic Co-operation and Development (OECD), key institutional investors held US$65 trillion in assets as at 2009, which is expected to continue rising as coverage increases and workforce ages.

The following section looks at the experiences of some countries regarding the evolution of their pension fund market and the contribution of same to infrastructure investment. Pension fund has helped provide alternative source of funding for financing infrastructure in several countries and there has been no report of default that has resulted in erosion or misplacement of pension funds in the course of its use to finance infrastructure projects.

Challenges

The major challenge would be the initial resistance to use pension funds for infrastructure development given past history of incomplete or abandoned infrastructure projects, project delays and cost overruns. Pension fund managers may be averse to investing in such projects as they may jeopardise the returns on their assets and ultimately, the realisation of retirement benefits of their benefactors.

There is an absence of a framework to leverage on pension assets to fund infrastructure projects. Furthermore, there is an absence of an effective public awareness campaign to enlighten pensioners and pension fund managers on the potential benefits of using pension funds to finance infrastructure projects. There is also lack of experience of pension funds and fund managers in PPP and project finance.

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The general weak capacity in the area of infrastructure building and funding, currently hinders the investment of pension assets in infrastructure finance. Nigeria's long-term financing market is underdeveloped, shallow and offers limited investment opportunity. Lack of the appropriate capacity in the area of infrastructure building and funding often results in the weak participation of local institutions in funding infrastructure projects.

IV.3 The Bond Financing Option - Eurobond

The operational phase of infrastructure projects is distinctively different from the initial phases. As the infrastructure project is starting to generate positive cash flows, default risks subside rapidly over time, on average, even below those of other highly rated debt securities. Infrastructure projects often represent (quasi-) monopolies, hence, cash flows are relatively secure as the price-setting power of infrastructure operations is high.

With stable underlying cash flows in the operational phase, infrastructure projects are akin to fixed income securities, therefore, bond financing is a natural and economically appropriate financing instrument. A key question is how infrastructure bonds can be promoted, especially in emerging markets such as Nigeria. The development of the local bond markets is a prerequisite for issuing infrastructure bonds.

One option is to issue infrastructure bonds off-shore to tap from the international capital markets. In this context, several issues regarding legal and disclosure frameworks arise. Policy actions are important. Short-term policy actions must continue to focus on achieving macroeconomic stability, maintaining debt sustainability, ensuring adequate use of proceeds from financing and investment in projects with high economic "multipliers". Others are avoiding the build-up of balance sheet vulnerabilities from currency and maturity mismatches, and managing the risk of significant slow-down or reversal.

Second, long-term policy actions should focus on developing domestic capital markets and institutions, and, adequately sequencing the liberalisation of capital accounts.

IV.5 Export Credit Agencies Option

A financing source of growing importance in emerging markets are export credit agencies (ECAs). Their involvement has become more prominent in emerging markets. In Asia, ECAs have become more involved in large infrastructure projects. For instance, the Japan Bank for International Cooperation and the Korea Export-Import Bank are large players. In Africa, the China Development Bank (CDB) has become a major player in the infrastructure market.

ECAs usually demand that materials, machines and sometimes, even labour for infrastructure projects are bought from their home jurisdictions. This can potentially raise costs. However, ECAs often allow repayment of debt in local currency, at least in part. ECAs are also seen as a potential insurer against political risks, hence they help reassure other

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lenders such as local commercial banks, which often do not have the necessary expertise and monitoring capabilities. As we all know, the Federal Government has decided to fund part of the 2016 budget through borrowing from foreign investors using bonds which would be infrastructure project-specific.

Project-specific bonds have been used in many countries for greenfield and brownfield projects. Canada is said to be the country that mostly relies on the capital markets to finance infrastructure projects. Specifically, the Government is expected to raise US$1billion through Eurobond for capital expenditure this year to augment domestic resources. Nigeria's low debt to GDP ratio means the country can borrow more to fund budget, infrastructure and other essential projects that will stimulate the economy and create jobs for the citisenry.

Nigeria's debt-to-GDP ratio is among the lowest in emerging markets at 10.0 per cent, with just US$8 billion in sovereign debt outstanding in hard currency which is an indication that it should be preferred by investors. The ratio for Kenya and South Africa is over 40.0 per cent.

The 2016 budget has a deficit-financing gap of ₦1.84 trillion for capital expenditure, which can be funded through borrowing from local and international markets. The Eurobond, therefore, is a welcome decision if indeed, it will be applied appropriately to drive the macroeconomy.

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IV.7 Diaspora flows Option

Worldwide, African diaspora members save an estimated US$53 billion annually. If one in every 10 members of the diaspora could be persuaded to invest US$1,000 in his or her country of origin, Africa could raise US$3 billion a year for development financing. Mobilisation of diaspora funds is possible through the issuance of a diaspora bond, a retail saving instrument marketed to diaspora members. The money raised through diaspora issuances could be used to finance projects that interest overseas migrants - such as; housing, schools, hospitals, and infrastructure projects that have a concrete benefit to their families or the community back home.

Diaspora bonds can tap into the emotional ties, the desire to give back—of the diaspora and potentially help lower the cost of financing for development projects back home. Because the diaspora savings are held mostly as cash under the mattress or in low-yielding bank accounts in the countries of destination, offering a premium on diaspora bonds could be attractive. Diaspora investors can be a more stable source of funds than other foreign investors because their familiarity with the home country often gives them a lower perception of risk. In particular, diaspora members generally are less concerned with currency devaluation risk because they are more likely to have a use for local currency.

Partial guarantees by multilateral development banks could enhance the creditworthiness of many diaspora bonds. Surveys of diaspora groups' income and investment characteristics and political risk perception would help with the pricing and marketing of

diaspora bonds. Embassies and consulates overseas can play a major role in marketing such bonds. Still, there are some dangers to the origin countries. Large foreign currency inflows after a bond issuance, and potential outflows when the bond matures, require careful macroeconomic management, especially of the exchange rate. Even if the bond is issued in local currency, Nigeria must pay attention to exchange rate management and prudential debt management.

The pioneers of diaspora bonds, Israel and India, have leveraged them over time to raise more than US$25 billion and US$11 billion, respectively. For sub-Saharan African countries, the World Bank has estimated that these instruments could raise as much as US$5 billion to US$10 billion annually (World Bank 2010 pp. 331).

V. Concluding Remarks and Key Recommendations

There are typically three ways of financing government spending: taxes, debt and money creation. Some governments also charge for the use of certain services. User fees for national parks, road tolls, and charging for public transportation are also used. However, they tend to be vastly dominated by taxes, bonds, and money.

Government debt is not necessarily a bad thing. Typically, a family that wants to buy a house cannot simply pay for it all at once, but must borrow much of the purchase price and then gradually pay it back over time. The same is true for governments. In these times of recession, the government of Nigeria should leverage more on innovative financing with less emphasis on traditional methods of funding programmes/projects.

That is the way to go.

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Financing Government Programmes in Economic Downturn: Policy Options

Frank U. Jacobs*

I. Introduction

Distinguished Guests, Ladies and Gentlemen, it is an honour to be a Guest Speaker at the 2016 CBN Executive Seminar with the theme, "Financing Government Programmes in Economic Downturn – The role of Central Bank of Nigeria". The theme of the Seminar is apt and timely, considering what our country is passing through at the moment. I commend the organisers' sense of judgement and remain grateful for the opportunity to speak on "Financing Government Programmes in Economic Downturn: Policy Options". For obvious reasons, I will zero in on policy options for the manufacturing sector of the economy.

The concept of business cycle clearly explains long-term swings in economic behaviour which can be classified as a period of economic boom, recession, depression and recovery. However, while little attention is given to the period of economic boom since it implies economic prosperity; greater attention is paid to the period of economic recession. Interestingly, it is common knowledge that sound economic management in the period of boom can mitigate the challenges of the period of economic downturn. Countries that have effective economic management framework in place tend to be less impacted during economic crisis. The economic impact and policy solutions of the various global economic downturns, including the Great Depression that began in 1929, the Asian economic crises that started in 1997 and the Global Financial Crisis of 2007/2009, are well documented in the literature.

Nigeria has had its fair share of economic crises which include the economic recession of the early 1980s, 1990s, 2007/2009 crisis and the current challenge. I believe that the current economic challenges would be eventually contained. Containing economic crises requires a sound and strategic economic management framework. Each of the three major global economic crises earlier referred to had devastating impact both on world output and on the economic performance of the individual countries affected, but were eventually contained with the implementation of requisite policy actions.

In the case of the Asian economic crisis, key policy actions employed included:

- Strong government commitment to resolving the challenge;
- Strong focus on price stability and economic growth;

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- Timely and forceful reactions of both monetary and fiscal policy-makers;
- Good coordination between the two authorities working;
- Reduction of interest rates on main refinancing operations;
- Well designed and implemented stimuli package;
- Tax cut (CIT and PAYE) and increase in unemployment benefits;
- Government support for the banking sector to maintain the flow of credit; and
- Low interest rates on new government bonds.

II. Financing Government Programmes in Economic Downturn: Policy Options

The downturn Nigeria currently is facing calls for strong government resolve and commitment to re-energise the economy for increased revenue, as any programme contemplated by the government can only succeed if there is adequate revenue to execute such programmes. We should take a cue from strategies adopted by other countries to overcome incidences of downturn in their economies. The major problem which Nigeria has experienced and which has impacted negatively on the economy is the over-dependence on crude oil revenue and weak industrial and manufacturing base of the economy. The drive by the current administration to diversify the economy is, therefore, a step in the right direction as this would further insulate the economy from the current ugly experience and also, future external shocks.

To this end, all efforts to increase non-oil revenue should be pursued vigorously through the following strategies: the industrial sector, especially the manufacturing sub-sector, should be strengthened by removing all obstacles restraining the growth and competitiveness of the sector such as the indiscriminate changes in the Monetary Policy Rate (MPR) which has been changed as many as 4 times between 2014 and July 2016, with its distorting effects on the economy; the exclusion of 41 items, mainly of essential raw materials from the official foreign exchange market as well as failure to synchronise monetary and fiscal policy actions. This will enable the sector to be optimally productive and play its expected role of employment generation, capital mobilisation and wealth creation as well as technology acquisition.

The resource-based industrialisation strategy championed by MAN and adopted by the Federal Government should be intensified as it involves the utilisation of the country's abundant natural resources in producing goods that the economy needs. This is a more sustainable and enduring form of industrialisation, compared with the import-dependent industrialisation option which has held sway over a long period. This would also save the country a lot of foreign exchange currently used in importing raw materials and free funds for government's development projects.

Intensification and aggressive undertaking of the development of key selected mineral resources through backward integration, especially those with high inter-industry linkages such as iron ore, zinc-lead, bitumen, limestone and coal. Government should intensify backward integration in the agricultural sector to catalyse more industrial input supply from the sector. These would also free more funds for the government.

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Reduction of the MPR and by implication other rates, especially refinancing rates and bank lending rates as the inflationary situation in the economy may not be purely a monetary phenomenon, but could also be a result of output gap created in the real sector; creation of special funding windows for the manufacturing sector, in view of its long-term gestation period, should be given serious consideration. This is in addition to the existing Bank of Industry which, at any rate, is under-funded.

Adoption of concessionary foreign exchange allocation mechanism for the manufacturing sector for raw materials and machinery. This would enable the sector to increase its productivity and become more competitive.

Encourage export of manufactured and other non-oil products as a way of boosting foreign exchange earnings for the country as well as, activate automatic stabilisers, especially for the industrial/manufacturing sector; allowing the payment of import duties and Company Income Tax (CIT) with the existing Negotiable Duty Credit Certificate (NDCC).

Development of support infrastructure so as to facilitate the country's industrialisation efforts. With the current situation, however, it may not be advisable to use borrowed funds only to finance infrastructure development. The private sector should be actively involved in infrastructure development. Government should, therefore, resuscitate the Public Private Partnership (PPP) programme through the establishment of Concession Agreements under Built-Operate-Transfer (BOT) in road construction and maintenance, rail construction and maintenance, among others.

Proper deregulation of the downstream petroleum sector to encourage private investment in domestic refining and petrochemical industry. Government should consider privatising the four national refineries to make them fully functional and save money for other purposes.

External and Domestic borrowing is an important and veritable option open to Government in this period of economic hardship, considering that Nigeria's current Debt/GDP Ratio of 20.77 per cent stands below the World Bank benchmark of 40 per cent. However, borrowing should be of very low interest rate, contracted on long-term basis, and targeted, preferably at the productive sectors of the economy.

Adjusting taxes (Corporate Income Tax, Value Added Tax, and Personal Income Tax) is another credible option that is open to government. However, considering that the country is at the brink of recession with growth of the productive sector being negative and the prevailing weak consumption as a result of inflation, it is not advisable to increase CIT, VAT and PAYE. Already, the productive sector is hit with dwindling investment, thus, any further tax increase will crowd-out more investment in the sector. I would, therefore, suggest that the current Tax-GDP Ratio of 12.0 per cent, which is below the World Bank Benchmark of 18.0 per cent, may be raised by widening the tax net and ensuring that all taxable individuals and entities are covered. Taxes on luxurious goods and property may also be raised.

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III. Conclusion

Distinguished participants, ladies and gentlemen, you may be wondering why I have concentrated mainly on the manufacturing sector of our economy. This is my primary constituency. I recognise that there are other very important options, but I believe that other speakers would speak on those. I am strongly convinced that with the above suggestions, Nigeria should be able to contain the present economic downturn.

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Governments' Options for Financing the Sustainable Development Goals (SDGs) in a Period of Economic Downturn

Robert C. Asogwa *

I. Introduction

The onset of low oil and other commodity prices in 2014, compounded by the slowdown in China and other Asian economies have generated economic challenges for commodity dependent economies. Prior to this, Africa and indeed, other commodity-exporting countries, benefitted largely, from the global commodity price boom which peaked during 2001/2. At this period, Africa seemed to outperform the world with an average growth of over 6.0 per cent per annum. By end-2014, there was a dramatic turn as decreasing global demand, in the face of growing supplies, led to massive fall in the prices of primary commodities, especially crude oil, iron ore and copper (UNDP, 2015)[5]. This recent downturn in commodity prices has presented serious consequences for several of these commodity-dependent African economies - a continent that had endured nearly 30 years of slow growth and started enjoying the benefits of recent growth recovery. The impact of this downturn on government expenditures, financial and foreign exchange markets as well as sovereign credit ratings for Africa's major economies including Nigeria are well known and even extensively discussed in literature (IMF, 2015; UNDP, 2016; Bloomberg Finance, 2015; among others).

A new challenge that now confronts these commodity-dependent economies (including Nigeria) is how to mobilise resources through old and new financing instruments to create opportunities for quick domestic economic recovery, finance the global Sustainable Development Goals (SDGs), as well as, Africa Agenda 2030. Recent estimates of financing requirements for African countries to achieve the SDGs indicated an amount between US$614.0 billion to US$638.0 billion per year as incremental financing needs (Schmidt-Traub, 2015). A funding gap of approximately US$130.0 billion – US$160.0 billion is estimated. How can this financing gap be closed given the challenges of growth, external financing and even retaining domestic savings in Africa? According to UNCTAD (2016), increasing domestic resource mobilisation alone is also not a panacea for financing Africa's development. Even with the repatriation of so called stolen assets, improved tax efficiency and the curtailing of illicit financial flows, there may still be challenges of financing the SDGs. Rather, what African countries need is a mix of development finance initiatives, including debt and blended financing options with a corresponding formulation of policies aimed at financial deepening and inclusion. As a matter of fact, both Africa Agenda 2063

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[5] The decline in prices of gold, silver and platinum was less. Similarly, agricultural commodity prices including cotton, soybeans, sugar , cocoa and coffee also declined during this period but not as much as crude oil and iron.

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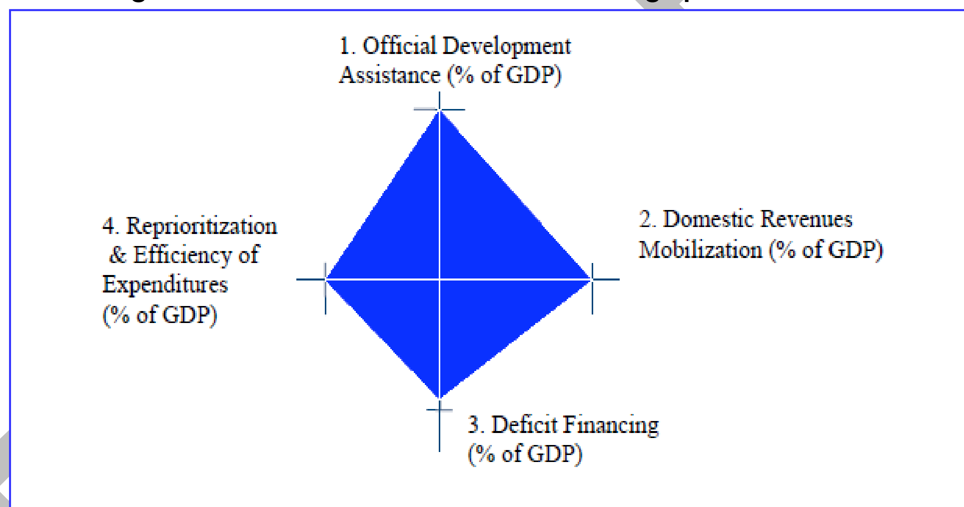
and the Addis Ababa Action Agenda recognised the importance of augmenting capacities for domestic resource mobilisation to finance Africa's development.

This paper reviews the strategies for strengthening the existing sources of traditional finance in Nigeria and also, introduces new sources of innovative finance that will be suitable for funding government development programmes, as well as, the SDGs Agenda 2030. Furthermore, the possible role of the central bank vis a-vis the government fiscal authorities in the management of some sophisticated financial instruments which is increasingly gaining momentum as part of innovative development finance is discussed.

II. The Old Financing Model for Government Programmes

In Nigeria, funding of government programmes, including the Millennium Development Goals (MDGs) has been through the traditional model based on the well-known Fiscal Space Diamond (Heller, 2005; see figure 1). The key instruments are Domestic Revenue mobilisation (oil and non-oil) deficit financing (domestic and external borrowing) Official Development Assistance (through aid and debt relief) and expenditure efficiency.

Figure 1: Traditional Government Financing Space Diamond



Source: UNDP (2016)

The Nigeria MDGs-ER (2015) reported that financing of the MDGs, unfortunately, relied more heavily on budgetary allocations and the Debt Relief Gains (DRG) with the latter accounting for much of the execution of MDGs programmes and projects. Eventhough some Nigerian entrepreneurs and humanitarian groups were noted to have contributed in no small measure to the fight to eradicate polio sometimes through resources mobilised from other private sources, the funds were still minimal. There were huge challenges of raising tax revenue to augment natural resource revenue flows. For the period 2000-2013, the average non-oil tax effort was 6.62 per cent of GDP, indicating a fairly low tax effort, while the revenue-GDP ratio was even lower at 4.8 per cent (UNDP, 2016).

With the mobilisation of domestic resources disappointing and limited deficit financing options, an annual funding gap of ₦1.0 trillion existed for funding the MDGs in Nigeria. This

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might have explained why MDGs implementation in Nigeria remained an unfinished business, partly because of the poor financial outlay. Given the fact that more funds are needed if domestic and international development goals, including the SDGs Agenda 2030 and the Africa Agenda 2063 are to be met in Nigeria, especially in the context of the present economic downturn, potential and innovative financing mechanisms and sources needed to complement the traditional financing instruments. This will be useful to reduce the current pressures on government budgets in Nigeria.

III. Financing Government Programmes: A New Conceptual View

Ever since the first international conference on financing for development (Monterrey, 2002), the conceptual thinking for financing government programmes has widened and the term innovative and new development financing has become popular. Subsequent International Conferences on Financing for Development (Doha Declaration, 2008 and Addis Ababa Agenda for Action- AAAA- 2015) all recognised the need for innovative sources of development financing. Even though there is no internationally agreed definition of innovative financing for development, several international agencies have offered various interpretations of the term and scope (World Bank, 2009). Innovative financing' according to the OECD (2009), comprised mechanisms of raising funds in support of development that go beyond the traditional approaches by either the official or private sector. This include new approaches for pooling private and public revenue streams to scale-up activities, new revenue streams for development activities or new incentives to scale-up ongoing government activities. It highlights the opportunities for individual countries to mobilise financing needed to support the implementation of government programmes and the sustainable development goals.

Early estimates of the amount of resources raised so far through innovative financing instruments vary significantly according to the definition which is used. The World Bank estimates that innovative fund raising generated US$57.1 billion in official flows between 2000 and 2008 (World Bank, 2009). The leading group (2011) with focus on a narrower definition of innovative financing estimated that a total of over US$5.5 billion has been raised for health through schemes such as the airline ticket tax and the international finance facility for immunisation. Similarly, the United Nations (2012) report based on the OECD definition of innovative finance, indicated that US$31.3 billion has been raised between 2002 and 2011 for climate and environment, a significant proportion of which was through carbon emissions trading.

In 2014, the United Nations Intergovernmental Committee of Experts on Sustainable Development Financing developed an innovative financing model that can help governments finance national development plans as well as international development commitments (such as SDGs and Africa Agenda 2063). Figure 2 shows the new model of development finance.

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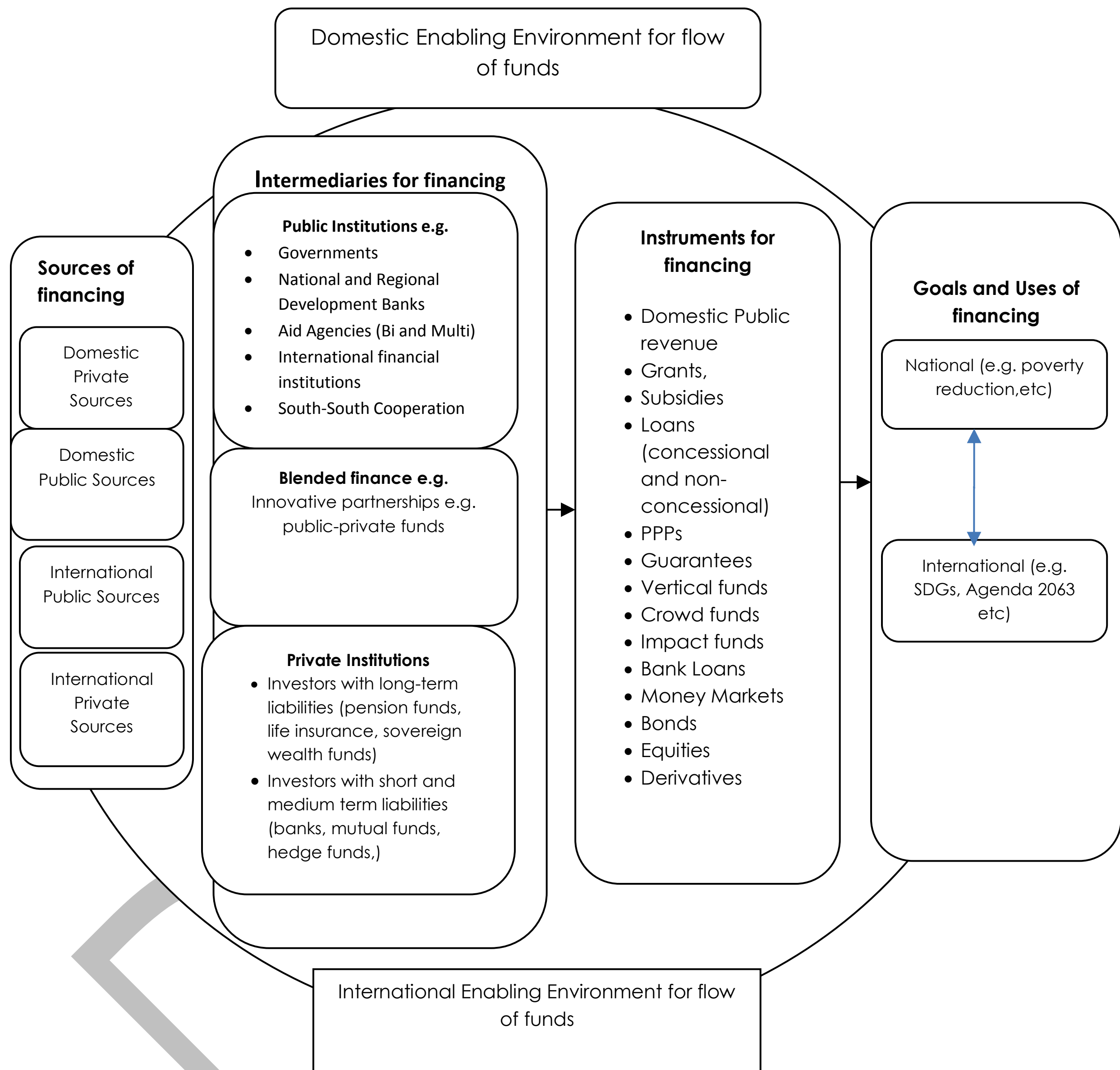
Figure 2: Flow of funds from International and National Sources to Government Programmes, SDGs and Agenda 2063



Source: Adapted and modified from the Report of the Intergovernmental Committee of Experts on Sustainable Development Financing (2012).

The new model of development finance recognises the importance of all four sources of finance (domestic-public, domestic-private, international-public and international-private). In addition, there is a blending of the sources to obtain strong financial packages and instruments. It is clear that each of the financing source is influenced by national policy frameworks, but complemented by the international financial architecture. The belief is that implementing these innovative financing mechanisms coupled with curtailing illicit financial flows will help several African countries achieve key goals of Agenda 2030 and the Africa Agenda 2063.

Table 1: The New Financing for Development (NFfD) Toolbox

	Domestic	**International**	**Blended**
Public	• Taxation (PIT, VAT, CIT, property etc • Taxation new (air-ticket, carbon taxes , tourism tax, GSM tax etc) • -Natural Resource Revenues (oil, etc) • -National Development Banks • Debt (Bonds etc)	• Multilateral/Bilateral agencies • South-South Cooperation • Triangular Cooperation • Sovereign Wealth (in some cases owned by national governments) • Debt conversion or swap (debt for education, debt for health etc) • Vertical funds (Global funds, GAVI Alliance and UNITAID)	- PPPs - Impact Investment - Funds - Social Impact Funds including Green Bonds - Crowd funds - Guarantees (eg Advance Market Commitments)
Private	• Household Income and Savings • Banking Sector • Private sector (large, medium and small scale enterprises) • Private agents (domestic philanthropic, NGOs, Religious groups) • CSR law	• Diaspora (especially remittances bond) • International (overseas) Banks • International Capital Markets (bonds and other instruments) • Multinational companies • Private actors (philanthropists, NGOs religious institutions)	

Source: Adapted and modified based on Hurley (2016)

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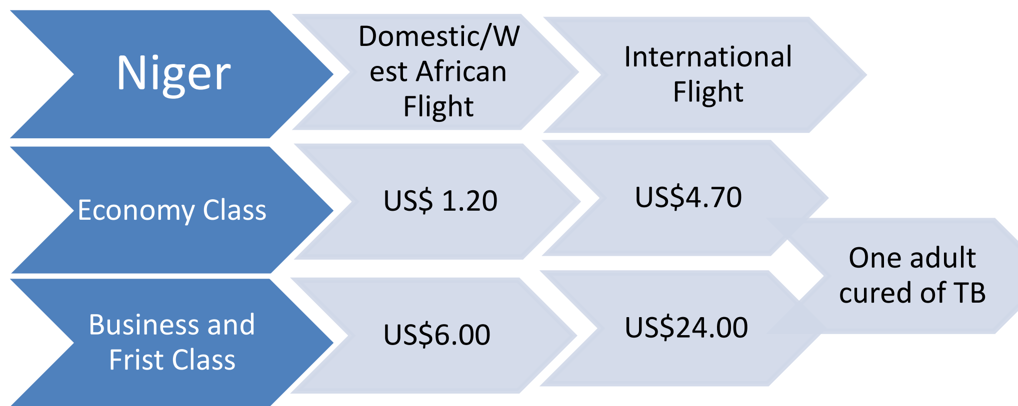
III.1 Domestic Public Financing

Both Agenda 2063 and the Addis Ababa Action Agenda (AAAA) recognise the importance of augmenting capacities for domestic public finance mobilisation. The main mechanisms in this category are (a) taxes and levies, including income taxes, value added/consumption, property taxes (b) revenues from commodities. There are also other forms of innovative taxes such as tax on activities which have negative impacts on the environment (carbon taxes, taxes on maritime and aviation transportation), but may require international agreements. The tax on airline tickets is coordinated internationally, but implemented nationally, while the financial transactions tax can be implemented nationally or internationally.

Box 1: How the Airline Ticket Tax works

The tax on airline tickets is paid by individual air passengers when they purchase their ticket and the airlines are responsible for collecting and declaring the levy and the resources are channeled into key development challenges such as treatment and care of those affected by HIV/AIDS, tuberculosis and malaria. As at 2011, countries such as Cameroon, Chile, Congo, France, Madagascar, Mali, Mauritius, Niger and Republic of Korea were implementing airline ticket tax to fund development programmes (UNDP, 2012).



In Belise, a tourism tax has been introduced and about US$3.75 is paid by a visitor at the point of departure. Also, a 20.0 per cent commission from cruise ship passenger is charged. UNDP (2016) suggested that a GSM fee can be introduced in Nigeria which can be as low as 1kobo per minute of phone calls and data usage. As Musgrave (1959) observed, resource mobilisation through taxes depends, however, on the size of the tax base, a country capacity to collect and administer taxes, tax elasticity, the volatility of sectors being taxed and commodity prices. This often limits the volume of taxes collected as is the case in Nigeria. The issuance of government debt instruments to finance sustainable development has been a long utilised option, but as Mavorots (2008) and UNCTAD (2016) noted, there should be a corresponding development of domestic debt instruments so as to bring the risk-return profiles of domestic instruments close to those of regional and international financial institutions. This will ensure that domestic savings are retained within domestic borders rather than letting them leak out of national borders.

The establishment of national development banks to finance small and medium sized enterprises, infrastructure and innovations is increasingly gaining momentum across the developing world. According to the UN (2014), national development banks in some countries finance their activities through the issuance of bonds that allocate funds raised towards a particular use such as green infrastructure. The advantage of national development banks is that they have deep knowledge of the domestic markets and can, therefore, provide relevant capacity development and assistance in project management

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but, the challenge is to ensure that the banks do not undertake activities that the private sector will competitively provide.

III.2 Domestic Private Finance

The mobilisation of private finance for sustainable development has always been a challenge not because of lack of interest but because private capital is always seeking good investment opportunities. In most cases, the private sector only commits to such prospects that meet its appetite for risk and reward. In Nigeria, despite the large and growing private sector (Banks, Oil companies etc.), their contributions to the achievement of the Millennium Development Goals was completely not available except for few private philanthropic donations in some health related goals. Sustainable Development Goal 7 (ensure access to affordable, reliable, sustainable modern energy for all), Goal 8 (promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all, and Goal 9 (build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation) are key areas among other goals that the private sector in Nigeria can provide the lead.

Ensuring an increased understanding by the private sector that their commercial interests and such public policy goals as SDGs or Africa Agenda 2063 are compatible and can be realised at the same time is important and herein lies the responsibility of key governmental private sector regulatory agencies in Nigeria such as the Central Bank, the Nigerian National Petroleum Corporation, among others. Due to a variety of reasons, many opportunities for funding key development goals are often perceived by the private sector as overly risky or uncertain. It is thus, necessary for governments and other public institutions to develop policies and programmes that will help incentivise the private sector into committing a large share of their investments into sustainable development goals. Bensoussan et al., (2013) suggested that if a government institution or a multilateral institution can offer to guarantee portions of loans made for such sustainable development goals investments, it could help the private sector to rebalance their assessments of the risk and reward and may help subsequently unlock considerable capital into development goals.

One good way that private finance can contribute to sustainable development is by stimulating the growth of small and medium scale enterprises (SMES) which are often underfunded because they are too small for commercial lending, but considered too large for microcredit financing. Even when there is ample liquidity in the banking sector as is the case in Nigeria, lending to SMEs remain low and often considered high risk. Even when the central bank adopts the 'lend to distribute' banking for MSME funds, the challenge of access from either deposit money banks or specialised banks (Bank of Industry, Bank of Agriculture). An innovative way of creating a set of instruments to serve this segment is, therefore, critical for the Sustainable Development Goals. A second important way that private finance can contribute to the sustainable development goal 1, 2 and 3 is by expanding the scope and scale of financial services offered to the poor, older persons, women, persons with disabilities and other key vulnerable populations. Recent experiences of donor agencies in the North East of Nigeria, showed that there are

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still large numbers of people that are completely unbanked. The mobilisation of household and corporate savings is only possible if affordable and appropriate financial services are available at reasonable proximity.

Private voluntary or philanthropic contributions played key roles in Nigeria during the MDGs, especially for health related goals (polio, tuberculosis etc.). The recent Presidential Initiative on the North East has also mobilised significant amounts of private sector financial support. An innovative way to increase philanthropic support for the SDGs according to Bensoussan et al., (2013) is for governments to establish national-challenge funds which can match commitments from corporations and individuals up to pre-specified limit. With this commitment, corporations, in addition to contributing their own funds, could employ innovative means to raise funds from their employees and customers. Alternatively, governments could identify priority development projects and select eligible private sector recipients for challenge fund proceeds.

In Mauritius, a Corporate Social Responsibility (CSR) law has been introduced which requires all companies to either spend 2.0 per cent of their profits on CSR activities or transfer the amount not spent to government. The law provides that every company shall use its CSR fund to implement an approved programme, or a programme under the National Empowerment Foundation. The companies may implement these projects on their own or in partnership with civil society organisations.

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III.3 International Public Finance

The most popular and important source of the international public finance is Official Development Assistance (ODA) which comprises traditional bi-lateral donor country and multilateral official outlays to developing countries often in the form of grants, concessional loans and technical cooperation. In 2002, as part of their commitments under the Monterrey Consensus of the International Conference on Financing of Development, donors agreed to significantly increase ODA in an effort to raise resources to finance the Millennium Development Goals. Following these commitments, ODA flows increased in the early 2000s, but still remained below the UN target of 0.7 per cent of donor GNI and averaged at about 0.3 per cent of GNI in 2013. Besides, ODA is currently not seen as a reliable means of financing development for many countries because it is believed to be more volatile than other capital flows (Markandya, Ponczek and Soonhwa, 2010), sometimes two to four times more volatile than domestic tax revenues (Vargas-Hill 2005) and about five times more volatile than the growth of gross domestic product (Kharas, 2008).

In Nigeria, ODA has always been insignificant, compared with the gross domestic product, but played key role in the achievement of many targets of the Millennium Development Goals (MDGs), especially in the health sector. Currently, there are huge outlays of ODA which is financing early recovery and social welfare programmes in the North East of Nigeria, especially for internally displaced persons. Interest in ODA for financing the sustainable development goals in Nigeria may increase given the present economic

downturn, but may also be coming at a time the volume of ODA as provided by donors are on the decline globally.

Recent discussions on innovative international public financing (using tax payers' funds to finance development in other countries) focus on: South-South cooperation; triangular cooperation; and debt conversion swaps. There are, however, new proposals for an IMF issuance of special drawing rights (SDRs) for financing development.

South-South cooperation as a complement to North-South cooperation is now emerging as a strong source of financing the SDGs and there are two types often discussed in the literature: emerging economy to developing economy cooperation and developing economy to developing economy cooperation. The relationship between China and Africa or between Brazil and Africa falls with the first category of South-South cooperation (SSC) which has been growing tremendously in recent times. According to the European Commission Report 'The European Union, Africa and New Donors: Moving Towards New Partnerships (2015), China is the largest provider of flows to Africa, representing about 76.0 per cent of total commitments from SSC providers over the period 2003-2012, followed by India and Kuwait, representing 6.0 per cent of commitments. Saudi Arabia, the United Arab Emirates, Turkey and Brazil together account for 5.0 per cent of total commitments. The second variant of SSC, which is being heavily promoted, is when a developing country initiative is being supported by another developing country, especially Africa to Africa cooperation. Nigeria's Technical Aid Corps (TAC) is a good example of the second variant of SSC.

Triangular Cooperation (TRc) is another emerging complement which is a partnership between traditional donor countries (e.g. Japan, Germany, USA) and emerging pivotal economy (Brazil, Thailand or South Africa) and a developing economy (e.g. Ghana, Mozambique, Malawi). One of the most cited possible benefits of SSC/TRc is the implementation of Agenda 2030 and Agenda 2063, especially SDGs 9 (Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation) SDGs 8 (Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all) and SDGs 13 (Take urgent action to combat climate change and its impacts).

Debt swaps convert existing debts of developing countries into increased expenditures on important development programmes. Under the debt swap agreements, creditors agree to forgo a portion of their claims on the condition that the debtor country spends an agreed amount on approved social or environmental programmes. Historically, there have been debt-for-nature swaps, debt-for-health swaps, debt for education swaps. Nigeria benefited from a debt-for-MDGs implementation swap in 2004 which enabled the government establish the MDGs office and embark on several programmes to achieve the MDGs, including the conditional grant scheme. The Global Fund (2010) reports that in 2011, about four debt-to-health agreements had been reached involving Germany and Austria as creditor countries, with Indonesia, Pakistan and Cote d'Ivoire as beneficiaries. Under the debt-to-health agreements, the creditor agrees to forgo payment of a portion of interest and principal on the condition that the beneficiary invests and agreed amount in health via the global fund (UNDP, 2012).

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There are also vertical funds such as Global Fund, GAVI Alliance and UNITAID. The Global Fund to fight AIDS, Tuberculosis and Malaria is a global health partnership that finances country-level programmes for the prevention, treatment and care of the three diseases, while the GAVI Alliance is a global partnership on immunisation which funds vaccines for children in the 70 poorest countries, with benefiting countries receiving support for the introduction of new vaccines. The UNITAID is a drug purchasing facility that seeks to supply affordable medicines for HIV/AIDS, Malaria and Tuberculosis to low income countries using its purchasing power to lower market prices of drugs and to create sufficient demand for niche products with large public health benefits (UN 2012).

III.4 International Private Finance

Innovative international private financing frequently discussed include diaspora bond, conventional bonds issued at the international capital markets, multinational corporations, international banks, as well as, international philanthropic individuals and agencies.

Diaspora bonds, specifically targeted at a country's emigrant population are a time tested, but still underused way to raise money for development. The pioneers of diaspora bonds, Israel and India, have leveraged them over time to raise more than US$25 billion and US$11 billion, respectively (Ketkar and Ratha, 2009). The World Bank estimated that for sub-Sahara Africa, diaspora bonds could raise as much as US$5 billion to US$10 billion annually, but so far, their potential has been almost completely untapped. According to UNCTAD (2016), the early African countries to explore issuing of diaspora bonds include, Ethiopia, Ghana, Kenya and Zimbabwe. For instance, in 2007, the Government of Ghana issued a US$50.0 million Golden Jubilee savings bond targeted at Ghanaians both at home and abroad. In 2011, Ethiopia also issued its second diaspora bond, the 'Renaissance Dam Bond', the proceeds of which were used to fund the construction of the 'Grand Renaissance Dam' at an estimated cost of US$4.8 billion. Nigeria and Rwanda have also experimented some form of diaspora bonds, but given the former's huge migrant population, it should be mobilising the highest volume of finance from such bonds if the perception of risks is at manageable levels.

International foundations and philanthropic organisations have also been identified as key to financing the SDGs. In Nigeria, the presence of the Bill and Melinda Gates Foundation, Clinton Health Initiative, among others, were helpful in pursuing health and environment based goals during the MDGs era. In addition to finance, international foundations and philanthropy often provides huge technical expertise, especially given their diverse background and global outreach.

III.5 Blended Finance

The most recent innovation in development financing is the use of blended finance instruments which are either provided by development finance institutions to leverage private finance or provided by government institutions to leverage private finance (eg through loans, equity investments etc). It can also involve a partnership between many stakeholders (civil society, philanthropic institutions, development banks and private for

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profit institutions). Blended finance is believed to be an innovative and strategic option to contribute towards the large financing gap for the full attainment of the SDGs and the Africa Agenda 2063. This is because the role of the private sector in supporting development is increasingly being realised. The IMF (2014) reported that since 2005, Africa has attracted more investment than aid and in 2013 alone, up to US$8.0 billion of total volume of impact capital reported by the Global Impact Investing Network was directed to Africa.

The key characteristics of blended finance is that risks and rewards are shared and that there is attractive benefit for the public sector (usually in terms of development objective) after the private sector is fully compensated (UNDP, 2012). Innovative types of blended finance include; impact investments, impact bonds, public-private partnerships, crowd funding and advance market commitments.

Impact investing refers to investments made into organisations, government and foundations with the intention to generate a measurable, socially beneficial or an environmental impact alongside a financial return. The term impact investment was coined in 2007 at the Rockefeller Foundation Centre and today, it primarily takes place through mechanisms open to institutional investors, mission investors but in few cases, individual investors. The investments are usually done through private equity, debt or fixed income securities, sometimes with a minimum of US$1000. With impact investing, many foundations, development banks are mobilising large pools of private capital from new sources to address the world's most critical problems. Since 2007, the growth of impact investments has been very huge and successful, partly attributed to the criticisms of traditional forms of philanthropy and international development which have been characterised as unsustainable and driven largely by the goals and whims of the corresponding donors. Big organisations participating in impact investing in Africa include the: Commonwealth Development Corporations (which is supporting the building of businesses throughout Africa and South Asia), Norwegian Investment Fund for Developing Countries (investing in the establishment and development of profitable and sustainable enterprises in developing countries), and Tony Elumelu Foundation (promoting innovating African businesses that create positive financial, social and environmental impact in key development sectors.

Closely related to impact investments are social impact bonds and green bonds. The social impact bond (SIB) is also a form of multi-stakeholder participation intended to leverage private capital for scaling-up solutions to social problems. In the SIB, philanthropic funders and impact investors will usually take on the financial risk of expanding proven social programmes. Most times, nongovernment organisations deliver the social programme to more people in need, while the government pays only if the programmes succeed. It is thus, a contingent contract with an investor for repayment on delivery of impact based results.

Crowdfunding is a practice of funding a project or venture by raising monetary contributions from a large number of people, often performed today via internet. It is a form of alternative finance which has emerged outside of the traditional financial system. The crowdfunding model is based on three types of actors: the project initiator who

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proposes the idea and/or project to be funded, the individuals or groups who support the idea and a moderating organisation called the platform (usually development organisations) that brings parties together to launch the idea. Even though average amounts raised are usually not too significant, it is estimated that in 2013 alone, over US$5.1 billion was raised via crowdfunding worldwide, which increased to US$16.0 billion in 2014 and was estimated at over US$34.0 billion in 2015. Crowdfunding can be of three types; rewards crowdfunding (where entrepreneurs pre-sell a product or service to launch a business concept without incurring debt or sacrificing equity/shares); equity crowdfunding (where the backer receives shares of a company, usually in the early stages, in exchange of money pledged) and debt-based crowdfunding (which is like a market place lending where the investors make money from interest on the unsecured loans; the system operators make money by taking a percentage of the loan and a loan servicing fee.

Advanced market commitments (AMC) has guaranteed future donor co-payments for vaccines against diseases that primarily affect low-income countries. The guaranteed demand provides an incentive for drug companies to engage in research, production and distribution of the relevant vaccines. A well-known AMC is that of pneumococcal vaccines launched in 2007 by Canada, Italy, Norway, Russia, the United Kingdom and the Bill and Melina Gates Foundation which was aimed to accelerate the development and availability of the vaccine. According to UNDP (2012), currently, the donors have committed about US$1.25 billion to guarantee the pharmaceutical companies the price of vaccines and this in turn, has provided incentives for several manufacturers to now develop products that might otherwise not be commercially viable.

Public-private partnership is also a popular blended finance instrument in Africa even though its utilisation is still low. According to UNCTAD (2016), the magnitude of PPPs is lowest in Africa, compared with Latin America, Caribbean, East Asia and the Pacific. Five countries (Nigeria, Morroco, South Africa, Egypt and Algeria) account for almost two thirds of African investments in PPP. In terms of sectoral distribution of PPPs in Africa, telecommunication ranks first (68.0 per cent), energy is second (21.0 per cent), transport is third (10.0 per cent) while water and sanitation ranks fourth with 1.0 per cent only a piece. What is required now is incentivising PPPs so as to alter the balance of sectoral distribution in favour of other key SDGs related goals.

IV. Possible Role of the Central Bank in the New Financing Model

In section 3, we reviewed key innovative development financing initiatives that exist and others that are still emerging across the world but are now being discussed in policy and academic literature. Several African countries are also in the process of developing their own innovative financial products with local peculiarities. A critical issue is what should be the role of the Central Bank and possibly by extension the fiscal authorities in developing innovative financing options for the SDGs and the Agenda 2063 in Nigeria. It is clear that rather than creating and duplicating institutional structures to manage innovative financing mechanisms, the existing monetary and fiscal authorities can be strengthened to oversee the evolution, implementation and monitoring of innovative development

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financing options for supporting government programmes and achieving the SDGs. In this section, we discussed possible roles the Central Bank of Nigeria can play in this regard.

IV.1 Country Ownership and Integration into the National Financial System Strategy and the National Development Roadmap

While there is an urgent need to increase the quantity and quality of financial resources (both traditional and innovative options) available for funding government programmes and the SDGs, it is also important that there is country ownership early enough and such financing options are carefully mainstreamed into national financial system strategy and of course, the national development roadmap. As UNDP (2012: 40) noted, country ownership involves much more than country devised financing proposals. Rather, it involves meaningful participation and inclusion in the governance structure of innovative finance initiatives. It also involves alignment behind countries nationally devised financial system and long-term development strategies, including if possible, greater use of direct budget and/or sector-wide support.

IV.2 Strengthening the legal and regulatory requirements for innovative development financing

Since governments control policy and determine the regulatory conditions that govern the space that investors are accorded, they can create the enabling environment for the acceleration of innovative development financing instruments. The legal and policy environment need to be right in order to accelerate institutional investments. Given the role of the private sector in this new model of financing, the ease of doing business should be addressed. Recent World Bank Ease of Doing Business ranking (2015) shows that out of 189 countries with 1 as being the best, Botswana ranked at 72 was the highest and best for Africa, while South Africa was 73, Kenya was 108, Ghana was 114 and Nigeria, 169. This discourages impact investors. The key constraints usually relate to infrastructure, including energy, political instability, macroeconomic instability, as well as, policy uncertainty.

In addition, a sound regulatory environment will help safeguard against possible financial crisis arising from innovative financing mechanisms given that the Basel III capital rules, especially the capital requirement directives did not consider these innovative financing instruments. Erten and Ocampo (2012) also noted that as part of international capital flows, significant inflow of some innovating financing into a country may lead to currency appreciation and the widening of current account deficits in the recipient country, which could increase the risk of financial crisis.

IV.3 Ensuring Predictability

A critical question is ‘if oil and other traditional financing mechanisms are not predictable, can the new innovative financing mechanisms be predictable?. One major criticism of the

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traditional ODA is its unpredictability which has led many low income countries not to rely on it for development planning purposes. Sometimes, there are instruments that generate more revenues in good times than in bad times i.e. being pro-cyclical which can introduce shocks frequently to the system. The design and choice of innovative financing instruments which could deliver resources in a countercyclical manner should be a clear priority.

IV.4 Dealing with new sets of financial intermediaries

Innovative development financing mechanisms may sometimes entail multiple forms of financial intermediaries such as development banks, aid agencies, NGOs, financial institutions, government entity and other special purpose vehicles. The microeconomic theory of financial intermediation may not have anticipated this diverse group playing roles as financial intermediaries. How do we deal with the agency conflicts, incentive incompatibility issues without increasing transactions costs which can itself be detrimental to the achievement of the SDGs. This is a key responsibility which the CBN should be positioned to undertake.

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