USAID/Nigeria: SO 2 Portfolio Review

MOBIS Contract #: GS-23F-9758H-001

USAID / Nigeria Economic Growth Activities Assessment

EXECUTIVE SUMMARY

David T. King, Ph.D.

April 2003

IBM Business Consulting Services
1616 North Fort Myer Drive
Arlington, VA 22209

1. Introduction

Nigeria presents possibly the most challenging development environment in the world today. It is a highly populous country, endowed with sizeable tracts of arable land, and is the world's sixth largest oil exporter. Yet its total GDP is one-fourth that of Poland, a transitioning economy three times smaller in land and people. More disturbing is Nigeria's persistent inability to grow out of its problems. GDP per capital is barely above its level at emergence from colonialism over forty years ago, and the poverty rate has actually doubled over the same period, now afflicting the seven out of ten Nigerians. Of most concern to donors and (perhaps more importantly) international investors, is Nigeria's well-deserved reputation as one of the world's most corrupt countries.

In the social area, half the population is illiterate and infant and maternal mortality rates are league-leading. In government utilities, Nigeria's total production of electricity is less than that of Bosnia, a country with one-twenty-fifth its population, and eighty percent of the non-urban population lacks a connection to electricity. One-half do not even have running water. For the country as a whole, there is an average of fifty households for each telephone land line. One of the few valuable inheritances from the colonial period, a good railway system, is now largely defunct. This deplorable record is not because Nigeria lacks ready income – its government has taken in over $300 billion during the past twenty years in revenues from oil. Nigeria must be judged one of the most poorly-governed countries in the world during the second half of the twentieth century.

With the timely demise of Abacha and the transition to an elected civilian government in 1999, there was widespread optimism, almost euphoria, about Nigeria's prospects. But actual progress against this promise in the past four years has been disappointing. While the administration and the legislature have adopted a number of reform measures, and a foundation of reform has been built in some areas, Nigeria's basic obstacles to economic development – oppressive statism and rent-seeking, a highly unfriendly business enabling environment, and severe macroeconomic policy instability – still dominate.

For these reasons it is understandable to be pessimistic about Nigeria's prospects, and skeptics are entirely justified in questioning whether investment in its development will be wasted, as it has so often been in the past. Has Nigeria done anything to show that further investment in its development will be productive?

Broadly speaking, the present assessment was commissioned by USAID / Nigeria to help answer this question, by looking at the "trial" investments that USAID has made in supporting economic growth during the four years of Nigeria's transition to democracy. Did USAID-funded activities effectively contribute to reforming macroeconomic policy, promoting competitiveness, and reducing corruption? If so, can we build on them for an effective medium-term economic development strategy going forward?

This report addresses these fundamental questions as follows:

- In order to provide the proper framework for evaluating the effectiveness of USAID's economic growth activities, it first identifies the critical obstacles to Nigeria's economic development.
- It then presents USAID's transition period economic growth (EG) program – its design, its execution, and its impact – including an evaluation of all nine of the EG project activities undertaken during this period.

- Finally, deriving from these findings lessons learned and success prerequisites, it provides prioritized recommendations for USAID activities going forward that are most likely to be effective, and most essential, in addressing the critical obstacles to Nigeria's economic growth.

Unsurprisingly in an environment such as Nigeria's, several of USAID's nine economic growth portfolio activities undertaken over the transition period fell short of desired outcomes, and only one of them can be considered an unambiguous success. But others were mostly successful, and all produced at least some forward motion. Several provided the essential analytical and strategic base on which to build further implementing assistance. Furthermore, the set of activities covered a wide front, allowing USAID / Nigeria to gain a comprehensive picture of where, how, and with which counterparts to best proceed going forward.

We conclude that well-crafted USAID development interventions for the coming five-year strategy can forcefully address Nigeria's fundamental economic growth problems at reasonable investment levels. "Well-crafted" means that they are incorporate the success prerequisites identified in the activities assessment, *i.e.*: (1) that they are situated with effective institutional counterparts, (2) that they focus on "business operations" in economic governance, and (3) that they work around the statist establishment by engaging the private sector in advancing its own microeconomic competitiveness and demanding reform.

Nigeria need not be consigned to forty more years of failure. There are "points of light" in the environment, finally. For the first time in its history, at the time of this writing, Nigeria is experiencing a second successive democratic civilian government election. The populace is overwhelmingly opposed to any return of the military to power. The international donor and NGO community is actively and widely engaged, and many foreign businesspeople operate in the country. There is no longer any real question about the failure of statist management of the economy, and the private business sector wants corruption to end and freedom to compete. These are the building blocks on which a well-designed economic development program can succeed.

We now provide an executive summary of the more detailed findings and conclusions of the report, which was prepared by a five-person team assembled by IBM Business Consulting Services, on the basis of over 100 interviews and more than 1500 pages of documents reviewed during a three-month period from November 2002 to February 2003.

2. Critical Development Obstacles

It is somewhat depressing to realize that the classic "Lagos Plan" adopted by the Organization for African Unity in 1980, the supposedly competing IMF/World Bank Accelerated Development Plan for sub-Saharan Africa presented in 1981, the Structural Adjustment Program launched in 1986, the first Nigerian Economic Summit of 1993, the Vision 2010 exercise of 1997, and the Obasanjo Economic Blueprint of 1999, all had the same broad goals of reducing Nigeria's dependence upon primary commodities, deepening the manufacturing sector, and achieving fiscal sustainability in order to achieve economic growth and reduce poverty. But as we have seen, despite all of this good planning, Nigeria is in considerably worse shape today than it was a quarter century ago.

The three major obstacles to Nigeria's economic development have not changed over this period. They are:

1. *Oppressive statism*, installed at independence with the decision by the political elite that government was most capable of controlling the “commanding heights” of the economy. In this environment, *rent-seeking and corruption* flourished and grew more and more resistant to attack. Even when well-intentioned, statism created a complex, highly interventionist, and capricious trade and tariff structure which, by shielding Nigerian producers from all competition, only ensured that they became less and less competitive. It also exposed Nigeria to perhaps the world’s most long-lasting case of “Dutch disease”, because the inrush of oil earnings to the state only entrenched its bureaucracy further and drastically expanded opportunities for enrichment from corruption.

   Statism and corruption feed each other. Statism constantly creates opportunities for rent-seeking, so rent-seekers in government naturally want to preserve statism. These are by far Nigeria’s greatest and most difficult economic problems. All proposed development support activities must first and foremost be judged as to the extent that they address this most critical obstacle.

2. *An unsupportive business enabling environment* is Nigeria’s second great obstacle to development. A business enabling environment can be considered supportive when it has three attributes: (1) an efficient system of protecting property rights, including loan collateral, (2) a financial sector that provides sufficient and reasonably-priced funding for valid business working capital and equipment investment requirements, and (3) reasonably-priced and continuous access to the basic utility inputs to production – electricity, water, communications, and transportation infrastructure.

   Nigeria is very seriously deficient in all three of these fundamental categories.

   - In common with most developing countries, the commercial law and enforcement environment is poor. Bankruptcy, secured transactions, land titling, and related law is not sufficiently supportive of the bank credit system or even of trade credit. Government administrative and registration services to business are inefficient, and judicial and administrative enforcement are ineffective.

   - Business finance is limited and expensive. Most of the limited supply of domestic savings in banks ends up devoted to trade inventory finance, much of it for consumer imports. There is virtually no long-term equipment lending from banks. State-supported development finance institutions have an extremely poor track record, with the majority of their assets unperforming, having limited resources, and prone to corruption or favoritism in loan granting. Capital markets have some institutional strengths but are shallow and not widely accessible to businesses.

     Because of its reputation for stagnation and corruption, Nigeria’s low level of domestic savings is not compensated by significant foreign investment. Most foreign direct investment is by existing multinational companies into their oil or natural resource sector subsidiaries operating in Nigeria. Roughly the same amount that comes into the country through the remittances of Nigerians working abroad – some $2 billion per year – leaves the country in capital flight by the wealthy. Foreign aid, meanwhile, is broadly offset in the balance of payments by foreign debt service.

- Poor utility services. Combined with the high cost of business finance, the expense forced on businesses because of the inability of the state, despite billions of dollars invested, to supply basic utility services, makes it impossible for them to be price competitive, despite low labor costs. Every business of any size in Nigeria, every building, must invest in a diesel-powered electricity generator, because of daily power interruptions from the state utility (NEPA). More power is generated in Nigeria by private generators than by the electric company. Beyond this universal essential, businesses often must drill their own water wells and cut their own access roads. Meanwhile, almost all freight must go by road, because the once-good rail system is mostly out of operation. Waterways need substantial investment to accommodate larger freight carriers.

  Land line telephone communications is extremely poor, with inter-city lines regularly inaccessible, and slow internet connections. However, in what is commonly viewed as the major achievement of first civilian administration, GSM licenses were sold to two private operators, who proceeded to quadrupled the number of telephone connections in the country in little more than a year. This was by far the most dramatic improvement in public utility services in Nigeria's history – but entirely due to private sector investment.

3. *Macroeconomic policy instability*, the third major obstacle to Nigeria's development, is almost entirely traceable to fiscal unsustainability, largely the result of irresponsibility in spending oil earnings, which account for three-fourths of consolidated government revenues. A ratchet effect, brought about by the tendency to spend all oil revenues when they are unusually high, but not to reduce spending when oil prices fall back, generates chronic government debt expansion. Domestic public sector debt has doubled over the years of the civilian administration. In addition, by spending instead of sterilizing excess oil revenues, the government tends to drive up the value of the naira, overvaluing it, a typical symptom of Dutch disease. If the central bank sells naira to prevent the exchange rate effect, then an inflationary effect is created. Better public expenditure management is essential to Nigeria's development.

A fourth obstacle to development in Nigeria has been the democratic transition itself. The struggle for power among largely ethnically-defined political parties has diverted the attention of the otherwise reasonably independent legislature from the needed focus on reform policy and law. As a federation of states, Nigeria also must grapple with constitutional federal-state issues, particularly in the area of sharing oil revenues.

3. The USAID Economic Growth Program

To attack these problems, USAID launched its economic growth activities in Nigeria within weeks of the inauguration of the civilian administration. It developed a detailed Results Framework and Performance Monitoring Plan for the transition period strategy, whose overarching goal was expressed as *broad-based sustainable economic growth and agricultural development.* Of four strategic objectives identified, Strategic Objective #2, the main focus of the present assessment, was defined as *strengthen institutional capacity for economic reform and enhance capacity to revive agricultural growth.* Intermediate and primary results and quantitative indicators were set with which to gauge achievement of the Strategic Objective.

The activities adopted by the Mission's Economic Growth and Agricultural development (EGA) office covered three broad areas, as follows:

Area	Activities
I. Economic Policy Reform	1. Support of the Economic Policy Coordinating Committee (EPCC)
	2. Support to the Federal Ministry of Commerce (FMC) in trade policy reform
	3. Support to the Debt Management Office (DMO) in domestic government debt management
	4. Support to the Federal Ministry of Finance's (MOF) Federal Budget Office (FBO) in budget planning and preparation
	5. Support to the National Investment Promotion Commission (NIPC) in identifying obstacles to foreign investment and strategies to address them
II. Competitiveness	6. Support for the Bureau of Public Enterprises (BPE) in privatization operations
	7. Support to private sector in evaluating and improving the competitiveness of selected Nigerian export sectors
	8. Cooperation with the World Bank in assessing private sector development prospects and needs
III. Economic Governance	9. Support for survey of corruption in Nigeria
	10. Support to develop the legal and regulatory structure for intellectual property rights
	11. Capacity-building for government sector economists

These eleven activities were undertaken through the following ten contracts:

Table 1: **Economic Growth Activities Contracts**

#	Activity	Contractor	Begin Date	End Date	Amount $ MM
1	Economic policy coordination	Nathan / MSI	Jun-01	Jun-03	2.000
2	Privatization	IBTCI	Jun-01	Mar-03	8.200
3	Foreign investment	FIAS; PwC / TSG	Jul-00	Oct-02	0.469
4	Tariffs and trade policy	Chemonics	May-00	Nov-01	1.200
5	Commercial law development	DOC	Jul-00	Sep-03	1.200
6	Anti-corruption	Casals	Sep-00	Jul-02	1.530
7	Domestic debt management	UST	Oct-00	Dec-01	0.420
8	Sectoral export competitiveness	Chemonics	Jun-01	Jul-02	2.000
9	Government economists training	Chemonics	May-00	Nov-01	0.300
10	FBO budget planning	DAI	Nov-02	Oct-04	2.000
				Total	**$19.319**

Of these ten activities, nine were evaluated for the present report. (The tenth, support for the Federal Budget Office, only started in late 2002 so did not have enough of a track record to evaluate.) The nine activities were examined in detail in the main report. The following table, taken from it, presents the assessed impact of these activities on the critical obstacles to Nigerian development identified previously. It also provides indications for continued assistance.

Table 2: **Summary of Impact on Key Economic Development Obstacles**	
Critical Obstacle	**Activity Impact**
1. Statism and rent-seeking	▪ Moderate positive impact through anti-corruption, with increased awareness from survey. Needs follow-through. ▪ Moderate positive impact through commercial law activity, with establishment of ICPC and draft Public Procurement Commission law and procedures manual. ▪ Significant positive impact through BPE, with establishment of transparent and publicized privatization process. In addition, privatizations themselves directly diminish statism. ▪ Potential significant impact through FBO project. ▪ EPCC, once it moved into PRSP facilitation, could have had an impact, but proved ineffective
2. Unsupportive business enabling environment	▪ Positive impact from DMO to the extent that it helps discipline budget deficit financing and improves availability of business finance ▪ BPE activities ancillary to privatization have had a positive impact on the regulatory environment in utilities, labor law, environment ▪ The trade policy activity has failed to have the desired impact here as yet. Needs follow-up. ▪ The NIPC activity has the potential for positive impact, if recommendations had been implemented. Needs follow-up. ▪ Export competitiveness made only a start in this area. Needs follow-up.
3. Unstable macroeconomic policy	▪ The EPCC activity was expected to be the primary contributor in this area, but failed ▪ The DMO project helps indirectly. Needs extension. ▪ Expected significant impact with FBO project. ▪ Economists training had minor positive impact
4. Democratic transition	▪ Consensus-building activities in a number of projects have built some popular understanding of the reform process and needs ▪ However, specific public awareness focus has been limited to the BPE project ▪ In general, insufficient attention has been paid to consensus-building in the National Assembly ▪ This obstacle needs greater activity focus

In addition, the extent to which the activities fulfilled the results and quantitative indicators identified in the Performance Monitoring Plan was assessed in detail. In general, those findings mirrored the conclusions contained in the above table as to particular activity effectiveness.

Summarizing broadly, three of the nine activities strongly advanced USAID SO2 goals, and contributed substantially to addressing Nigeria's development obstacles. In these activities – BPE, DMO, and commercial law – institutions were clearly strengthened and FGON policy performance was measurably improved, even if less than originally desired. In four other projects – NIPC, trade policy, anti-corruption, and export competitiveness – a foundation was set for impact that could be significant and will probably be seen in some measure, especially if effectively followed up. In the other two activities, EPCC and economists training, impact on SO2 objectives was weak.

4. Strategic Program Recommendations

Armed with these findings, lessons learned and impediments to effective impact were derived. These lessons were then incorporated in deriving the three major prerequisites for success for further interventions noted in the introduction above:

- *Effective counterpart institutions.* The most effective activities occurred in counterpart government institutions which had (i) focused, reformist leaders, and (ii) clear and well-specified functional responsibilities within the government. The best examples were the DMO and BPE. In counterpart institutions with weaker leadership or with poorly-defined mandates, projects were much less effective.

  For effectiveness, programs that support economic governance institutions should be conditioned upon the agency's having a well-defined mandate in the government and a leader with authority, clear reform commitment, and management ability.

  The same of course goes for private sector counterpart institutions – business / industry associations, public-private partnerships, or private business development service providers. Just because they are non-government does not mean they are effective. They too must have good leaders, independence, clear mandates, and active representation from actual operating companies.

- *Support activities must have an operational, business process focus*. Opportunities should be sought which improve key business processes of government, rather than relying on outstanding professional strategic capacity. The installation of computer-based business information and transactional systems, which must be used in order to award contracts, order supplies, obtain funds, register permits, licenses, collateral, and so on is highly effective in reducing the opportunity for corruption even as it improves the quality and efficiency of government services. A good example is donor assistance to the public expenditure management process in Nigeria, including the IMF, World Bank, EC, and most recently USAID's Budget Processes Support project. USAID assistance to the DMO and the BPE, and at least at a beginning stage the Public Procurement Commission, were in this category.

  Such activities are also sustainable: they leave behind embedded tools and directly relevant staff capacities.

- *A public constituency for reform must be built*. Economic reform carries initial costs, and particularly in a country like Nigeria is powerfully resisted by vested interests. The only force really strong enough to counter such resistance is popular demand. Investment in economic growth activities can be wasted without continuous public support for reform, and certainly is far more efficient with such support. Nevertheless, investment in building a public constituency is usually a stepchild of economic growth activities, and this has so far been the case in Nigeria.

A reform constituency must be built outside the government, through direct media programs, and through work with effective private sector organizations or public-private partnerships focused on improving the business enabling and investment environment, or simply on cooperating to better market their members' products.

With these success prerequisites in mind, twelve specific programmatic recommendations were developed for USAID / Nigeria's consideration in developing its medium-term economic growth strategy. These were organized in two broad areas, economic governance and private sector competitiveness, as follows.

Economic Governance

1. *Single Treasury account.* To improve government expenditure management, all GON revenue and expenditures should be consolidated into a single account that is administered according to proper business procedures. This is a high-leverage activity that requires numerous related operational improvements in fiscal management.
2. *Public Procurement Commission.* Through promoting transparent and businesslike tendering and procurement business processes, this is an essential institution in the war on corruption and in achieving efficiency in government spending. Assistance would focus on establishing detailed best-practice procurement operations, communicating procedures to spending agencies and responding to their questions, and auditing actual procurements.
3. *Public Enterprises financial management*. Major public enterprises, in particular NEPA (electric company) and NNPC (oil company) would be provided assistance in developing IAS-consistent financial reports and proper managerial accounting practices. Such assistance would help enable the restructuring and privatization of these companies, and bring desperately-needed transparency to their cash flows. Leverage is high because these two companies above all others are at the base of many of Nigeria's economic problems.
4. *Trade Policy reform*. While the trade policy activity undertaken by USAID during the transition period was disappointing in its policy impact, it did produce a good blueprint for institutional improvement. Radical revision of Nigeria's trade policy is too critical to its development to be ignored. This activity would provide a resident senior advisor reporting to the Minister of Commerce to support the setting up of the institutional structure and the adoption of liberal trade policy. This activity would also work to advance the ECOWAS goal of an integrated economic space in West Africa.
5. *Extended support to the DMO and Capital Markets development*. The clearly successful DMO project needs to be extended so that it can complete its valuable work in creating a viable domestic private market for government debt and getting the Central Bank of Nigeria out of the position of primary underwriter of fiscal deficits. This project needs to be complemented by an activity for targeted improvement of Nigerian capital markets, which appears to be the most efficient means of expanding business access to long-term finance.
6. *Public constituency-building for reform*. A sustained and professional effort must be made to get public opinion strongly behind the reform process. This activity would work

through a small number of non-government or private sector entities to develop high quality TV-focused media campaigns.

The above six activities are considered to have the highest priority in economic governance. The following three activities are also highly desirable if funding is available.

7. *National Assembly budget office*. The National Assembly lacks any institutionalized economic policy analytical capability. This proposed activity would support the creation of a budget analysis office in the Assembly, which would become a resource for all representatives for understanding budget issues and evaluating their policy alternatives, so that the Assembly can more constructively respond to executive branch budget proposals and improve its own accountability.
8. *State Governments financial management support*. Over half of consolidated government spending in Nigeria is at the State level, where management practices and rent-seeking are as bad or worse than at the Federal level. Selected states with reform-oriented administrations could be offered assistance in budget management processes. One avenue would be to extend the existing FBO project to two or three state governments, since the desirable budget operational structure is basically the same at both levels.
9. *Tax administration reform* is one of the most important and productive areas for government business process improvement, and offers promise in Nigeria because the Director of Inland Revenue is considered a businesslike reformer. However, tax administration reform is expensive because it requires major investment in information and communications technology.

Private Sector Business Development

10. *Agricultural exports competitiveness*. USAID's transition period activity in this area, along with agriculture portfolio activities, created a foundation on which to build a major market-oriented agricultural sector growth project. It is essential that Nigeria's farmers re-create effective joint marketing and extension service institutions – owned and managed by them, not by government. Strong linkages to western markets, backed by seller power through marketing cooperation, is the most effective way to promote continuous improvement in product quality and competitiveness. In Nigeria's economy, one-third of which is agricultural, this is the most important direct business development focus. At the same time, USAID's original project also built an analytical foundation in Nigeria's textile and apparel sector (which has some back-link to agriculture in natural fibers). Given AGOA, and given the demonstrated ability of a successful apparel sector to catalyze broader manufacturing growth, this sector should be included in the activity.
11. *Improving the Business Investment environment through support to NIPC.* Even though the transition period activity to set the basis for expansion of foreign investment in Nigeria did not have as much impact as desired, a very good blueprint was created (through the FIAS study and the production of an Investors' Roadmap). The activity was not followed with any implementing support to the NIPC. There must be a vocal institutional champion in the GON for thorough improvement in the business enabling environment, and the NIPC is the right place to put this, conditional upon its own commitment to professionally reorganize itself along the lines of the BPE, with which it has a close institutional relationship.

12. *Microenterprise development*. Support for the microenterprise sector in Nigeria, using tested methodologies, directly addresses poverty, stimulates broad support for reform of the business enabling environment in general, and promotes much broader access to financial services.

All three of these private sector business development activities are important, but if they must be ranked they are probably in the proper order.

Cost estimates for these projects were developed in the main assessment report. The budget for the eight highest priority projects (1-6, 10, 11 above) is approximately $6.7 million per year, of which perhaps $1.5-2.0 million could be co-funded from non-EG portfolio resources or initiative funds. The budget for all twelve recommended projects is estimated at $10.7 million annually over the first 2-3 years of the medium term strategy period.

Areas of Collaboration

The main report concluded with a review of various areas of collaboration and cooperation to enhance activity effectiveness, including (1) collaboration across sectors within USAID to address cross-cutting themes, (2) collaboration across USAID implementing partners, and (3) cooperation with other donors.

Within USAID, opportunity for collaboration with the Democracy and Governance sector was seen particularly in public reform constituency-building, but also in conflict management (with community conflict a serious problem for business development in the Niger delta), and in civil society building in the anti-corruption area. As the World Bank PRSP process moves forward, Economic Growth should bring Health and Education into the effort. Meanwhile, as is clear from the above programmatic recommendations, Economic Growth and Agriculture should closely collaborate at all times, since the principal recommended business development activity is agriculture sector-focused.

Gender-focused activities should be collaborative across sectors. In Economic Growth, microenterprise development tends to heavily promote women in business, and the various economic governance institutional support activities should leverage other sectors' gender programs to address the under-representation of women in higher levels of Nigerian government.

Finally, donor cooperation in Nigeria appears to be unusually good. Major donors communicate frequently and strive to develop complementary programs and deliver a mutually-reinforcing message. The most prominent active areas of combined donor effectiveness are in public sector financial management.

This concludes our executive summary of the 70-page Economic Growth Activities Assessment main report.