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Capital flows and current account sustainability in African economies

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Capital flows and current account sustainability: The case of Nigeria

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Table of Contents

	Pages
I. Introduction	1
II. Framework for Assessing Current Account Sustainability	2
2.1 some Basic Concepts	2
2.2 Capital Flows	4
2.3 When is the Current Account Sustainable	5
2.4 Some Indicators for Assessing Current Account Sustainability	6
III. Current Account Balances and Capital Flows: Trends and Patterns (1970-2002)	8
3.1 Trends in Current Account Imbalances in Nigeria, 1970-2002	8
3.2 Capital flows – Trends and Patterns	10
3.3 Summary: Current Account Deficits and Capital Flows to Nigeria	13
IV. Determinants of Current Account Sustainability in Nigeria	13
4.1 Model and Methods	13
V. Policy Implications – Enhancing Current Account Sustainability In Nigeria	14
5.1 The Institutional and Policy Environment – Some Good Practices	14
5.2 Enhancing Capital Inflows into Nigeria	19
V. Conclusion	19
References	21

I. Introduction

Policy-makers view the evolution of the Current Account balance as a key indicator of the health of a nation's economy. A Current Account deficit is a reflection of the strength of a developing country's economy as it measures the resources coming into a country to finance investment demand in excess of national savings. On the other hand, it can also reflect a dangerous and unsustainable imbalance between national savings and domestic investment and the accumulation of debts that cannot be serviced (Roubini and Watchel, 1997). The Current Account balance is also a focal point for measuring the economic performance of an open economy for various reasons (Roubini and Watchel, 1997). Firstly, the Current Account balance is closely related to other components of national investment and saving – the fiscal balance and private savings, it therefore has implications for overall growth. Secondly, the Current Account balance has implications for the exchange rate and competitiveness. A study of exchange rates, competitiveness and balance of payments should therefore begin with an examination of Current Account imbalances and the extent to which they are sustainable (Roubini and Watchel, 1997). Understanding the factors that affect the Current Account balance thus appears to be a good strategy for effective policy-making (Calderon, et al, 2001)

A striking feature of the Balance of Payments of African countries is the recurrent Current Account deficits, which have been described as excessive. There is general concern that prolonged Current Account deficits may become unsustainable, crowd out domestic saving or lead to economic instability, especially when financed with short-term debt or foreign exchange reserves and when it reflects high consumption spending. Given that Current Account sustainability is important for economic progress, issues of concern to Africa are; do Current Account deficits matter and are African Current Account deficits different? Is the sustainability of Current Accounts important in the case of Africa? What are the indicators of Current Account sustainability in African countries and what is the role of capital flows and other factors in Current Account sustainability in African economies? It is important to understand how African countries can establish policy prerequisites that will allow them to exploit the gains and minimize the risks associated with increased financial integration and improved Current Account sustainability.

This paper addresses some of these issues in the Nigerian context. Studies of episodes of currency crises in other regions showed that the crises were associated with large, growing and eventually unsustainable Current Account imbalances. A combination of fixed rate regimes, real appreciation, worsening of Current Accounts, short-term foreign debt accumulation, and weak financial systems, had contributed to currency crises in Mexico and South East Asia. It is therefore important to study whether the Current Account imbalances in African economies are sustainable or not.

Nigeria, Africa's most populous country is the leading oil producer in Sub-Saharan Africa and a potential economic giant. A notable feature of the Nigerian economy since independence has been the recurrence of Current Account deficits and an increase in external debt, which grew from about US\$960 millions in 1970, to over US\$30 billion by 2004. As a ratio of GDP, World Bank estimates showed that external debt was 10% in 1970, reached 110% in 1986, 143.8% in 1993 and 65.2% in 2002. Nigeria's Current Account balance has shown variation over time, it has fluctuated between deficits and surplus as oil prices varied. It showed a deficit pattern over the period 1960-73, with an average of 2% of GDP. It ranged from 0.1% in 1973 to – 4.4% in 1971. Over the period 1960-73, the cumulative Current Account deficit was approximately 33% of GDP (Adedeji, 2001). The period 1974-80 marked a turn in the evolution of the Current Account balance, there were Current Account surpluses in 1974,1975, 1979 and 1980, reflected in

substantial rises in crude oil prices. Outside these years, Nigeria had Current Account deficits. The Current Account balance ranged from 10% of GDP in 1978 to 20% in 1974. During 1981-83, the Current Account was consistently negative, the following three years were marked by surpluses as a result of trade controls during the period. Annual average of Current Account deficit to GDP for the period 1981-85 was 4.4%. The Current Account maintained a negative trend during 1986-88, except for 1987, 1989-92 marked Current Account surpluses, followed by deficits up to 1995. The Current Account was positive in 1996 and 1997, and negative in 1998. It swung back into a surplus in 1999, and in 2000, the Current Account balance was a surplus, equivalent to 10% of GDP. Thus, Nigeria's Current Account has swung between deficits and surpluses as world prices for oil changed. This sensitivity to oil prices is due to the non-diversification of the economic base.

The evolution of Nigeria's external debt also makes it important to study Nigeria's Current Account imbalances. The origins of Nigeria's debt date back to policies pursued during the 1970s oil boom that led to extreme vulnerabilities to downturns in oil prices. Successive governments emphasized heavy investment in public works which were financed by oil export earnings, some domestic financing and moderate levels of external borrowing, primarily from multilateral and bilateral sources. Most of Nigeria's external debt was contracted during the 1980s. Oil exports declined by over 50% between 1980 and 1982 (from US\$24.8 billion to US\$11.9 billion), and then by half again in 1986 (to US\$6.4 billion) as a result of lower export prices and reduced export volumes (ThisDay, 2005). Majority of Nigeria's external debt was accumulated between 1981 and 1986, when the debt stock, including late interest, increased five-fold from US\$5 billion to US\$25 billion. Over this period, the debt-service to export ratio increased from 6% to 72%. By 2002, debt service to exports ratio was 15.4% while debt to GDP ratio was 65.2% for the same year (World Bank, 2004). Recurring Current Account deficits, in addition to the evolution of external debt, make it desirable to examine the sustainability of Nigeria's Current Account imbalances.

The concept of sustainability examined in this paper is as defined in Milesi-Ferretti and Razin (1996). An earlier study of the size and sustainability of Nigeria's Current Account deficits between 1960 and 1997 showed that there were years marked by excessive Current Account deficits, and that Current Account deficits accompanied by macroeconomic instability and structural weaknesses can degenerate into an external crisis (Adedeji, 2001). The present study will extend the period of analysis to 2003, to include the period after transition to civil rule, when major economic reform programmes were initiated. The role of capital flows in enhancing Current Account sustainability will also be examined. Section two discusses criteria for assessing Current Account sustainability. Section three examines trends and patterns of Current Account imbalances and capital flows in Nigeria. Section four identifies the determinants of Current Account sustainability in Nigeria, using various indicators identified in the earlier section. Section five discusses some best practices for macroeconomic management in Nigeria, a few areas for further policy attention for enhancing Current Account sustainability in Nigeria are also mentioned. Section six concludes the paper.

II. Framework for Assessing Current Account Sustainability

2.1 Some Basic Concepts

The Current Account

The Balance of Payments records an economy's monetary transactions with the rest of the world. BOP accounts are divided into two groups – the Current Account which records transactions in

goods, services, income, and other current transfers; and the Capital and Financial Account, which records capital transfers, acquisition or disposal of non-produced, non-financial assets, and transactions in financial assets and liabilities. Since the fifth edition of the IMF Balance of Payment Manual (1993), capital transfers now include items previously included in the Current Account such as debt forgiveness, migrants' capital transfers, and foreign aid to acquire capital goods.

Components of the Current Account

Nowadays, the Balance on Current Account is the most commonly used basis for identifying imbalance in the international payment of nations. The Current Account records exports and imports of goods and services, investment income, and unilateral transfers. It is usually divided into the following main components (Heakal, 2003; Husain, 2005).

Trade Balance – This is the sum of exports and imports of merchandise goods. These include general merchandise, goods used for processing other goods, and non-monetary gold.

Net Services Balance – This is the sum of receipts and payments on exports and imports of services such as travel, freight, insurance, transportation, tourism, business services, etc.

Net Income Balance - Net income refers to receipts and payment of employee compensation to nonresident workers, and investment income (receipts and payments on direct investment, portfolio investment, and other investments and receipts on reserve assets). This includes all receipts and payments on interest on loans, profits, dividends, royalties, etc.

Current Transfers: This is the sum of all private and official transfers with nothing received in return. They include workers' remittances through banks, receipts through Exchange Companies, foreign currency deposits of residents, donations, aids and grant flows, official assistance and pensions. Net current transfers are recorded in the BOP whenever an economy provides or receives goods, services, income or financial items without a quid pro quo (unrequited). Current transfers include workers' remittances, donations, aids and grants, official assistance and pensions

Thus the Current Account includes transactions in goods, services (previously nonfactor services), and income (previously nonfactor income).

Current Account Balance

The Current Account balance (CAB) is the sum of net exports of goods and services, net income, and net current transfers (World Bank, 2001). It can be expressed as follows (Heakal, 2003)

$$CAB = X - M + NY + NCT \quad (1)$$

Where: $X - M$ = Balance of trade,

NY = Net Income abroad,

NCT = Net Current Transfers.

The Current Account is thus the sum of the balance of net exports of goods (visible trade), the balance of net export of services (invisible trade or services), investment income and other current (unilateral/unrequited) transfers (Sodersten and Reed, 1994; IMF, 1993). It can also be regarded as the difference between savings and investment (Roubini and Watchel, 1997). A country that is running Current Account surpluses is accumulating Net Foreign Assets (NFA), while a country that is running deficits is increasing her Net Foreign Liabilities. The Current

Account Deficit measures the rate at which the country is becoming indebted to the rest of the world, that is, the rate at which Net Foreign Liabilities are increasing. It measures the rate of a country's overall net international indebtedness.

2.2 Capital Flows

Foreign capital flows consist of movement of financial resources from one country to another. Foreign capital inflows can make significant contributions to the host country's economic growth and development by easing the constraints of low domestic saving and investment. They can also reduce foreign exchange constraints. Capital inflows have also helped individual countries to cushion shocks. However, capital flows tend to display a boom and bust pattern. In a world of increasingly integrated financial markets and high financial mobility, the volatility of capital flows and sudden loss of market confidence have often resulted in severe financial crises with significant domestic and international effects (Obadan, 2004).

Types of capital flows

External capital flows can be broken down into: official development assistance, export credits, and foreign private flows (Obadan, 2004).

Official flows: Official flows include official development assistance (ODA), and other official development flows (ODF). ODA consists of official grants or loans with acceptable grant elements from agencies of government or multilateral institutions aimed at supporting economic development or welfare objectives. ODFs are also loans from official lenders (government or multilateral agencies), they however are less concessionary than grants.

Export credits: These are credits designed to finance specific purchases of goods or contractors' services, the importer agrees to postpone payment to a later date. Such claims may be short-term, usually up to three to six months. In recent years, long-term export credits have developed with maturities up to ten years (Obadan, 2004). Export credits are provided either directly by the exporters or contractors, or through commercial banking channels, or by official institutions or agencies of the exporters' government (suppliers' credit, buyers' credit, and official export credit).

Foreign private flows: These comprise international bank loans and bond issues, private export credit, foreign private direct investment, and portfolio investment. International commercial bank lending usually takes the form of Eurocredits extended through the Eurocurrency/Eurodollar market. They are rolled over credits from bank consortia in which the major banks of the major industrial countries participate. International bond markets deal in medium- and long-term credits through the issue of bonds. Foreign direct investment (FDI) is a form of capital flow in the area of equity participation, and it is aimed at acquiring lasting and controlling interest in an enterprise operating in an economy other than that of the investor. Portfolio investment refers to the holding of transferable securities, equity shares, debenture bonds, promissory notes and other money market instruments issued in the domestic markets of other countries. Portfolio investors do not exercise management functions, they are only entitled to dividend and/or interests.

Of these capital flows, short-term flows such as renewable loans and portfolio investments are the most problematic because of their high degree of volatility and liquidity as they are easily and quickly sold or withdrawn. Given this background, we shall examine Nigeria's Current Account Balances from 1970 to 2002 in the next section of the paper.

Capital Inflows: Capital Inflows KI can be defined as follows (Calvo and Reinhart, 1999):

$$KI = CAD + \Delta R \quad (2)$$

Where ΔR reflects accumulation of international reserves. Note that:

$$KI - \Delta R = \text{Growth of International Indebtedness} \quad (3)$$

The net value of the balance of direct and portfolio investment defines the Balance on Capital Account. The major components of the financial accounts are: direct investment, portfolio investment, other investment and reserve assets. The net value of the balance of direct and portfolio investment defines the Balance on Capital Account.

International Reserves: International Reserves, R, are defined as official holdings of short-term liquid assets by foreign governments (Calvo and Reinhart, 1999).

2.3 When is the Current Account Sustainable?

Popular analysis suggests that large Current Account deficits are a sign of disequilibria and should be brought under control. The standard analysis is usually based on the concept of “sustainability”. There is no simple rule to help one determine whether a Current Account deficit is sustainable or not. However, a number of criteria, which can be used in assessing Current Account imbalances have been developed (Milesi-Ferretti and Razin, 1996; Roubini and Watchel, 1997; Edwards, 2000). Experience has shown that balance of payments crisis can be linked to one or more of these root causes (Roubini and Watchel, 1997). A country can run Current Account deficits for some time and remain solvent as long as there are surpluses at some time in the future. However, a dynamics of the Current Account that leads to an increase without bounds of the foreign debt to GDP ratio will be effectively unsustainable. This is because the financial markets will become concerned about the country’s ability and willingness to repay its debt and will therefore limit their borrowing, leading to a foreign debt crisis.

A non-increasing foreign debt to GDP ratio is seen as a practical sufficient condition for sustainability (Roubini and Watchel, 1997). This condition can be restated as follows (Folkerts-Landau, 2000):

$$\frac{CAD}{GDP} = g \frac{NFL}{GDP} \quad (4)$$

Where g is the rate of growth of GDP

Equation (4) states that countries (developing or growing) can generate Current Account deficits continuously while maintaining a stable ratio of Net Foreign Liabilities to GDP. The accumulation of Net Foreign Liabilities is proportional to the rate of growth of GDP, such that the ratio of NFL to GDP is constant.

Following the Mexican financial crisis, in an IMF post-mortem, the Director of the Western Hemisphere Department and Chief of the Mexico Division wrote as follows: “large Current Account deficits, regardless of the factors underlying them are likely to be unsustainable” (Edwards, 2000). Secretary Summers went on to say that “close attention should be paid to any Current Account deficit in excess of 5% of GDP, particularly if it is financed in a way that can lead to reversals.” (Edwards, 2000).

Milesi-Ferretti and Razin (1996) argued that, *ceteris paribus*, a Current Account deficit is likely to be less sustainable if: (1) it is large relative to GDP, (2) the imbalance is due to a reduction in national savings rates rather than an increase in national investment rates, (3) national savings rates are low.

Specifying an operational definition of sustainability, it can be argued that a Current Account deficit is sustainable as long as no external crisis occurs. External crisis can come in the form of an exchange rate crisis or a foreign debt crisis. An exchange rate crisis can be a panic that leads to rapid deterioration of the currency or a run on the central bank's foreign exchange reserves. A debt crisis could be inability to obtain further international financing, or to meet repayments or an actual default on debt obligations (Roubini and Watchel, 1997). A sustainable Current Account is one that can be maintained without any of these crises occurring. We now examine some of the criteria for assessing Current Account sustainability.

2.4 Some Indicators for Assessing Current Account Sustainability

Various authors have classified indicators for assessing Current Account sustainability in different ways. Milesi-Ferretti and Razin (1996) classified them into the following groups:

- Structural factors: savings and investment ratios, economic growth rates (overall and sectoral), openness (ratio of exports to GDP), composition of external liabilities (short-term versus long-term), capital flows, financial structure, and capital account regime (open).
- Macroeconomic policy stance: exchange rate flexibility and policy, and fiscal balance (public sector deficits).
- Political economy: political instability/policy uncertainty, and market expectations.

In their study of Current Account sustainability in transition economies, Roubini and Watchel (1997) classified indicators as follows:

- Sources of Current Account deficits (investment and savings rates, rate of growth of output and fiscal balance).
- Composition of Current Account: trade deficit/surplus and factor income from abroad.
- Composition and size of capital flows: short-term capital inflow, foreign direct investment (FDI), portfolio flows, and official flows. Portfolio flows were more volatile while FDI and official flows were more stable than short-term flows.
- Real exchange rate appreciation.
- Foreign exchange reserves and debt burden.
- Fragility of the financial system, and
- Political instability and uncertainty about the economic environment.

In their own analysis of African Current Account deficits, Calderon et al (2001) defined the following classes:

- Domestic economy factors: domestic output growth, public and private savings, and macroeconomic uncertainty.
- External sector: openness (exports as percentage of Gross National Domestic Income), black market premium, balance of payment controls, terms of trade, real effective exchange rate, international aid, and external debt.
- Evolution of world economy: growth rate of industrial economies and international real interest rate.

In this analysis, we adapt Milesi-Ferretti and Razin's classification which distinguishes three classes of factors as described above (Milesi-Ferretti and Razin, 1996). Only those considered in this analysis are discussed in this section (Milesi-Ferretti and Razin, 1996; Robini and Watchel, 1997). They are:

Structural factors: Structural factors considered include – savings and investment ratios, annual growth rate of GDP, ratio of exports to GDP, capital flows (net inflow, remittances, FDI), financial structure (ratio of M2 to reserves).

Macroeconomic stance: Variables indicating this include real exchange rate, fiscal balance (budget deficits), and external debt.

Political economy: These include political instability, international interest rate.

A brief description of the indicators to be used in the analysis of Nigeria's Current Account imbalances will be now be presented.

Savings and investment ratios: Since the Current Account balance is determined by the difference between national savings and investment, a Current Account deficit can emerge from either a fall in savings or investment. Since running a Current Account deficit involves borrowing from abroad, this is less dangerous if it is used to finance investment rather than consumption (lower savings). Higher investment rates will increase productive capacity and potentially higher exports which can be used to service the foreign debt. High savings and investment ratios also signal credit worthiness to international investors.

Growth rate of output: Rapidly growing economies can sustain persistent Current Account deficits without increasing their external indebtedness relative to GDP. High GDP growth rates tend to lead to higher investment rates as expected profitability increases. Higher growth rate will usually lead to a smaller increase in the foreign debt to GDP ratio and make the country more liable to service its external debt (Roubini and Watchel, 1997).

Openness – ratio of exports to GDP: To service its foreign indebtedness, a country needs to rely on the production of traded goods as a source of foreign exchange. Countries with large export sectors can service their debts more easily because debt service will absorb a smaller fraction of total export proceeds. However, a more open economy is more vulnerable to external shocks such as fluctuations in terms of trade or reductions in foreign demand. A Current Account imbalance may therefore be less sustainable if it derives from a large trade deficit rather than a large negative factor income. The ability of a country to sustain deficits is also weakened if it has a narrow export base or is very dependent on raw materials for its imports.

Composition and size of capital flows The composition of capital flows is also an important determinant of Current Account sustainability. With regard to equity, portfolio investment is usually more volatile than foreign direct investment. A Current Account financed by large inflows of foreign direct investment is more sustainable than a deficit financed by short-term flows that can be reversed if market conditions change. Inflows from official creditors are also more stable and less reversible in the short run than private flows.

Composition of external liabilities: With regard to debt, the maturity structure, currency composition and interest structure of the debt affect a country's vulnerability to shocks. Short term maturities, bunching of debt redemption, foreign currency denominations and variable

interest rates all increase risks of vulnerability as they magnify the impact on the debt burden (Milesi-Ferretti and Razin, 1996).

Financial structure: The depth of the domestic financial system is also important in determining a country's ability to sustain a Current Account deficit. Lack of confidence in the banking system will inhibit willingness of foreign investors to finance the Current Account deficit by investing in the economy. Bank supervision is therefore very important.

Exchange rate flexibility and policy: The degree of exchange rate flexibility in response to external shocks also affects an economy's ability to sustain Current Account deficits. A rigid exchange rate regime may be the target of speculative attacks that precipitate an external crisis.

Fiscal balance: Large and persistent structural fiscal deficits may result in an unsustainable build-up of foreign debt.

Political instability: *Political instability influences all the factors discussed above. Political instability increases domestic and foreign investors' susceptibility to sudden policy reversals, reducing credibility of the current policy stance. It can also lead to capital flight. Studies have associated political instability with high inflation, low investment and low growth (Milesi-Ferretti and Razin, 1996). Indicators of instability include frequency of change of government, or attempted coups or measures of industrial strife. The political situation can affect sustainability of external liabilities in different ways. A weak government may lack the will to undertake required economic adjustment/reforms needed to respond to a shock. A government facing an election may be unwilling to implement adjustment measures so as not to jeopardize its chances of winning the election. It is however difficult to devise indicators for measuring these political factors (Milesi-Ferretti and Razin, 1996).*

III. Current Account Balances and Capital Flows: Trends and Patterns (1970-2002)

3.1 Trends in Current Account Imbalances in Nigeria, 1970-2002

Table 1 shows some of the components of Nigeria's Current Account for the period 1970-2002.

Imports and exports: Table 1 shows that the values of imports and exports have fluctuated over time although they have tended to be increasing. Export values have varied with the price of crude oil in the world market. Imports have also generally been on the increase over time. Exports as a proportion of GDP increased from 10% in 1970 to 52% in 1980 and have declined thereafter. In 2002, export to GDP was about 4%. (See Table 3) This has implications for the country's ability to generate sufficient foreign exchange to service her debts.

The balance of trade: Nigeria's merchandise trade balance is dominated by oil exports. From the table, it can be seen that the balance of merchandise imports and exports (the balance of trade) was positive for most of the years, it was only negative during the years 1978, and 1982 and 1983 when Nigeria experienced a fall in the prices of her main export – crude oil. The balance of trade in non-oil exports has been consistently negative for most of the years covered (figures not shown). In years of high oil prices, the trade balance moves strongly into a surplus.

Services and investment income: Table 1 shows that net services and investment income were negative for all the years, that is, Nigeria is a net importer of services, while she earned little from investment abroad. Nigeria runs persistent deficits in net income because of her reliance on foreign oil company partners to operate its oil and gas facilities and because of its repayments on her substantial foreign debt. Data show that direct investment income remittances (DIIR) were insignificant at the end of the 1950s, but had become substantial by the end of the 1960s. Net income payments to foreigners averaged only N12.6 million in 1955-1960 compared with N118.7 million for 1955-1973. Remittances have been on the increase over time, and increased substantially during the SAP period. DIIR increased from N1,599.8 million or 13.6% of merchandise exports in 1987 to N4,261.7 million or 47.1% of merchandise exports. Thereafter, increases in remittances were phenomenal, rising from N18,739 million in 1989 to N399,578 million or 20.5% of merchandise export earnings by 2000. Table 2 shows remittances as a percentage of GDP and merchandise exports. The repatriation of DIIR in Nigeria has been very high in both absolute terms and as proportion of merchandise exports earnings, net capital inflows and foreign reserves. Net service and income outflows to GDP peaked at 26% in 1993, and has generally remained at between 10% and 17% for most of the years between 1990 and 2003 (Table 3). This reduces the contribution of FDI to the Nigerian economy and also places stress on the Current Account balances in the balance of payments. There is a need therefore to encourage multinationals to reinvest larger proportions of their earnings in productive activities in Nigeria.

Transfers: Current transfers moved from a negative figure to surplus from 1987. This period coincided with the beginning of the Structural Adjustment Programme when many Nigerian professionals started to leave the country. Nigeria now receives a persistent annual inflow of transfers from Nigerians who work abroad. Net transfers are becoming more significant, amounting to about 3% of GDP in 2002 and 3.68% of GDP in 2003.

The Current Account Balance

Table 1 shows that Nigeria's Current Account balances have fluctuated between deficits and surplus, depending largely on the price of crude oil. This is not surprising since oil contributes 90-95% of Nigeria's export earnings as well as about 40% of GDP and 80% of government revenue. The country's Current Account and overall balance of payments reflect changes in the world prices of crude oil and Nigeria's obligation to OPEC to restrict its crude oil production and exports. It was negative from 1970 to 1972, but was positive in 1974, 1975, 1979 and 1980, because of the substantial increases in the price of crude oil as well as stringent exchange controls during the period 1977-1980. The Current Account was consistently negative from 1981-1983 and positive from 1984 till 1992. It was negative from 1993 to 1995 after which it swung into a surplus. It was negative in 1998, but has been positive from 1999 to 2002. Overall, the Current Account has been in deficit for slightly less than half of the period covered, and surplus for over half of the period. The behaviour of Nigeria's Current Account has been sensitive to developments in the world crude oil market, reflecting the non-diversification of the economy and dependence on crude oil.

As a proportion of GDP (see Table 3), the greatest period of concern was between 1981-1983 when the Current Account deficit averaged over 10% of GDP – 12.71% in 1981, -14.01% in 1982, and -7.58% in 1983. This period also marked the scaling up of Nigeria's debt problem. Nigeria's external debt rose sharply from 1982 onwards, and continued to increase until 1996. External debt service as a proportion of GDP also increased from 1981 and remained high up to 1996.

A deficit Current Account balance reflects an economy that is a net debtor to the rest of the world, it is investing more than it is saving and using resources from other countries to meet its domestic consumption and investment requirements. Nigeria's external debt rose very sharply during the period she was experiencing persistent deficits. Financing the Current Account deficits through borrowing created debt servicing problems and a debt overhang for Nigeria. The analysis of Nigeria's Current Account balances suggests that Nigeria's deficit stems from a rise in foreign investments and the accompanying increased obligation to pay investment income, debit on trade in services, and debit on trade in non-oil exports. The burden of debt service repayments has also contributed to the Current Account deficits. The surpluses recorded for several years derive from trade in oil exports, and increasing net current (unrequited) transfers arising mainly from migrant workers' remittances from abroad.

However, Nigeria has experienced Current Account surpluses as often as it experienced deficits. A country with Current Account surpluses is using some of its output to build up claims on the outside world. While rich countries can afford to do this, a growing country like Nigeria should be trying to acquire additional resources for capital formation in order to promote development. Nigeria should rather run Current Account deficits and build up debts to the outside world. This is what countries like the United States did for most of the nineteenth century. A Current Account deficit is not bad if it can be financed on acceptable terms and if the proceeds of borrowing are used effectively. A country runs into trouble if it borrows at high interest rates or if it has to refinance its debts at interest rates higher than those at which it borrowed initially, or if it fritters away borrowed resources on consumption rather than investing them. This is what happened to Nigeria, where arrears of interest and higher interest rates resulted in Nigeria paying back more than it borrowed while the debts kept on increasing in value.

3.2 Capital Flows – Trends and Patterns

The Capital and Financial Account

While a Current Account deficit is financed by Capital Account transactions, the magnitude and sources of capital flows are very important in determining sustainability of Current Account deficits. The basic distinctions in the capital account are between private and official transactions, between portfolio and direct investment, and by the term of the investment (short or long term). Table 2 shows trends in Nigeria's capital flows.

Portfolio Investment: Portfolio investment is relatively recent in Nigeria. Up to the 1980s, Nigeria did not record any figures on portfolio investment inflow in her balance of payment accounts. The non-participation of international investors was due to the non-internationalization of the country's money and capital markets (Obadan, 2004). Since 1986, the portfolio investment account has featured data on promissory notes issued by Nigeria to her foreign trade creditors (inflows), and the value of redeemed notes under the Debt Conversion Programme (outflows). It is not surprising therefore that, the 1990s recorded net outflows of portfolio investment. In Nigeria, the portfolio investment in the Balance of Payments include: transactions in bonds, debentures and notes, as well as non-direct investor equity, preferred shares or stocks, mutual funds and investment trusts. It also includes transactions in money market instruments such as treasury bills (Olisadebe, 1995). The table shows that the level of portfolio investment is low in Nigeria. The net portfolio investment flow was negative from 1990 to 1997, but has remained positive since then. The main reason for poor performance is the absence of an enabling environment. Impediments include political instability and weak macroeconomic fundamentals. They also include structural weaknesses manifested in the high transaction costs of doing business. Trading in portfolio investment also demands sophisticated, open and internationalized

money and capital markets with relative ease of investment and divestment under conditions of liberalization. Although efforts are being made to promote the internationalization of Nigeria's domestic money and capital markets, progress has been slow.

Foreign Direct Investment (FDI): Foreign direct investment flows fall into two categories – foreign investment for the establishment of new enterprises and foreign investment inflow through existing enterprises (Odozi, 1995). Foreign investment for establishing new enterprises comes mainly in the form of machinery and equipment, and foreign currency imported at the establishment of the enterprise. Inflow for existing industries could be for expansion or working capital support. Foreign direct investment inflows into Nigeria have not been very impressive (see Table 2). Inflows of FDI increased from N251 millions (4.8% of GDP) in 1970 to N786.4 millions in 1980, and to N2,193.4 millions in 1982, but declined by 1983 to N1,423.5 million. Inflows of FDI increased substantially during the Structural Adjustment Programme, rising from N4,024 millions (5.6% of GDP) in 1986 to N42,624.9 millions (6.2% of GDP) in 1993. Inflow of foreign investment averaged only 3.4% of GDP between 1970 and 1995. However, as a proportion of Gross Fixed Capital Formation, FDI inflows were more significant, averaging 22% between 1970 and 1995, with fluctuations (see Table 3). The marked rise during the SAP period was due to various factors such as: the devaluation of the Naira, favourable investment policies such as the establishment of the Industrial Development Coordinating Committee, restructuring and streamlining of incentive policies, export stimulation and expansion policies, privatization and commercialization programme, and the shift from regulation to liberalization and other market-based arrangements (Obadan, 2004).

Foreign investment outflow has also increased, from N129.4 millions (2.5% of GDP) in 1970 to N519.7 millions by 1977. Like the inflows, outflows were also highest during the SAP and immediate post-SAP era, rising to N10,450.2 millions in 1990 and N9,630.5 millions in 1993 (figures not shown). In the context of a country's BOP, net inflows can positively or negatively influence the overall position in the external sector. A net outflow of FDI implies divestment of foreign interests or capital flight. The table shows that outflows were generally less than inflows for most years, that is, net investment flow was positive for most years, except 1989-1990 when it was negative.

Official flows: Official flows were persistently negative for all years, starting from 1977 when entries were recorded in the BOP. This is because they include a large volume of past borrowings from multilateral lenders such as the World Bank and the IMF. The official accounts have resulted in net outflows as amortization payments on existing debt have consistently exceeded new loan disbursements for all years covered.

Short and long-term capital flows: Flows of private capital are largely related to oil and gas facilities. Because of the joint venture agreements under which these facilities are built, the investment inflows are categorized as investments rather than as loans. Table 2 also shows that other long term private capital flows were consistently negative, while short term capital flows were negative for several years. Negative flows suggest that foreign investors were divesting from the Nigerian economy, that is, there was massive capital flight out of Nigeria.

The Capital and Financial Account Balance

The net value of the balances of direct and portfolio investment defines the balance on Capital and Financial Account. A surplus on Capital and Financial Account represents an increase in the nation's liabilities to foreign interests. It can lead to a Current Account deficit when it generates obligations in the form of investment incomes to overseas investors. However, it can offset the

Current Account deficit if foreign investments generate domestic incomes in excess of the costs of servicing foreign investments (Rankin, 1997). Nigeria's Capital and Financial Account has been largely negative (see Table 2). This is due to the massive capital flight from the economy as foreigners divested their interests and domestic investors preferred to invest abroad (It could also include transfers of illegal wealth abroad by corrupt public officers)..

Overall Balance of Payments Balance

What matters for each country is its overall Current Account and Capital Account balances with the rest of the world (Stanford, undated). The overall balance is equal to the sum of the Capital and Current Accounts. It is also equal to the change in foreign reserves. That is, the sum of the Current Account (CA) and Capital Account (KA) of the Balance of Payments is equal to the change in the official foreign reserves of the country (Δ FAG) or:

$$CA+KA = \Delta(FAG) \quad (5)$$

A Current Account deficit requires a Capital Account surplus to offset the deficit, that is, it requires a capital inflow (net new borrowing) from the rest of the world to finance the deficit. Thus, a positive Capital and Financial Account as the counterpart of a negative Current Account implies that the country is accumulating debt or losing out on its stock of assets (Mueller, undated). The converse is that a positive Current Account surplus and a negative Capital and Financial Account deficit implies that the nation is reducing its debt and acquiring foreign assets. If the Current Account is in deficit and the Capital Account in surplus to the same extent, then the overall BOP balance remains zero. The situation is problematic if both the Current and Capital Accounts are in deficits, that is, the capital inflow is insufficient to finance the Current Account deficit. In that case, reserves have to be drawn down or new debts contracted to finance the deficit.

Table 2 shows that the overall Balance of Payments has been negative from 1986 to 1999, except for 1997 when it was positive. It was positive in 2000 and 2001, but negative again in 2002 and 2003. As a percentage of GDP, overall balance was -8.4% in 1997, +4.4% in 1998, -10.2% in 1999, -10.3% in 2002, and -2.2% in 2003. As a result of negative balances, Nigeria has persistently drawn down her foreign reserves for most of the years covered by this analysis. However, Nigeria's has been accumulating reserves since 2002 largely as a result of the very favourable market for crude oil which has resulted in Current Account surpluses. Nigeria has continued to record negative overall Balance of Payment balances since 1986 because of deficits in her Capital Account for several years. A major factor in Nigeria's overall performance is her external debt and liabilities.

The ability to sustain deficits depends on a country's stock of international assets. An existing large burden of international debt will make it more difficult to finance a country's Current Account imbalances. A large debt-servicing burden can easily exhaust export revenues and preclude imports of investment goods required for growth. The debt burden creates a trap that inhibits any growth policies (Roubini, 198). Foreign exchange reserves and a small debt burden reduce the risk of unsustainability and enable a country to finance a deficit at a lower cost. Table 3 presents some statistics on the severity of Nigeria's external debt and liabilities. Capital flows as a proportion of GDP are still very low. Investment income remittances to GDP and especially remittances to exports ratios are very high. Similarly, debt service to export ratios are very high. Persistent Current Account deficits increase a nation's indebtedness to the rest of the world. The higher the debt to GDP and debt to export ratios, the more difficult it is for a nation to service her debt. A high debt burden results in a net capital outflows from the economy. Thus the main

issues for Nigeria are how to increase the volume of non-oil exports, monitor her debt, and increase net capital inflows into Nigeria.

3.3 Summary: Current Account Deficits and Capital Flows to Nigeria

The following conclusions can be made from the analysis of Nigeria's Current Account balances and capital flows:

- Nigeria has experienced recurrent Current Account deficits over the years. The deficits have reflected fluctuations in the world price of crude petroleum, Nigeria's main export product. The Current Account has been positive in the last few years because of improved prices of Nigeria's primary export (crude oil).
- The Current Account deficits were not usually prolonged, averaging about three years before the Current Account swings into a surplus.
- The legacy of past levels of Current Account deficits was a large and rapidly growing external debt stock, rising to about US\$ 34-36 billion by 2005.
- Net capital inflows into Nigeria have been largely positive, however, net inflows have not been substantial as a proportion of GDP.
- Foreign direct investment has increased over time. As a proportion of GDP, it has not been substantial. However, as a proportion of Gross Fixed Capital Formation, foreign direct investment has been more significant.
- The balance of trade in services has been persistently negative for all the years suggesting that Nigeria is a net importer of services.
- Nigeria is now benefiting from migrant workers remittances from abroad, there is a growing positive balance on current (unrequited) transfers from abroad. The figures have become substantial over the years, especially since 1985.
- There is a growing negative balance on investment income. Direct Investment Income Remittances abroad have been very substantial as a proportion of GDP and especially as a proportion of merchandise exports.
- Nigeria's Current Account deficits were fuelled by: rising investment income going to foreigners, deficits in non-oil exports, deficit on the balance of trade in services. Surpluses were due to rising export income from crude oil (when prices are favourable), growing current transfers in the form of migrant workers' remittances.
- Nigeria's Capital and Financial Account has recorded deficits since 1985 (except for 1994 and 1998 when surpluses were recorded), suggesting massive capital flight by domestic investors who have preferred to invest in foreign assets.
- Overall, the Balance of Payments has recorded deficits, especially since 1987. As a result, Nigeria has been drawing down her foreign reserves. However, since 2002, Nigeria has been building up her reserves, largely due to improved prices in the crude oil market. As at now, the foreign reserves were about US\$27 billion at the end of August (Ministry of Finance/Central Bank of Nigeria, 2005).
- Nigeria's external liabilities and debt appear to have played a very significant role in the country's overall relatively poor economic performance.

IV. Determinants of Current Account Sustainability in Nigeria

4.1 Model and Methods

The objective here was to analyze the various determinants of Current Account balances in Nigeria in order to determine their likely impacts on Current Account balances. A dummy

dependent variable was estimated (Current Account Balance equals 1 if deficit, and zero if surplus). Current Account balances were hypothesized to be a function of structural, macroeconomic and external variables as discussed in section 2 of this paper. The operational set of variables were: savings and investment ratios, export/GDP ratio, trade balance, government fiscal deficit, debt/export ratio, net capital inflow, net current transfers, remittances- export ratio, regime change, and lag of Current Account.

Data: Data for the period 1975 to 2001 were used in the analysis. The Microfit 4.1 for Windows was used in estimating the equations. Different alternative specifications were estimated, most of the variables were not statistically significant. The equations reported here suggest that only Trade Balance/GDP, Domestic Interest Rate, and Exchange Rate were statistically significant (see Equation 6 below).

$$\text{CAB} = 15.75 - 77.349\text{TBG} - 0.413\text{INR} - 0.033\text{EXR} + 20.424\text{M2G} \quad (6)$$

(1.749) (-1.740) (-1.821) (-1.841) (1.169)

Goodness of Fit = 0.92593
Pseudo- R-squared = 0.69235

Where:

- CAB = Current Account Balance = 1 if deficit.
- TBG = Trade Balance to GDP ratio
- INR = Domestic Interest Rate.
- EXR = Real Exchange Rate
- M2G = Ratio of M2 to GDP

The equation suggests that the Current Account is more likely to be in deficit the lower the Trade Balance to GDP ratio, the lower the Domestic Interest rate, and the lower the real Exchange rate (that is, an appreciation of the domestic currency). In other specifications, the likelihood of the Current Account being in deficit was higher, the higher FDI (because of investment income flows out of the country), the lower Export to GDP ratio, and the higher debt service to export ratio. They were however not statistically significant. The Current Account was more likely to be in deficit the higher government fiscal deficits, this was only marginally significant in one specification. The lag of Current Account balances was positive but not statistically significant, suggesting that deficits were not persistent. Trade Balance to GDP was consistently statistically significant in several specifications. Thus, the results imply that Nigeria has to make efforts to increase her Trade Balance, as well as improve her interest and exchange rate management in order to ensure that the Current Account deficit remains sustainable. Efforts should also be made to reduce government fiscal deficits.

V. Policy Implications – Enhancing Current Account Sustainability in Nigeria

5.1 The Institutional and Policy Environment – Some Good Practices

From the analysis of trends in Nigeria’s Current Account balances in the last two sections, this section describes some best practices in macroeconomic management in Nigeria which can enhance the institutional and policy environment for increasing trade and capital inflows. The variables of interest are: the exchange rate policy, the financial and capital market, and Nigeria’s debt management policy.

1. Debt Management Strategies in Nigeria

Nigeria has adopted various strategies over the years to manage her external debt. They include the following (Obadan, 2004).

- Embargo on new loans. This was applied in 1984 and then in 1996.
- Limits on maximum external borrowing.
- Directives to state governments to restrict their external borrowing.
- Limits on debt service payments.
- Other strategies include:
 - Debt restructuring entailing refinancing of trade arrears, rescheduling of debts, debt buyback, collateralization and new money options.
 - Debt conversion programme, and
 - The new external borrowing policy.
 -

In 2000, the Federal Government of Nigeria established the Debt Management Office (DMO) it commenced operations on October 4, 2000. It was set up by the Federal Government to centralize and professionalize the management of Nigeria's public debt. Before then, responsibilities for debt servicing were split across seven different agencies or departments, namely:

- External Finance Department of the Federal Ministry of Finance,
- Multilateral Institutions Department/African and Bilateral Economic Relations Department of the Federal Ministry of Finance,
- Home Finance Department of the Federal Ministry of Finance,
- Treasury Department of the Office of the Accountant General of the Federation,
- Debt Management Department of the Central Bank of Nigeria,
- Debt Conversion Committee Secretariat of the Central Bank of Nigeria,
- Public Debt Office of the Central Bank of Nigeria.

This duplication of efforts resulted in several shortcomings, including (Debt Management Office, 2002):

- Diffusion of debt management responsibilities across numerous agencies, leading to inefficiencies and coordination problems;
- Inadequate debt data recording system and poor information flow across agencies, resulting in inaccurate and incomplete loan records;
- Complicated and inefficient debt service arrangements which created protracted payment procedures;
- Low quality human resources and poor incentive systems; and
- Lack of a coherent, well-defined debt strategy.

One manifestation of this was that although Nigeria originally borrowed about US\$17 billion, after paying back US\$22 billion, she was still said to be owing US\$34-36 billion. Nigeria's debt grew rapidly because of accumulation of debt service arrears and the escalation of market interest rates. In a bid to address these problems, the President requested from the World Bank the services of Dr. Ngozi Okonjo-Nweala, the then highest-ranking Nigerian at the World Bank (and presently the Minister of Finance), who worked as a Special Adviser to the President. During her

six-month assignment, she conducted a number of studies of the Nigerian economy, and recommended the establishment of a number of offices within the Presidency, such as the Debt Management Office and the Economic Policy Coordinating Committee (EPCC). Upon acceptance of the recommendations, the Debt Management Office was set up and commenced work in October, 2000.

Objectives/Mandates of the DMO

The main objective of creating the DMO was to consolidate debt management functions under a single umbrella to ensure proper coordination. The DMO centralizes and coordinates the country's debt recording and management activities, including debt service forecasts, debt service payments and advising on debt negotiations as well as new borrowing. The DMO's specific functions include:

- Maintaining a comprehensive inventory of loans together with forecasts of debt service;
- Provision of timely and accurate information on the country's debt to assist policy makers and improve transparency in debt management;
- Effecting debt service payments accurately and on time;
- Managing the country's debt portfolio so as to minimize returns with an acceptable risk profile;
- Advising government on borrowing policy;
- Assisting in formulating and implementing the country's debt management strategy, ensuring appropriate linkages to fiscal and monetary policies as well as overall macroeconomic management; and
- Negotiating with, and securing debt relief from the Paris Club and other creditors.

Successes achieved: The DMO which is part of the President's Economic Technical Team, has achieved some success in streamlining Nigeria's external debt. After persistent international shuttling by the President and his economic team, the Paris Club has agreed to enter into negotiations with the Nigeria authorities on a comprehensive debt treatment. The Paris Club took note of Nigeria's economic reform programme implemented since 2003, and her willingness to take advantage of her exceptional revenues (from crude oil sales), in order to finance an exit treatment from the Paris Club. The debt treatment would include debt reduction up to Naples terms on eligible debts and a buy back at a market related discount on the remaining eligible debts after reduction (Paris Club, 2005). By this agreement, Nigeria is to obtain a debt relief of about 67% of her present debt amounting to about US\$ 18 billion out of a total debt of US\$34 billions. About US\$31 billion of this was owed to the Paris Club.

On October 20, Nigeria signed the agreement leading to the cancellation of Nigeria's debt to the Paris Club. At the Paris Club at the Club's Headquarters in Paris. As a first step towards the cancellation of US\$18 billion of Nigeria's debt under the Naples terms, Nigeria paid the first installment of US\$12 billion on October 31st, 2005. This significant debt relief would ensure long-term debt sustainability and represent an important contribution by Paris Club creditors to Nigeria's economic development. On the part of Nigeria, using its oil windfall revenues to finance an exit from debt is a more prudent use of her resources than spending it on consumption expenditure. This will help Nigeria escape her debt overhang, and in future release resources that would have been used to service her debt for investment purposes in subsequent years. The money to be saved was to be spent on critical areas such as education, health and agriculture and poverty reduction. This represents a best practice in debt management and the use of windfall revenues from export products.

2. Recapitalisation of Banks

The health of the financial sector is very important for Current Account sustainability as financial sector crisis will affect a country's ability to finance its deficit. It affects the willingness of foreign investors to hold portfolio or financial assets in the economy or to extend credit to a country. A weak banking system also encourages capital flight by domestic savers making it difficult to finance a deficit. In addition, banks facilitate international payments and foreign exchange transactions. The overall quality of the financial system and the efficiency of financial transactions are important indicators of political and economic stability, the ability to withstand shocks, and to develop a market economy (Roubini and Warchel, 1997).

Ferguson (1999) in an address at a Policy Seminar in Washington D.C, emphasized that against a background of modern, technologically driven global finance, the policy-maker's challenges are: to build strong institutional structures, policy credibility, and private sector discipline. This was because it has become clear that adjustments have to be made because with the absolute scale of global financial markets increasing, the size of bailout packages needed to fill gaps during international crises will become progressively larger and become less feasible to assemble (Ferguson, 1999). Countries that wish to participate in the modern global financial market need to modernize their institutional underpinnings. Banks are an important mechanism for transmitting funds both domestically and internationally. Banking institutions therefore have to be put on a sound footing through adequate capitalization and appropriate supervisory practices and safeguards.

The Nigerian banking sector is relatively underdeveloped compared to some other African countries, although it has experienced tremendous growth since the liberalization of banking licensing in 1991. In 1981, there were only 26 merchant and commercial banks operating in Nigeria, the number had increased to 89 by 2000. However the banking sector was very fragmented. Liberalization led to a large number of banks with small capitalization, limited banking skills, and limited regulatory oversight. Irregular banking practices and bank failures have occurred frequently in the past. Changes in the banking sector therefore became imperative.

On July 6, 2004, at a special session of the Bankers Committee, the Governor of the Central Bank unveiled a 13-point reform agenda for the banking sector. One of them was the upward review of banks' capital base from N2 billion to N25 billion. As a result of their weak capital base, banks in Nigeria have not played their expected roles in the economy. It was therefore necessary to strengthen and consolidate the banking system among other reforms designed to ensure a diversified, strong and reliable banking sector. The reforms are aimed at ensuring: the safety of depositors' money (Nigeria has witnessed the crash of several banks in its history); that banks play developmental roles in the economy and also become competent and competitive in the regional and global financial system (NigeriaBusinessInfo_com 2005). In line with global trends, the inability of the Nigerian banking system to voluntarily embark on consolidation in line with the global trend, has made it necessary to consider the adoption of appropriate legal and supervisory frameworks as well as comprehensive incentive package to facilitate mergers and acquisitions in the country, as well as crises resolution option and to promote the soundness, stability, and enhanced efficiency of the system. Banks were directed to raise their capital from N2 billion to N25 billion by December 31, 2005.

Since then, banks have started to comply by exploring options such as: new capital raising programmes through the stock market, private placement, foreign equity participation, group consolidation, and outright mergers and acquisitions. Consolidation in the banking system is expected to lead to: improved capacity of local banks to finance major projects such as the oil and

gas sector; raising the level of confidence in the banking system by curing the problem of financial distress; improve retaining capacity of financial capital through the promised retention of external reserve in banks, which could encourage the return flight of capital; ensure healthy competition on a level playing field and reduction in regulatory abuses and operating malpractices; increase the value of the Naira, encourage the growth of the agricultural sector, and the reduction of interest rates (NigeriaBusinessInfo_com, (2005).

Recapitalization of banks is a good practice for promoting the development of a sound financial system. Such recapitalization and restructuring of banks had taken place in the transition economies of Europe in the 1990s. Countries with sound banking systems and relatively well developed financial and securities market are more likely to attract foreign investment because a well functioning banking sector provides a signal of stability to the international community and makes financing of Current Account deficits easier.

3. Attracting Foreign Investment – The Nigerian Investment Promotion Commission

Macroeconomic instability has been identified as an important reason why African countries find it difficult to attract foreign capital inflows. These include large structural fiscal deficits, erratic monetary and exchange rate policies, and weak financial systems. Nigeria has over the years tried to attract foreign investors through various policy and incentive packages (Bhattacharya, et al, 1997). In July 1995, the Nigerian Investment Promotion Commission (NIPC) was established by Decree No. 17 1995. The Commission serves as a central investment approval agency, streamlining the activities of ministries, government departments and agencies involved with investment promotion. It assists in such matters as registration or incorporation of foreign enterprises, obtaining expatriate quotas, or finding out about the different tax regimes for different sectors.

Functions: The functions of the NIPC include the following:

- Advises the government on policy issues related to investment,
- Guarantees the protection of foreign interests in Nigeria against expropriation,
- Administers appropriate incentive packages available to investors,
- Guarantees transferability of profits and other funds by investors,
- Identifies difficulties and problems encountered by investors, proffers solutions and renders assistance to solve them.

Services: Services provided by NIPC to interested investors and prospective investors include the following:

- Provides up-to-date information on investment opportunities available in the country,
- Links foreign investors with local partners,
- Provides information on available incentives for investment,
- Coordinates the issuance of expatriate quota,
- Negotiates specific incentive packages for investors in consultation with appropriate government agencies,
- Enters into bilateral agreement with investors for the purposes of investment protection, and
- Identifies specific projects and invites interested investors to participate in them.

The NIPC has a website (www.nipc.Nigeria.org) where information useful to foreign investors can be found. It has also published a brochure providing information about various agencies

regulating business activities in Nigeria, etc. The establishment of the Nigerian Investment Promotion Commission can be regarded as a best practice. It has centralized all activities relating to investment information in Nigeria, thereby facilitating access to information by potential foreign as well as domestic investors in Nigeria.

5.2 Enhancing Capital Inflows into Nigeria

Other problems which have contributed to Nigeria's current and capital accounts imbalances and which also affect capital flows include; excessive government deficits, burdensome external debt (debt relief is on the way and so this may be reduced), dependence on one major export (crude oil), dependence on imports for food and raw materials, poor infrastructure, especially electricity supply, etc. Studies have also shown that the capital market in Nigeria is not very efficient (Edo, 2005). Efforts are being made to address some of these problems. Overall, in Nigeria, policies are required in the following areas:

- Policies to attract capital inflows and reduce capital flight.
- Policies to promote non oil exports and reduce dependence on imports of food and raw materials.
- Diversification of the Nigeria economy.
- Reduction of budget deficits.
- Better debt management strategies to ensure that the debts do not accumulate again after Nigeria secures debt relief from the Paris Club.
- Policy and institutional environment: This will include proper management of interest and exchange rates, transparent privatization processes, combating corruption, civil service and judicial reforms, etc
- Promotion of private sector-led growth: Efforts to create an enabling environment for the private sector to lead the growth process in Nigeria should be intensified.
- Improved recording and management of workers remittances. Workers' remittances are already contributing to capital inflows in Nigeria. However, an unknown proportion is not recorded as they come through informal channels. There is need to ensure better channeling of workers' remittances as is done in India or Pakistan. In Pakistan, workers' remittances finance the trade and investment income deficits to the tune of up to US\$7 billion (Husain, 2005). The sustainability of worker remittances, especially from second and their generation migrants, also needs to be addressed

V. Conclusion

The experiences of some of the world's industrial economies which have experienced persistent Current Account deficits suggest that Current Account deficits are not necessarily bad if the economy is stable and diversified (USA, Australia, etc). Some analysts have suggested that the persistence of Current Account deficits in the USA for instance is due to the attraction of the USA as a harbour for international capital (Poole, 2003). The analysis of Nigeria's Current Account and Capital and Financial Account Balances in this paper suggests that Nigeria's Current Account Balances fluctuate between deficits and surpluses, depending on the price of crude oil, her major export product. In the last few years, Nigeria's Capital and Financial Account has been registering deficits, and the Current Account surpluses. These trends suggest that there is capital flight out of Nigeria, foreigners have been divesting, while domestic investors have been investing abroad.

Regression analysis of Current Account balances suggests that key determinants of whether Nigeria registers a deficit or surplus on her Current Account are the exchange rate, the domestic

interest rate as well as the Trade Balance to GDP ratio. These results imply that Nigeria needs to adopt policies to increase her exports and reduce her import dependence, and that key policy variables are the real exchange rate and the domestic interest rate. Overall, the analysis does not suggest that Current Account deficits are protracted or unsustainable in Nigeria, as they usually swing back to a surplus after a short interval (three years). What is required is effective management of resources borrowed from abroad to finance the deficits, the financial and capital markets should also be developed to boost the confidence of investors, both domestic and foreign, in the economy thereby encouraging investment. Now that Nigeria is about to exit the debt trap by securing debt relief from the Paris Club, future borrowings have to be properly scrutinized to ensure that terms are acceptable and in the interest of Nigeria.

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Table 1
Trends in Current Account Imbalances and Related Flows: 1970-2002

Year	GDP N'Mills.	Exports N'Mills.	Imports N'Mills.	Current Account N'Mill	Trade balance	Net Services + Income	Net Current Transfers	Overall BOP Balance	Change in reserves
1970	8962.	885.4	756.4	-50.0	129.3	-268.0	45	46.5	-46
1971	10375	1293.4	1078.9	-229.4	214.5	-516.2	1.8	117.4	-117.4
1972	11035	1434.2	990.1	-322.7	444.1	-785.9	-14.3	57.2	-57.2
1973	12252	2278.4	1224.8	52.7	1053.6	-1078.8	-35.4	197.5	-192.0
1974	19604	5794.8	1737.3	4761.5	4057.5	-1314.7	-62.1	310.2	-310.2
1975	22945	4925.5	3721.5	42.6	1204.0	-1367.7	-76.8	157.5	-157.5
1976	28611	6751.1	5148.5	-258.4	1602.6	-1455.0	-97.8	-339.0	339.0
1977	33585	7630.7	7093.7	-647.5	537.0	-2082.7	-118.7	-527.2	527.2
1978	36053	6064.4	8211.7	-1157.4	-2147.3	-1474.6	-170.6	1293.6	-1293.0
1979	42912	10836.8	7472.5	9427.3	3364.3	-1724.4	-233.5	1868.9	-1868.9
1980	50270	14186.7	9095.6	13057.9	5091.1	-3462.2	-315.2	2402.2	-2402.2
1981	50751	11023.3	12839.6	-10070.3	-1816.3	-2948.4	-346.5	3020.8	3020.8
1982	51953	8206.4	10770.5	-7281.8	-2564.1	-2779.9	-289.4	-1398.3	1398.3
1983	57144	7502.5	8903.7	-4331.8	-1401.2	-1684.4	-285.8	-301.3	301.1
1984	63608	9088.0	7178.3	8234.3	1909.7	-2001.9	-253.8	354.9	-354.9
1985	72355	11720.8	7062.6	10738.9	4658.2	-2607.7	-232.0	349.1	-349.1
1986	73062	8920.6	5983.6	8006.6	2937.0	-6202.6	-240.4	-5667.7	784.3
1987	108885	30360.6	17861.7	-17138.2	12498.9	-14167.2	-96.2	-18264.8	-159.2
1988	145243	31192.8	21445.7	31586.1	9747.1	-12786.0	385.3	-20795.0	2294.1
1989	224797	57971.2	30860.2	59112.0	27111.0	-23678.8	1140.8	-22993.5	-8727.8
1990	260637	109886.1	45717.9	79810.1	64168.2	-28998.3	3614.6	-5761.9	-18498.2
1991	324010	121535.4	89448.2	51969.8	24275.0	-39314.4	7291.9	-15796.6	-5959.6
1992	549809	205611.7	143151.2	93680.5	244282.9	-54257.7	12680.1	-99332.8	-65271.8
1993	701473	218770.1	165629.4	-34414.7	12004.6	-106224.5	17924.6	-39550.7	-13615.9
1994	914939	206059.2	162778.8	-52304.3	43270.4	-124592.6	10952.4	-42623.3	-7194.9
1995	1977740	950661.4	755127.7	-186084.6	195533.7	-484811.0	51546.5	-195316.3	-15325.1
1996	2823900	1309543	562626.6	240180.0	746916.8	-497053.5	61234.0	-53152.0	-183952.6
1997	2939600	1241662	845716.6	268899.3	395946.1	-507333.4	366824.4	1076.3	-251593.1
1998	2881300	751856.7	837418.7	-331435.2	-85562.0	-428054.5	115069.1	-220675.1	36961.0
1999	3320160	1188969	862515.7	46336.2	326454.1	-468551.6	118924.7	-326634.3	152361.0
2000	4980960	1945723	962963.9	713023.9	982759.4	-511634.9	165455.7	314139.2	-453399.7
2001	4864460	2001230	1357695	242901.3	643535.8	-676066.3	152005.0	24729.9	-56531.9
2002	5602570	1882668	1580527	40224.9	302141.0	-576010.8	170410.4	-565353.3	330792.5
2003	5454150	2889846	1956110	507117.1	933736.3	-805281.5	200834.0	-162839.7	27595.1

Source: Central Bank of Nigeria, Statistical Bulletin; and Annual Report and Statement of Accounts, Various Issues

Table 2
Capital and Financial Account Flows in Nigeria: 1970-2002 (N' Millions)

Year	Capital Account Balance	Portfolio Investment	Net Foreign Direct Investment	Net Capital Inflows	Net Official flows	Other Long-term	Other Short-term	Foreign Capital Inflow
1970	49.2	-	128.6	121.6	-	4.4	-76.8	251.0
1971	293.4	-	142.8	319.6	-	31.0	116.4	489.6
1972	269.2	-	297.8	248.3	-	35.8	-62.4	432.8
1973	144.8	-	186.3	192.6	-	-49.7	9.2	577.8
1974	-5.9	-	181.6	48.3	-	-65.1	-136.7	507.1
1975	141.1	-	253.0	475.4	-	-135.7	15.2	757.4
1976	-50.6	-	212.5	46.3	-	-234.2	-32.2	521.1
1977	150.4	-	245.5	197.6	-20.2	-11.1	-84.0	717.3
1978	1111.9	-	134.4	331.8	-884.4	881.2	96.3	664.7
1979	813.2	-	184.3	289.9	-598.2	622.8	6.1	704.0
1980	97.4	-	-404.1	467.0	-330.3	356.1	145.4	786.4
1981	929.5	-	334.7	137.3	-480.0	498.4	96.4	584.9
1982	3470.9	-	290.0	1624.9	-720.3	736.8	2444.1	2193.4
1983	2735.7	-	264.3	536.7	0	1109.5	1361.9	1673.6
1984	171.9	-	-270.7	534.8	-233.3	-198.9	10.4	1385.3
1985	-2555.0	-	434.1	329.7	-3763.6	-5109.3	2030.2	1423.5
1986	-1900.9	151.6	735.8	2499.6	-4502.4	-4533.5	1745.2	4024.0
1987	-16743.3	4353.1	2452.8	680.0	-15124.0	-15079.5	-8469.7	5110.8
1988	-18447.3	2611.8	1718.2	1345.6	-16094.6	-16209.5	-6567.8	6236.7
1989	-30221.9	-1618.8	13877.4	-439.4	-24226.5	-24226.5	-18254.0	4692.7
1990	-49245.3	-435.2	4686.0	-464.3	-28595.6	-28550.4	435.1	10450.2
1991	-27482.9	-594.9	6916.1	1808.0	-30679.5	-30679.5	22108.4	5610.2
1992	-138755.6	-36851.8	14463.1	8269.2	-97559.1	-97558.3	-48004.5	11730.7
1993	-23060.6	-396.4	29675.2	32994.4	-38303.0	38176.3	-10087.9	42624.9
1994	11252.8	-203.5	22229.2	3907.2	-41471.7	-41471.8	30698.8	7825.5
1995	-4254.0	-6785.0	75940.5	48677.0	-108037.0	-108037.0	34625.7	55999.3
1996	-290200.5	-12056.6	111292.7.0	2731.0	-212258.0	-212258.7	-177182.5	5672.9
1997	-263360.2	-4785.8	110456.2	5731.0	-206871	-206871.7	70705.4	10004.0
1998	116720.5	637.5	80750.4	24078.9	-125738	-125737.7	161027.4	32434.5
1999	-366820.7	1015.7	92792.5	1779.1	-153229	-153233.1	-303358.8	4035.5
2000	-390356.3	51079.9	115952.2	3347.0	-99566.2	-99516.2	-	16453.6
2001	-211211.3.	92518.9	132433.7	3377.0	-94521.9	-94521.9	-	4937.0
2002	-596311.9	16082.6	225972.0	8206.8	-164434.5	-163753.8	-	8988.5
2003	-658961.1	18996.5	259250.4	13056.1	-180320.1	-	-	13531.2

Source: Central Bank of Nigeria, Statistical Bulletin; and Annual Report and Statement of Accounts, Various Issues

Table 3
Capital and other Flows as Percentage of GDP/GFCF, 1970-2002

Year	FDI /GDP	FDI Net /GDP	FDI /GFCF	Net Capital /GDP	Net Capital /GFCF	Remittance /GDP (%)	Remittance /Export (%)	Export/ GDP	Current Account /GDP (%)	Debt Service/ Export (%)	Services + Income /GDP	Net Curr Trans/ GDP
1970	0.03	0.01	0.28	0.010	0.140	2.28	13.4	0.10	-0.56	7.16	-0.03	0.005
1971	0.05	0.01	0.38	0.030	0.250	5.10	25.9	0.13	-2.21	4.73	-0.05	0.0002
1972	0.04	0.03	0.31	0.020	0.180	7.69	39.3	0.13	-2.92	4.10	-0.07	-0.001
1973	0.05	0.02	0.22	0.020	0.070	5.34	25.3	0.19	0.43	6.11	-0.09	-0.003
1974	0.03	0.01	0.16	0.002	0.020	2.59	8.17	0.30	24.2	1.91	-0.07	-0.003
1975	0.03	0.01	0.14	0.020	0.090	2.30	9.7	0.21	0.19	2.95	-0.06	-0.003
1976	0.02	0.01	0.06	0.002	0.010	1.72	6.9	0.24	-0.90	3.67	-0.05	-0.003
1977	0.02	0.01	0.07	0.010	0.020	1.82	7.3	0.37	-3.02	1.04	-0.06	-0.004
1978	0.02	0.004	0.07	0.010	0.030	0.95	5.2	0.29	-10.41	1.29	-0.04	-0.005
1979	0.02	0.004	0.07	0.010	0.030	1.02	4.1	0.39	3.89	2.17	-0.04	-0.005
1980	0.02	-0.01	0.07	0.010	0.040	2.08	7.3	0.52	10.29	4.15	-0.07	-0.006
1981	0.01	0.01	0.05	0.003	0.010	1.65	7.5	0.35	-12.71	9.09	-0.06	-0.007
1982	0.04	0.01	0.23	0.030	0.170	1.81	10.2	0.23	-14.01	16.17	-0.05	-0.006
1983	0.03	0.005	0.22	0.010	0.070	1.22	8.9	0.18	-7.58	23.60	-0.03	-0.005
1984	0.02	0.006	0.33	0.010	0.130	1.86	12.8	0.19	0.19	33.62	-0.03	-0.004
1985	0.02	0.006	0.28	0.005	0.060	2.24	13.6	0.18	3.59	38.75	-0.04	-0.003
1986	0.06	0.01	0.52	0.030	0.320	5.91	47.1	0.07	0.28	29.55	-0.08	-0.003
1987	0.03	0.02	0.53	0.010	0.090	11.0	39.7	0.07	-0.06	13.08	-0.13	-0.001
1988	0.04	0.01	0.66	0.010	0.140	6.70	30.6	0.05	-0.20	29.26	-0.09	0.003
1989	0.02	0.06	0.25	-0.002	-0.020	8.4	32.3	0.04	0.48	24.70	-0.11	0.005
1990	0.04	0.02	0.34	-0.002	-0.010	13.4	31.5	0.05	1.9	22.60	-0.11	0.014
1991	0.02	0.02	0.16	0.010	0.050	12.1	31.8	0.04	0.37	21.90	-0.12	0.023
1992	0.02	0.03	0.20	0.020	0.140	12.2	32.3	0.02	0.41	28.70	-0.10	0.023
1993	0.02	0.04	0.52	0.050	0.410	10.7	33.8	0.01	-0.11	13.00	-0.15	0.026
1994	0.06	0.02	0.09	0.004	0.050	7.2	31.9	0.01	-6.7	40.9	-0.14	0.012
1995	0.03	0.04	0.49	0.020	0.420	21.2	24.6	0.06	-8.4	33.9	-0.25	0.026
1996	0.002	0.04	0.03	0.001	0.020	7.9	19.5	0.06	8.5	31.3	-0.18	0.022
1997	0.003	0.04	0.05	0.002	0.030	8.6	22.4	0.05	9.1	32.2	-0.17	0.125
1998	0.010	0.02	0.17	0.001	0.001	9.6	29.2	0.03	-12.6	36.6	-0.15	0.040
1999	0.001	0.03	0.02	0.0004	0.001	8.1	21.9	0.04	1.4	26.1	-0.14	0.036
2000	0.003	0.02	0.06	0.001	0.010	8.3	20.5	0.05	15.7	14.9	-0.10	0.033
2001	0.001	0.03	0.01	-	-	-	-	0.01	4.7	14.6	-0.14	0.031
2002	0.002	0.04	0.02	0.001	0.010	-	-	0.04	0.7	17.4	-0.10	0.030
2003	-	-	-	-	-	-	-	-	6.9	15.1	-	-

Source: Central Bank of Nigeria, Statistical Bulletin; and Annual Report and Statement of Accounts, Various Issues; and calculation by author.