emerging market economics

Privatisation in Nigeria

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Macroeconomic Context

Nigeria has made substantial progress in transitioning from a military dictatorship to an open and democratic nation. The Peoples Democratic Party, under the leadership of President Obasanjo, has been returned for a second term of office with much stronger support in the National Assembly and in the states. This stronger mandate is essential to political stability and will facilitate consensus building around key national policy issues such as privatisation.

A committed and professional economic team has commenced implementation of an ambitious programme of reforms. The team has led the preparation of the National Economic Empowerment and Development Strategy (NEEDS), Nigeria's plan for prosperity and effectively its poverty reduction strategy. The NEEDS focuses on poverty reduction, wealth creation and human development through reforms and initiatives in three key areas: (i) overhauling the way government works, particularly to address governance and to improve the growth and poverty impacts of government expenditure; (ii) growing the non-oil private sector; and (iii) implementing a social charter to achieve improvement in human development.

The new leadership team has also guided Nigeria towards much improved macroeconomic stability. Inflation and exchange rate instability have both been reduced. The government has also adopted a much more prudent fiscal stance and has prepared a fiscal responsibility bill which is designed to create fiscal stability through smoothing the troughs and peaks of oil receipts. And while structural reform was patchy during the first Obasanjo administration, progress has improved markedly since the last election. As an example, the deregulation of the downstream petroleum sector has brought domestic petroleum prices to border price parity.

Despite this impressive progress on reforms, significant challenges remain. Institutional capacity remains weak across all three levels of government, and state and local administrations are particularly deficient. Capacity for policy formulation is limited, while capacity for service delivery in the lower tiers is clearly inadequate. This constitutes a significant barrier to implementing wide-spread privatisation programmes.

The democratic government has inherited a legacy of bloated federal and state civil services, which, in addition to imposing a considerable fiscal burden, are widely viewed as very inefficient in service delivery. At the federal level, approximately one million people are employed in public service and 2004 estimates indicate that staff payroll accounts for about 66 percent of total federal government expenditure. This limits the government's ability to fund new development priorities and results in a very large share of government in the economy. The government is still involved in many production and service delivery activities which are better left to the private sector.

The legacy which the new administration has inherited is that of a constellation of institutions and other public bodies with overlapping roles and responsibilities. States face similar issues, sometimes even more pronounced in their severity. Unfortunately, many government agencies and other public institutions and enterprises have suffered breakdowns of financial control mechanisms. This has led to poor budgeting, limited implementation follow-up and, with only limited mechanisms of accountability, in some cases outright diversion of funds. There are a very large number of unfinished projects, both at the federal and state levels.

Despite the increased government attention to the issue of fiscal restraint, this has been a significant problem for the past several years. Consolidated government spending is estimated to have increased about 155 percent between 1999 and 2003 and amounted to about 40 percent of GDP in 2002. Fiscal expansion has been most striking at state and local government levels. In some states public spending increased 300 percent between 1999 and 2003. These trends have repeated the historically pro-cyclical nature of fiscal policy in Nigeria, with large surges in public expenditure and growing fiscal imbalances on the upswing of the oil price cycle.

The federal government's 2004 budget proposal targets a reduction in the overall fiscal deficit to under 3 percent of GDP. However, fiscal pressures from near term costs of implementing proposed reforms (pensions, civil service reforms and monetisation of public sector benefits) coupled with government's desire to start to address Nigeria's huge infrastructure deficit continue to pose significant challenges of economic management. The fiscal responsibility bill is important because it can play a role in ensuring adherence to fiscal spending targets. Privatisation is strongly linked to this issue because of the burden that SOEs represent to the exchequer and because they represent a major constraint to the efficient delivery of public services.

Nigerian SOEs: the Dead Hand of the State on Non-Oil Growth

Looking at the effect of privatisation programmes worldwide, it seems that one of the larger impacts privatisation has had is through its ability to release the private sector from the dead hand that SOEs can exercise over the development of markets. While the negative macroeconomic effects of public enterprises are not to be underestimated, the real effect that SOEs have on the economy is due to their inability to provide public services effectively. The inadequacies of Nigerian infrastructure, much of which remains in state hands, is consistently identified as one of the top 3 constraints to the growth of the private sector in the country. The fact that Nigeria, a major oil and gas producer, is chronically short of power is due to decades of mismanagement of public enterprises and inappropriate policies towards tariffs that have subsidized the rich whilst denying access for the poor.

Lack of access to power is one of the biggest constraints to non-oil growth. Foreign investors are driven off by the fact that they will have to deal with regular power outages as a consequence of doing business in Nigeria development. International competitiveness of all activities is reduced by having to pay for high cost private generation and by the high level of waste produced when process industry has to shut down frequently.

This mismanagement and inappropriate policies also extends to water, sanitation and roads that, beyond the inter-state highways, represent a major constraint to improving rural livelihoods. These inadequacies will contribute to Nigeria failing to achieve the first Millennium Development Goal (MDG) and, most likely, other MDGs too.

The Nigerian Privatisation Context

Nigeria was one of the first countries in Africa to start on privatisation; its programme got underway in the early 1990s. However, apart from the most saleable enterprises, not many operations were divested and, with the end of structural adjustment in 1992, privatisation virtually came to a halt. Since the Obasanjo administration came to power, the pace of privatisation has picked up again. But it is fair to say that most of the privatisations that took place during the President's first term encompassed commercial operations which were easily disposed of and enterprises which had already had some of their shares floated.

Now, with the publication of NEEDS and the appointment of a new director of the BPE, there is a renewed momentum behind the drive for privatisation. This momentum has resulted in the very substantial support that DFID and the World Bank are now extending to the privatisation process.

However, some major problems and challenges to privatisation remain, including:

- The nature of the portfolio of assets to be privatised. Many of the enterprises remaining to be sold are virtually defunct entities and a large share of the asset base is in infrastructure. Infrastructure, in addition to having the transactional problems that accompany other privatisations also poses regulatory problems.
- The need to restructure many of the assets to be privatised. Given the nature of portfolio that remains, most of the entities require some pre-privatisation restructuring. That raises issues of the cost of restructuring and contingent liabilities, how they are to be addressed and how much pre-privatisation restructuring should be done to make enterprises attractive to potential investors.
- The failure to get buy-in on the aims of privatisation from wider stakeholder constituencies including politicians, line ministries, state governments and particularly labour unions. As discussed above, Nigeria's SOEs are extremely overstaffed. This creates a payroll burden which has contributed to the degree of un-profitability of these enterprises. A likely consequence of any potential privatisation project is that either the state as part of pre-privatisation restructuring or the private entity gaining control of the enterprise will immediately look for ways to increase efficiency, and this means that jobs

will be cut. The consequence of this is that certain stakeholders, particularly the strong labour unions of Nigeria, are opposed to privatisation. The situation is further complicated by the fact that unions have the ability to make redundancies difficult, which drives down the sale value of enterprises and deters investors.

Privatisation Considerations

Privatisation is not a panacea; it requires difficult decisions to be made which almost always cause some interests to lose from the process of change. Striking a balance between the objectives of privatisation is almost always a matter of judgement. And in Nigeria's case, these judgements will be difficult to make.

Even with the most creative ways of attempting socially responsible restructuring and privatisation, it is unlikely that all of the problems can be avoided, so some tradeoffs must be made. The following is a list of some of the issues that must be considered when a privatisation is to be made:

1. How can the transaction maximise economic benefits, in terms of growth, jobs and equality impacts, to the country?
2. How can transaction proceeds be maximised and will the fiduciary obligations of the treasury be discharged effectively? I.e. will the Ministry of Finance be maximising its shareholder's (citizens') value?
3. Will the transaction improve the chances of the enterprise becoming or remaining successful?
4. How can the transaction secure the best interests of the staff and employees of the enterprise? Are they likely to resist change?
5. How can the transaction maximise the interests of wider stakeholders and customers of the enterprise?

In practice, it is necessary to trade-off one consideration against the other. So, in the interest of maximising economic benefits by attracting appropriate new owners, it may be necessary to discount the proceeds from privatisation. And, the interests of employees may need to be sacrificed for the benefit of wider stakeholders. Making these trade-offs is always difficult, requiring a measure of consensus over the objectives of privatisation. This consensus does not exist in Nigeria and it is unlikely that it will emerge by itself soon. Overcoming resistance to change, by building constituencies of stakeholders that are for change is therefore critically important for the progress of privatisation in Nigeria.

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