THE IMPACT OF COUNTRY RISK ON CROSS-BORDER FINANCING

AND NATIONAL DEVELOPMENT

BY

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<u>CERTIFICATION</u>

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This project thesis entitled "IMPACT OF COUNTRY RISK ON CROSS - BORDER FINANCING AND NATIONAL DEVELOPMENT" by Kolawole Morayo TAIWO meets the regulations governing the award of the degree of Masters in Business Administration of Ahmadu Bello University and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

This thesis is dedicated to God (in Trinity)

My very enduring and loving wife, Funke and

My children: Molabo, Mofiyinfoluwa and Morireoluwa

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It obviously takes the grace of God Almighty to see me through the rigors of undergoing a part-time course at such a distance (Abuja to Zaria) attending lectures every weekend. I therefore give all the glory to God in heaven for his financial provisions and divine protection throughout the journeys to and fro Zaria. Thank you Lord for the fortitude that saw me through the programme.

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ABSTRACT

Most borrower countries have had to reschedule their debts to stretch the repayment farther or incorporate more of their total debt in the restructuring agreement through a Multi-Year-Restructuring-Agreement in order to obtain a better debt structure. Grace and repayment periods were prolonged while spreads were gradually reduced. Inspite of the good growth in the economic environment of the OECD countries between 1985-1987 with most commodity prices and interest rates declining thereby offering a generally better debt profile and positive economic environment, no country which had had to reschedule its debt reached credit worthiness and hence could not obtain funds in the international financial markets. In essence, the different adjustment programmes adopted by the major debtor nations helped to avert insolvencies but failed to lead the different nations back to credit worthiness. Indeed, as at 1987, the Third World states owed over $ 1 trillion in external debt.

A wind of change has therefore been witnessed since the late 80's due to a feeling of frustration among the major borrowing countries because they cannot see any opportunity of breaking out of the vicious cycle in which they have found themselves. The wind of change include making unilateral decisions such as neglecting their loan repayment dates without prior notice, limiting the amount of money available to service the debt or declaring a moratorium on debt payments; requesting for debt relief etc.

Different new initiatives have so far been launched such as the Phillipine Investment Note (PIN) in 1987, Exit Bonds by Argentina in 1987 and Debt Conversion Programmes. While the first two are yet to be accepted, the Debt Conversion Programme has had a positive impact in the area of alleviating the debt problems.

Inspite of this trend, international trade is continuous and the need to finance it is non-negotiable even if the nations country risks do not look very attractive.

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CHAPTER ONE

INTRODUCTION

1.1 General Background of Study

Most economies of the world, especially those in the Third World have at one time or the other experienced shortfall between domestic savings and the desired level of investments. External borrowings have often been resorted to in order to fill such gaps. Such loans are healthy when invested in long run development perspective in which a sustained flow of external resources complement domestic investment with a view to accelerating growth. External loans, optimally deployed to give higher marginal return on investment than the cost of borrowing is self liquidating and therefore self-sustaining because they are productive. Effective strategic management of external loans result in the long run liquidation of such loans and growth of the borrowing country simultaneously. However, loans not properly planned or budgeted are easily misdirected or mismatched resulting in debt servicing burden.

From the early 1840s, the United States of America went through a period of terrible reputation in Europe when she faulted on her debts. In 1870, Egypt was expending about 16.7percent of her export earnings, servicing debts. When Egypt could no longer afford to pay, European countries (spearheaded by France and Britain) took control of Egypt's domestic finance. This provided ready grounds for Britain to invade Egypt. In the 19th century, Tunisia, Morocco, Bulgaria, Greece, China and Turkey actually defaulted or threatened to default on their foreign debts. This led to the direct control of their finances by foreign powers who were determined to squeeze out the money to pay off their

bankers. Almost all the Latin American countries defaulted on their debts in the 1920s and 1930s.

By 1973, more than thirty developing nations have had to undertake negotiations with creditors to reschedule their debts. The rate of default has risen to the point that it is referred to as "creeping default" in financial circles. Egypt, Tunisia, Morocco, Turkey, Argentina, Brazil, Chile, Ghana, Indonesia are instances of such debtor nations. The magnitude of the debt was such that most of them commit 40 percent and above of their export earnings to service debts thereby making it extremely difficult to pay for essential imports for future economic production so as to enhance their export earning capacity to further service their debts. Indeed, as at the end of 1987, the Third World states owed over one trillion U.S. Dollars (US $ 1 Trillion). According to Angemueller (1987), the resources of the indebted nations far outweigh their debts (1). The dilemma is that the debtor nations are quietly crumbling under the weight of the debt burden but helplessly continue to silently negotiate for new loans needed to replenish ageing infrastructures and provide new investments that will encourage economic growth. The critical question is "should developing nations strive to pay their debts at the expense of their people and economies?"(1).

External debt management has been very difficult and painful for many third world nations because its process is a balance of both local and external forces interested in the final outcome of the developing states' management strategies. At the home front, the country is faced with managers of the multinationals, working class, indigenes etc. while at the external stage are the international financial institutions, traders and

producers owning or controlling the multinationals. In most cases, these countries have yielded to the external and domestic forces[1]. The problem of debt management is a factor of the susceptibility of the third world governments to creditors' solutions for their debt problems out of desperation, improper monitoring of the countries debts resulting from over-invoicing etc., volatility of exchange rates, arm twisting by the creditors to implement Structural Adjustment Programmes (IMF pills). Another problem of the third world nations worthy of note is their inability to have a common or general debt restructuring programme. Unlike the creditors forming themselves into London and Paris clubs, debtor nations approach their creditors individually.

Lenders are able to recover while borrowers are able to repay their loans on schedule only when the repayment capacity of the borrower equals or exceeds debt service, which consists of principal and interest due for payment. This simple relationship defines the role that credit plays in development and influence the fate of efforts to expand the frontier of finance. Debt capacity is not a disembodied theoretical concept. It rests on social and institutional infrastructures and management of debt capacity requires sensitivity to the risks and possibilities of the environment in which it is created.

Since the end of the third world war, cross-border trade among countries took a new turn based on such economic theories as absolute and comparative advantages. The emerging trends saw the Less Developed Countries (LDCs) being agriculturally oriented witnessing negative balance of trade and hence negative balance of payment having exhausted their foreign exchange reserves over a short period of time (where it ever existed in the first place). Most of the less developed countries therefore became

borrower countries. The international lending talked about today dates back to the 60s with the development of the "Euromoney" the transactions of which involve the borrower borrowing in a currency other than that used for domestic transactions from a financial centre. The availability of funds from the international financial institutions which were established and revolutionalised over time, did not help matters as the less developed countries now amassed huge debts far above their capacities or their resources can manageably repay over a short time. The situation led most borrower countries to rescheduling their debts to stretch the repayment of the debts or incorporate more of their total debt in the rescheduling agreement through a Multi-Year-Restructuring-Agreement (MYRA)[2] in order to obtain a better debt structure. Infact, out of frustration, some of these borrower nations now limit the amount of money available to service their debt or declare a moratorium on debt payments, requesting for debt relief. Various debt management strategies have been introduced but have had little or very insignificant impact on the weight of the debts under which these borrower nations gradually crumble.

Today, debts have become a source of great concern and threat to global trade patterns. While foreign debts mortgage the resources of future generations, there are also implicit potent elements of politics in which lender nations enforce harsh monetary policies on borrowing countries. The major international banks were suddenly faced with a big recycling task for all the Oil Producing Economic Countries (OPEC) money looking for a return on investment due to the 1973 hike in oil prices (the first shock in the oil industry). Recycling proved much more difficult and risky after the second oil shock in 1979.

Between 1982 and 1983, country risk assessment have become of great import in the lender-borrower relationship. The international financial institutions through their experiences over the years recognised the importance of country risk assessment and monitoring far beyond the usual credit risk involved in lending. The first lightning struck the Euromarket with the polish crisis in 1981. The Falkland Island conflict was the forerunner of earthquakes that Mexico and Brazil produced in the market for international lending. Rescheduling of international debts has by now become a task for nearly all banks with cross-border exposures.

1.2 Statement of The Problem

The economic development in Nigeria since the turn of event from "oil boom" to "oil doom" has put the nation in a state of doubt as to its ability to honour her financial obligations to, and incur further loan from external creditors3. Also, the instability in government and the political risk emanating from it leave so much room to wonder "where is the country heading to?". Beyond the ability of a country to repay its loan,that is, economic risk, there exists country risk which is political. This has been having great effect on cross-border financing.

The burgeoning field of International Business is intriguing especially as the Nigerian government is encouraging production for export. Government is also wooing foreign investors through various fiscal policies. Country risk knowledge becomes of great significance for the international businessman as payment for his transactions and repatriation of his returns must factor in, the country risk of the importing nation.

The problem of this research / dissertation is therefore to examine the concept of country risk and its assessment with a view to projecting what impact it has on the cross-border funds flow to and development in Nigeria.

1.3 Objective of Study

The purpose of this study is basically to expound the knowledge and importance of country risk and to examine the impact it may have on external financing both at the micro and macro levels as well as on national development. To this end, the study will examine the methods of assessing country risk as well as sources of internationally accepted ratings based on their associated risks.

1.4 Significance of Study

The significance of this study is in two folds. At the micro level, it prepares international businessmen for risk expectations in dealing with any other country. It also forms an important factor in analysing international business opportunities[4].

At the macro level, this study will serve as a "third eye" in the analysis of the nation's financial crisis and external debt management.

1.5 Scope and Limitation of Study

Focus on the concept of country risk is not more than three decades. Though not new, the subject is not widely expressed except in the developed countries where it is regarded as a key-success-factor in granting loans to other countries of the world.

To this end, the scope of this study is limited to introducing the country risk concept, its importance and assessment. The impact of a nation's rating on its development will be examined with particular reference to the current situation in the development of Nigeria. Being a relatively new concept, there are limited textbooks and publications on country risk. The data sources and collection are also limited to secondary information. Government agencies such as Ministry of Finance and the Central Bank of Nigeria were contacted for primary information on Nigeria's debt management strategies.

1.6 Definition of Terms

(1) **Country Risk** - A combination of influencing factors, economic and political, to watch out for in cross-border transactions.

(2) **Cross Border financing** -Any transaction that involves an exchange or transfer of money across the borders of a nation.

(3) **Credit Risk** - The possibility of non-repayment of loan by the borrower to the lender because the borrower does not have the capability to repay when it is due.

(4) **Deadweight Debt** - Loans obtained and not covered by a real asset or investment

(5) **Debt Reschedule** - A request and eventual agreement to convert debt repayment due within a short period to a longer period to allow for adjustment on the part of the borrower.

(6) **Debt Restructure** - To rearrange or reorganise initial repayment schedule drawn between a borrower and a lender.

(7) **Debt - Equity Swap** - Transformation of a debtors obligation into equity capital in the creditors name within the country of the debtor.

(8) **Expropriation** - Refusal to repay loan obtained

(9) **Hedging** - Precautions available for consideration against risk in a business or financial transaction

(10) **LIBOR** - London Inter Bank offer Rate

(11) **OECD** - Organisation for Economic cooperation and Development

(12) **Political Risk** - The unwillingness of a borrower to repay his loan when it falls due for reasons other than his inability

(13) **Refinancing** - Alternative source of funds to replenish stock of already depleting foreign exchange with a view to refinancing old projects

(14) **Repudiation** - The refusal to accept or meet up with repayment obligation due to a borrower.

(15) **Reproductive Debt** - Debt incurred to acquire a real asset or investment

(16) **Rescheduling** - To postpone payment of maturing loans to allow a breathing space for corrective measures to be undertaken in order to expand the country's productive capacity which will allow return to normal international trade and repayment activities

Footnotes

1. Nigeria's case is no exception leading to forward and backward journey with no considerable progress made.

2. The Multi-Year-Rescheduling Agreement is an indication of the borrower nation losing grip of managing the repayment of the loan obtained.

3. Mismanagement and inadequate planning turned the oil boom of the 70's to oil doom because the economy was basically import dependent.

4. The success of international business highly depends on knowledge of the political and credit risk factors of the foreign country the bussiness relates with.

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CHAPTER TWO

LITERATURE REVIEW

2.1 Cross-Border Financing

It is clear that borrowing is not undesirable. This is so because the rationale underlying debt rests on its contribution to accelerated growth. External resources can logically accelerate growth by adding to countries' investment capacity with a view that the acquisition of public debt is related to a long run development perspective in which a sustained flow of external resources complements domestic investment. Foreign assistance is consequently to relieve constraints by permitting a full use of available resources and in the process, ensure higher growth. Today however, external debts constitute great threats to international relationships. Apart from the truism that foreign debts mortgage the resources of future generations against the hopes of an immediate economic paradise, the potent elements of political instability resulting from harsh monetary policies being forced on borrowing countries by their creditors leaves the borrower countries groaning under the debt weight. Thus while external financing can be a useful tool for achieving positive objectives, the conditions attached destroys the social, economic and political harmony of a country.

Cross-border investments generally involve vast quantities of money conversion from one currency to another the size of which is a reflection of the magnitude of international business as a whole. With constant changes in the values of currencies and money market conditions, various institutions and facilities are created to reduce the risk in such changess. Such institutions include international banking operators. These are

multinationals with facilities to move funds across the borders. A major attribute of international banking is geographical spread. The power of this is so great that leading banks in industrialised countries have had to extend their scope from national to multinational operations. In certain instances, groups of banks have pooled resources at home and abroad for the conduct of international businesses.

International business exposes a manager to international money movement problems and risks. Money is traded like any other commodity, through the foreign exchange market. The core of the world's foreign exchange markets consists of a handful of international commercial banks (about 50-60) linked together by telephone, fax, telex and computer operating a professionally inside market (15). The banks in turn serve as intermediate market quoting prices to its customers with one eye on the prices that prevail in the inside market.

One reason for the intimate link between international banking and foreign exchange market is due to the fact that businessmen use the market to hedge against future fluctuation in foreign exchange rates. The accessibility of a spot market and local credit eases the problem of hedging against foreign risk.

Internationally, there has been a radical shift in the pattern of external financial flows to developing countries in the early 1990's from debt to equity financing and from bank to non-bank sources. Commercial bank loans have been replaced by bond and equity portfolio flows and greater direct foreign investment. These new financial opportunities have the likelihood of better benefits. For foreign direct investments, these benefits

include technology transfer, management know-how and export marketing access for bonds, a diversified investor base; and for equity portfolio flows, a reduction in the domestic cost of capital.

2.2 **International Financial Institutions**

There are various international financial institutions in the world. The notable ones for this report are itemised below:

2.2.1 International Monetary Fund

The International Monetary Fund (IMF) was established in 1944 by the International Conference of Bretton Woods, U.S.A at the same conference the International Bank For Reconstruction and Development (World Bank) was created. The objectives of the IMF were:

- to promote international monetary cooperation through an institution which creates a system of consultation and collaboration for all international monetary problems
- to help the expansion and harmonious growth of international trade
- to promote the stability of the different currencies
- to establish a multilateral system for the settlement of transaction between member states and to eliminate exchange restrictions
- to help member states to cope with balance of payments problems by providing temporary funds at their disposal against guarantee

The International Monetary Fund relies on two sources of funds: ordinary and borrowed resources.

The ordinary resources are based on the approved quota system for member states according to their economic standing and their ability to support the fund over the long term. The borrowed resources include unused credit lines. The resources of IMF are extended to assist member countries under regular and special facilities programmes.

2.2.2 *Institute of International Finance Incorporated*

This is an international body of over 180 banks which are responsible for more than 75 percent of all bank debt in the non-OECD countries. Established in 1983, the body is charged with the following basic objectives:

- to improve the timeliness and quality of information available on sovereign borrowers
- to facilitate communications among participants involved in the international lending process
- to foster a greater understanding within the financial community of the future international lending

A country evaluation system which provides on-line information on the major economic indicators of debtor countries indebted to the international banking community was created. The data available from the Institute of International Finance are a valuable contribution to the quantitative part of the country risk assessment but do not cover political risks. The quality and timeliness of their information will however significantly add to the sources known internationally.

2.3 **Country Risk Versus Credit Risk**

Credit risk is the possibility that a borrower may not be able to repay his loan, principal and interest, as they become due. This and solvency risk are interchangeable. Every

lending involve credit risk. As a result, the banks generally evaluate the borrowers capability of honouring his debts through analysis of the economic and financial milieu of the borrower in the past, present and future as presented in a feasibility report. In essence, the borrower is revealed in the appraisal of the financial reports in the recent past as well as projected into the future. To further reduce the credit risk, the creditor requests for collateral in most instances, because of the difficulty in evaluating the borrower's future economic performance. A bank's credit officer must have intimate knowledge of his clients market, he must appraise the production know-how and technology of his client, the quality of management etc. The financial statements give a guide but the fundamentals are missing[6].

The scope of risk elements involved in cross border lending is of great interest because of its magnitude. In other words, crossing a nation's border raises series of risks beyond the usual credit risk in lending. These risks are equally vital in appraising the borrower. They are collectively referred to as country risk. A look at these risks will be an eye opener at this juncture.

2.3.1 Foreign currency risk can be on the part of the borrower, lender or for both. A British bank confirming a letter of credit of a Brazilian bank in U.S. dollars involves a foreign currency risk for both parties while a Luxembourg consortium bank lending Deutschmarks to a West German company means a foreign currency risk for the lender only. In the same vein, a U.S. bank lending dollars to a Nigerian company confers foreign currency risk on the borrower only. The significance of this risk is unfolded when the fundamentality of its concept is

revealed. Foreign currency risk is in twofold: one stems from parity adjustment resulting from the values of the currency at time of contracting the loan as against the time of repayment; the other is the inability of the borrower to remit the foreign currency due to government regulations.

Another element of country risk is the difficulty of dialogue between the lender and the borrower. The usual case is that the farther away both parties are, the more intricate is dialogue between them due to language barriers, cultural differences or even time zones.

Legal risk in cross-border transactions involve the laws of two countries. This can be reduced by choosing the law of a certain country most popular of which is English law.

Political risk is usually associated with political turmoil and revolution. Embargo or boycott measures instituted for any reason can lead to solvency problem for the countryor a change in the country's foreign exchange reserves of the country. Labour unrest and nationalization are components of country risk and can affect loan repayment. Syndication risk is a more recent one: the case of U.S. freezing Iranian assets to non- U.S. banks is a typical case history.

From the above, it can be inferred that it is easier to quantify and evaluate credit risk than country risk. It is obvious as well that transactions that involve country risk will

always have a credit risk as well. Even where credit is available, country risk is apparent in every international transaction.

The most extreme case of a credit risk is bankruptcy of the debtor in which case the lender partakes in the bankruptcy proceedings so as to recoup part of his credit or losing it completely and writing it off as bad debt. Country risk is manifested in three folds: delayed payment, lasting weakness in which case the country can no longer pay the interest or principal when due and repudiation in which case the country will refuse to pay its debts on the ground that it no longer accepts them(16). The first phase of deterioration in country risk is not severe but lasting weakness leaves a country with the options of renegotiation and rescheduling a moratorium (suspension of repayment until situation improves). Repudiation rarely occurs because a country cannot be bankrupt. However, in the 1960s, Cuba repudiated its loans to the U.S. and USSR repudiated its debts after the revolution. Repudiation cuts the borrower country off completely from international financial and economic community[7].

2.4 External Debt Management

2.4.1. Debt Refinancing

The refinancing situation for a bank ranges between two extremes of one with no natural refinancing sources and others with large amounts of funds from the public. Banks having assets that involve country risk are mainly denominated in an internationally accepted or convertible currency and must therefore be refinanced in the same. Banks engaged in cross border lending require U.S dollars based loan portfolio to refinance. Banks with large foreign currency asset portfolio easily face major refinancing problems,

that is, in liquidity crisis situations, they have no lender of last resort such as the Central Banks in the case of domestic banks. Most banks have no natural source for refinancing their foreign currency assets in the same currency but rather depend on inter-bank money market. They therefore either face liquidity problems or obtain funds at higher costs if the inter-bank money market dries up.

In order to alleviate the refinancing problem of medium term lending, the syndicated loan market was created. While the loan may extend for seven years, the actual interest period is fixed for six months. Therefore a six-month refinancing instrument (inter-bank deposit) assists in eliminating interest mismatch which is one of the dangers of maturity transformation. Banks are obliged to incur an interest risk and lend at terms such as six months while having to refinance themselves in the inter-bank market at a shorter maturity to avoid liquidity problems. The bank can therefore profit from this situation and borrow even shorter than it lends. However, it is fairly risky as the situation can change suddenly.

As on each rollover date, funds must be available, banks attempt to find refinancing sources that can cope with these requirements. Generally, in the inter-bank market, credit lines are not confirmed, therefore availability of funds is tied to market conditions. A contraction due to shift in liquid assets towards other non-liquid assets can have immediate impact on availability of funds. Banks with large portfolios of cross-border assets must therefore have stable supply sources. Several refinancing instruments are available to deal with this situation as follows:(16)

Stand-By-Credit---- This is a lender-borrower relationship between small banks and a large U.S. dollar based city bank to cover the risk emanating from the refinancing aspects of their cross-border exposures. The borrowing bank pays a front-end fee and commitment fee over the running period of the stand-by-credit . A U.S . bank becomes effectively the lender of last resort for the amount of the stand-by- creditor (the non-U.S bank) to refinance its U.S. dollar loan and asset portfolio. With high cost and volatility of stand-by-credit, the instrument is gradually being eroded.

Floating Rate Note Issues (FRN)--- This issue involves a borrowing bank obtaining a certain amount of U.S. dollars for a period of several years averaging twelve years. The interest rate is normally fixed for six months based on LIBOR plus a margin which is influenced by the standing of the bank and the prevailing market conditions. An arranging syndicate in addition receives front-end fees for placing and selling the issue.

Certificate of Deposit Issuance Facility--- This instrument also gives the borrowing bank access to medium term funds through a short term money market instrument. This facility, if negotiated, can be bought and sold in an active and broad secondary market. The issuing houses and the other members of the syndicate commit to purchase a maximum given amount of certificate of deposit from the borrowing bank at any time during the life of the facility for a fee, the certificate of deposits are sold.

Swap Arrangements--- A swap in the foreign exchange market means that a bank sells to another bank e.g. U.S . dollars to Swiss Francs and undertakes to buy it back at a future date against delivery of the Swiss Francs. This can be limited to interests or covers currencies swaps. A variable /floating interest liability calculated on LIBOR or prime basis is swapped against a fixed rate interest liability.

2.4.2 Debt Rescheduling

Rescheduling is a reflection of a change in the quality of the economy of the country involved. Lenders have been forced into rescheduling of recent. Each rescheduling involves a different pattern. These are as follows:

Rescheduling Repayment of Capital

Repayment due within one year are normally rescheduled over a specific period. Generally, the repayment of capital is usually extended far enough into the future with a view to enabling the country adjust its economy. To a bank, rescheduling means that a one year commitment which can also be the last year of a long-term commitment, becomes a medium or even long run credit. This has an effect on the liquidity of the bank which has to rearrange its refinancing of the rescheduled amount.

Adjustment of Interest, Spread and Fees

This is an upwards adjustment of interest resulting from rescheduling of debt due. The adjustment is for the spread and a front-end fee is charged and paid for the rescheduled package.

New Money Facilities

This is created to finance the liquidity gap of the country in question for the coming twelve or more months. It is often tied to the facility of International Monetary Fund. It serves to provide money facilities for the payment of outstanding interest on the total of the country's foreign debt thereby keeping non-rescheduled debt currencies and thus out of the rescheduling. New money facilities are constructed as medium term loans on a floating rate basis. Rescheduling lowers the quality of the assets from the country in question.

2.4.3. Debt-Equity Conversion

Debt-equity swap, an instrument to alleviate the debt burden of the indebted nations, was created in Chile in 1984. This does not involve new financing but neutralises debt by swapping it into local equity. Therefore, the need to service debt through interest and amortisation is replaced by the investor's looked-for return. Through debt-equity conversion, a foreign currency denominated debt is exchanged at a discount into local currency which is then in local equity. This instrument has spread to Argentina, Costa Rica, Ecuador, Mexico, Philippines and Nigeria. The Central Banks of the countries monitor the programme.

Debt-equity conversion programmes can serve as a source for repatriation of flight capital. However, this is political to the extent that investment policies and attitudes towards foreign investments are manipulated. Economically, this programme can influence money supply and hence cause inflation. Therefore, the Central Banks adopt various control measures through their monetary policies to control possible problems. If the political and economic conditions of a country improves, the investor will become more eager to invest while sellers, willing to sell the debt at a high discount will become scarce. Therefore, it is difficult to realise a debt-equity conversion programme that is attractive to all three parties involved, including the institution.

It is best for a country to fix a goal in its conversion programme regarding the amount of the debt to be swapped into equity before a scheme is constructed to at least encourage repatriation of flight capital and attract potential investors as well as protect the home interest group.

Footnotes

5. Institutions such as banks and insurance companies assist in hedging against the risks involved in business such as fluctuations in values of currencies, credit risk, etc.

6. Advance credit analysis looks beyond the financial statements of an investment by digging into the technical capabilities and management competence.

7. If effectively managed, every country has potential hence repudiation is only a total refusal to repay rather than rescheduling.

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CHAPTER THREE

ASSESSMENT OF COUNTRY RISK

Country risk is a combination of those elements which result in the inability of a debtor nation to repay his debts resulting from cross-border transactions. These elements range from inability to unwillingness on the part of the debtor - ANONYMOUS

Country risk is a combination of transfer or economic risk and political risks. The former is the capability to honour one's debt while the latter involves the will to honour one's obligations. Both risks are mutually interrelated. This is more pronounced in a situation where one is worsening. However, the distinction line between both risks is thin. The assessment of country risk will be treated based on the separate evaluations of political and economic risks.

3.1 Political Risk Elements

Political risk and political instability are not synonymous. While political instability may exist without endangering business interest, political risk does and it is measurable. Political risk evaluation considers the various influencing factors which can be inherent, evolve out or have their origin outside a particular country. These factors can have positive or negative influence hence leading to political opportunities or risks.

Political risk factors inherent in a country can result in such situation as internal turmoil, rebellious conflicts, revolution or coup d'etat, corruption etc. Such factors include the formulation of policies on constitutional environment, political parties, quality of government, government crises, foreign policy, economic systems, social structure, demographic structure, ethnic and religious differences, labour relations, legislation

regarding foreign investment. Recall that the management of these factors determine whether the result will be political opportunities or risks(16). For instance, a combination of high literacy rate and unequal distribution of income leads to discontent and instability; high literacy rate and equal distribution of income results in contentment and stability while low literacy rate and unequal distribution of income bring about lack of awareness and stability.

There are external political factors worth mentioning. These have their origin from outside the specific country. They include non-beligerent intervention by a third country through arms supply for instance, discriminating acts such as disinvestments, sanctions etc. by international organisations or multinationals; war or warlike conflicts involving several countries.

3.2 ***Assessment of Political Risk***

Assessment of political risk is not only the task of foreseeing a deteriorating situation but also finding new opportunities where the degree of political risk is diminishing. Three basic methods exist as follows:

3.2.1 Qualitative Method

This is based on experience and analytical abilities of experts in the field. It can lead to classification of different countries according to the scale of extremely high risk, high risk, medium risk, low risk, very low risk. The extremely high risk country have most risk factors asserted negatively though a single factor such as expropriation, nationalisation, controlled or restricted capital repatriation can significantly determine

political risk rating. In such countries, business transactions are usually done on a government to government basis while private companies abstain from doing business with them. Where it is done, it can be highly profitable. A very low risk country on the other end of the scale gives no headache whatsoever to foreign investors or lender. Here, competition is at its peak.

Due to the intricacies and subjectivity of the qualitative assessment, certain crucial conditions are recommended for effective assessment. These include:

- the evaluation should be based on teamwork of at least three persons with at least two of them having a good knowledge of the country and first hand access to intelligence report on the country.
- one of the members must be a political analyst, a political experts.

The use of a political adviser who is an expert on the political developments of a specific country or area is another method. This however depends unilaterally on the quality of the expert who of course is not a monopolist of knowledge hence is also prone to mistakes. The most recognised qualitative method is the Delphi method, where the advice of experts is sought in a systematic way. The institution enumerates the different political factors that influence the political future of a nation; then rank and weigh the importance of these factors based on the views of the independent experts. The results are then assembled in a ranking or index of political risk.

3.2.2 *Quantitative method*

This method relies on the use of multivariate analysis. The distinguishing factor is that one or several variables are taken as independent variables of some others. The variables influencing each of the political risk factors are determined, measured on a scale and added together to form an indicator. For instance, consider social structure as a social factor with wealth per head, degree of urbanisation income distribution and degree of literacy as variables of its risk. Using literacy and GNP per head as the dependent variables scaled on 1-10 or 100 percent for GNP per head of more than =N=10,000. Relating both variables, the sensitivity of the political risk can be measured thus:

I=A/B where A = degree of literacy (1-10)
B= GNP per head (1-10)
I= indicator sensitivity political risk

Introducing a third variable such as the distribution of wealth can be given by

I = A/B x C where C= distribution of wealth

The basis of the quantitative method involves

- careful selection of quantifiable political factors
- interrelating them such that they influence political risk. These help to give one political risk indicator. Other indicators are likewise determined and weighted against each other. Because of the difficulty of finding quantifiable variables and weighing the different indicators, the quantitative method is often limited to risk such as expropriation or nationalisation.

3.2.3 *Integrated Method*

Here both subjective and objective approaches are brought together. It involves establishing a check-list of the relevant political risk factors, attributing variables to them

which are then weighted. For instance, foreign policy as a political factor can be evaluated as follows:

-the foreign policy of the country evaluated in relation to its neighbours, to its belonging to a bloc, to its cultural heritage, is in view of the political risks involved:

<u>Points</u>

-very comforting	0
- stabilizing	2
-no influence	5
-dangerous	8
-very risky	10

This factor is then weighted in the context of all the other political factors evaluated giving a score which would then be indexed according to riskiness.

Two crucial elements: the actors and time horizon play important roles in political risk assessment because the actors determine the level of risk while the time horizon gives a dynamic approach to it.

3.3 **<u>Transfer Risk Elements</u>**

This refers to the "economic risk". The total risk involved is the total of the cross-border liabilities of a country and its institutions which is usually denominated in the most active international currencies(16). The economic risk or capability to honour the obligations/debts of a country therefore has a direct relation to its capability to earn or obtain the sufficient foreign exchange to service its debt as a sovereign borrower and

those of the private institutions operating within its frontier. This ability is rooted in its current account balance and the balance of capital movements.

Like in a commercial credit, the cross border liabilities of a country is paid through future foreign exchange earnings or additional capital import. A country's will is therefore examined in view of its economic situations, its production potential, its foreign trade, its inflation and its resources as well as remittances of persons working abroad.

The earning or spending of foreign exchange is in direct relation to a country's international activities, that is, import and export as well as to its international service activities such as tourism, financial activities, royalty income from licensing agreements, insurances, etc. The building up of foreign exchange assets or incurring of liabilities is the difference between the amount earned or spent.

Various factors influence the foreign exchange operations of a country both from within and without having their effects on the current account or capital movements or on both. From within, we have such factors as inflation, currency parity policy (devaluation and revaluation), economic policies, use of foreign funds, terms of trade and services, natural resources, foreign debt management, capital movement and unilateral transfers. From without, factors worthy of note are trade barriers, commodity prices, interest rates, natural catastrophy, transportation, market conditions, and concessional funds. Beyond the above are factors like size of the economy, GNP per head and membership of an economic grouping that determine the capability of a country to obtain or incur foreign debts(16).

3.4 **Assessment of Transfer Risk**

There are several quantitative and qualitative methods of assessing transfer or economic risk. However, depending on the aim, the assessment method is chosen according to whether the primary objective is to determine the liquidity (ability to liquidate debt in the short run) or its solvency (long run settlement). The important work is the elaboration of the best mix of methods.

The best known and most pertinent measures of transfer risk are given below:(16)

3.4.1 *Debt-Service Ratio*

This is a ratio measured for a period of one year and expressed as percentage. It is given as:

$$\text{Debt-Service Ratio} = \frac{\text{Principal + Interest paid on external debt}}{\text{Foreign Exchange Income}}$$

This ratio is also a forecast for future periods. However, while the interest and principal payments can be predicted from the repayment schedule, the stream of income may not be easy except based on certain assumptions .

Generally, the lower the ratio, the better. For instance, 10% is considered very good, 25% indicates difficult situation.

3.4.2 *Debt -GNP Ratio*

This ratio excludes short term debts up to one year. It is expressed in percentage. It is given as:

$$\text{Debt-GNP} = \frac{\text{External Public + Private Deb}}{\text{GNP}}$$

The higher the ratio, the higher the risk. Less than or equal to 15% is considered acceptable while less than or equal to 30% signifies difficulty. The Debt-GNP ratio cannot be used for spotting liquidity problems but in assessing the overall creditworthiness of a country i.e. long run solvency rather than liquidity.

3.4.3 *Interest Service Ratio*

This focuses on the liquidity aspect while still excluding short term external debt under one year. It is usually lower in value than the debt service ratio the difference being the percentage of exports of goods and services needed each year to service the principal. It is given as :

$$\text{Interest Service Ratio} = \frac{\text{Interest payment over period N}}{\text{Exports of goods \& all Services over period N}}$$

3.4.4 *External Debt -Export Ratio*

This ratio indicates the extent to which total exports of goods and services can be used to liquidate external debt obligations.

$$\text{External Debt -Export Ratio} = \frac{\text{External Debt}}{\text{Export of goods \& Services}}$$

3.4.5 *Reserves - External Debt Ratio*

This measures the extent to which external reserves could be drawn down to liquidate external debt commitments. The lower the ratio, the more precarious the external debt situation and vice versa. This is expressed in percentage.

3.5 Global Assessment of Country Risk

Having examined the political and economic risks, we shall examine how both risks are combined to arrive at the country risk assessment. A global assessment of country risk is obtained through an overall index, combined index or the matrix solution.

3.5.1 Overall *Index*

Here, the basis is that the weighting of the two aspects is different for different types of cross-border liabilities. For instance, an investment in another country depends on political risk while a sovereign loan is more influenced by transfer risk. In country rating based on this method, political risk is often assigned a 30 percent weight while transfer risk is weighted 20 percent and 50 percent for solvency and liquidity respectively. Most rating agencies apply this method.

3.5.2 *Combined Index*

Here, the index for transfer risk is divided into score groups, that is, 1-20 for category I and 81-100 for category V. This is further divided into solvency or liquidity risk index. The political risk index groups it into A-E. For instance, a country rated A/IV/IV has a very low political risk and a low transfer risk for the solvency as well as liquidity aspects.

3.5.3 Matrix Solution

Here, the political and transfer risks are divided into their components. Each country is scored for each of these major aspects of country risk assessment which is then placed in the squares of the matrix (see figure 3.1).

FIGURE 3.1 **MATRIX FOR COUNTRY RISK ASSESSMENT**

POLITICAL RISK

	I	II	III	IV	V
A					
B					
C					
D					
E					

Source: Country Risk Assessment and Monitoring

3.6 Country Risk Rating Agencies

Because of the expertise required in rating countries and the diverse elements of political and transfer risks, a few international agencies[10] rated and published country ratings based on certain selected criteria. They generally involve experts in the ratings. Such agencies include Business Environment Risk Information Institute (BERI) now called Business Risk Service which base its assessment on three criteria -business climate for foreigners, political stability and currency/repayment risk. Euromoney base its assessment on the performance of countries in the financial markets (Yankee and Eurobonds etc.) such as access to the market selldown (success of the operation) as key criteria. Institutional Investor bases its assessment on survey on credit worthiness by 75-100 internationally operating banks. International Country Risk Guide (ICRG) rates

countries based on specific scores on political, financial and economic risks with the first contributing 50 percent while the other two contribute 25 percent each(16).

Footnote

8. The presence of a political expert does not elimiate the subjectivity of the assessment but offers direction as to the assessment based on his skill and experience

9. The net of a country's import and export values periodically determines accummulation of foreign exchange or debt

10. A few international agencies have been identified over the years as competent to assess country risks using portfolio approach.

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CHAPTER FOUR

DATA ANALYSIS

Failure in political governance coupled with the consequencies of macroeconmomic instability have led to dramatic increase in violent crimes and general deterioration of security of lives and properties- Chief Christopher Eze (Guardian,12/12/95)

4.1 Genesis of External Debt In Nigeria

Nigeria's external debt dates back to the 60's which ranged between =N=82.4 million and =N=489 million in 1960 and 1970 respectively. Then interest rates were as low as 2 percent in some cases, debt service ratio was 1.1 percent in 1960, 3.7 percent in 1965 and 3.5 percent in 1970. The nation's economic burden (debt service to GNP ratio) was 3.4 percent in 1960, 12.5 percent in 1965 and 8.2 percent in 1970. Then the access to loan was limited by the doubt of the Less Developed Countries to repay.(1)

The turn of event was drastic in the 70s. The discovery and quadrupling of oil prices in the mid 70s drastically reduced the country's debt-service ratio to 2.7 percent in 1975 and 0.4 percent in 1977 while the total debt declined to =N=374.6 million in 1976(1). The phenomenal increase in the country's revenue raised Nigeria's credit worthiness forcing attention on the economy by the forces of International Capital Market while the multinationals established links with members of the indigenous bourgeoisie and state officials plunging the nation into debt trap11. The sustenance on large scale importation of inputs such as raw materials, spare parts machinery and so forth for modern industries and agricultural sector development required increased funds (domestic and foreign). The oil revenue inflow (foreign exchange) was steady covering the contradictions inherent in the heavily outwardly-oriented import substitution industrialisation strategy which started surfacing at the sudden drop in oil price witnessed in 1977. Therefore, by

1978 the foreign exchange reserve available to the country was no longer sufficient to sustain the huge import needs of the economy. It was at this point that Nigeria entered the International Capital Market for a loan of $ 1 billion in 1978 to finance a number of major public sector projects such as laying of oil pipelines, construction of storage tanks, establishment of oil refineries, pulp and paper mills, steel plants, sugar projects and port development across the country(1).

The loan was faced with problems from the onset and in its management. For instance, the disbursements and repayment schedules were unrelated to the profitability or viability of the projects. In spite of this, importation continued until the total unrefinanced trade arrears accumulated by Nigeria rose from 39.2 percent in 1982/83 to 92.3 percent in August 1983/84. By 1986, the trade arears of Nigeria accounted for 20 percent of total debt(1). Another major problem was the sectoral allocation of the loans. For instance, in 1983, outstanding debt was 34 percent in manufacturing which was more into light industrial consumer goods, 31 percent in infrastructures, 21 percent in community development, 5 percent in agriculture, 5 percent in services and others-19 percent(1).

4.2 Dimensions of Nigeria's External Debt

With the upward trend in the country's debt on one hand and the downward trend in foreign exchange generation on the other hand, Nigeria introduced the stabilisation programme. Because the country could not meet repayments of the loans as they fell due, the need to negotiate with the foreign creditors arose. Technically, short term loans are not part of external debts but because of the arrears in payments for imports,

negotiations resulted in conversion of such repayments into medium term loans or rescheduling.

Negotiation is never easy especially with the debtor nation at the receiving end. Foreign creditors usually insist on implementation of austerity measures as a pre-condition for negotiating loan rescheduling, refinancing and servicing. In essence, they use the carrot of the various loans at their disposal and the stick of punitive international financial boycott to impose a particular kind of adjustment package on the debtor country.(16) The *trend of Nigeria's debt burden between 1983 and 1991 is shown in* Table 4.1. About 75 percent of the total external debt outstanding by 1985 was known to have been borrowed from private sources with short repayment periods. These consequently bunched and opened into the crisis Nigeria is still wriggling to get out of today. The debt / GDP ratio rose from 3.8 percent in 1980 to 20.5 in 1983 and 350.1 percent in 1991 as shown in figure 4.3(3). As Western creditors refused to open up new credit lines, the IMF Structural Adjustment Programme (SAP) became a precondition for negotiation.

Table 4.1 **NIGERIA'S DEBT BURDEN (1983 - 1991)**

	1983	1984	1985	1986	1987	1988	1989	1990	1991
Multilateral	844	1097	1317	1887	2985	2838	3171	3842	3650
Paris Club	5390	5811	7833	10228	12589	14400	15871	17171	17793
London Club	6263	4996	3560	6088	5860	5960	5680	5861	5988
Promisory Note	3702	4125	4255	4498	4850	4810	4553	4550	4479
Others	1526	1318	1939	2873	2032	2685	2311	2675	1454
Total	17765	17347	18904	25574	28316	30693	31586	33099	33364

Source: CBN Economic & financial review Vol. 30, No. 2 page 79

Table 4.2 **SELECTED EXTERNAL DEBT RATIOS (PERCENT)(1990-94)**

Ratio	1990 (1)	1991 (2)	1992 (3)	1993 (4)	1994 (5)
Debt Service Payments Due/Exports	50.0	47.1	71.3	42.1	42.5
Actual Debt service payments/Exports	26.8	29.1	20.1	16.9	18.7
Interest Payments due/Exports	20.6	19.9	20.3	20.3	17.6
Actual Interest Payments/Exports	11.6	14.3	5.7	6.3	9.7
Capital Repayments/Exports	29.4	27.2	51.0	21.8	24.9
ActualCapital repayments/Exports	15.2	14.9	14.6	10.5	9.7
Debt Stock/Exports	242.1	275.0	231.9	273.3	292.1
Debt Stock/ G.N.P.	114.3	101.2	98.9	79.0	72.3

Source: (i) Central Bank of Nigeria

(ii) Federal Ministry of Finance Review vol.30, No.21 page 80

Table 4.3 **DEBT-SERVICING CAPACITY RATIOS (1983-91)**

	1983	1984	1985	1986	1987	1988	1989	1990	1991
Debt Service Ratio	16.6	25.9	28.4	29.4	19.3	26.3	21.9	26.4	25.8
Debt Service to External Reserves	190.6	225.3	219.1	89.9	136.9	268.1	104.5	88.3	79.8
External Reserves to Import	1.1	2.0	3.0	7.9	3.4	2.0	5.9	10.5	6.9
Debt Service to Govt. Revenue	23.9	36.8	37.0	40.5	39.4	56.3	52.7	78.2	109.6
Debt to GDP	20.5	21.1	24.5	62.3	158.9	179.1	278.5	294.2	350.1
Debt to Exports	148.9	133.7	131.7	404.2	341.0	418.3	362.9	227.6	241.5

Source: CBN Economic & Financial Review, Vol 30, No 2, Pg 80

4.3 **Nigeria's Debt Management Strategies**

Management of Nigeria's debt problem has generated different policies and strategies. In 1982, the Economic Stabilisation Act was promulgated. Various exchange and trade control and regulatory policies were introduced. The commissioning of Chase Manhattan Bank to ascertain the extent and genuineness of the short term loans in 1984 was a precursor to the introduction of the structural adjustment programme in 1986. This programme was introduced with emphasis on reliance on market forces. Analysis of the measures taken by the Federal Government to manage the country's external debt is enumerated below:

4.3.1 *Refinancing of Short Term Trade Arrears*

The economic difficulties facing the country in the early 1980's constrained the nation's ability to pay for its imports, arrears of trade debts were accumulated. The foreign creditors refused to open new lines of credit hence it became imperative to seek for relief by refinancing the arrears. The $ 2112 million worth of letters of credit outstanding as at July 1983 was renegotiated and refinanced under such terms as repayment period of thirty months with grace period of six months and interest rate of 1 percent above LIBOR per annum(3). This could not help issues because international trade continued while forex earnings and reserves depleted. Thus in 1984, government again refinanced the existing arrears especially those contracted through open accounts and bills for collection by issuing promissory notes. The terms were repayment in fourteen equal quarterly installments over six years with two and a half years moratorium; interest rate of 1 percent above the average lending rates of international banks in New York, London and Paris(3). The same reasons earlier mentioned led to the country's inability to meet up hence renegotiation to stretch the repayment period for twenty two years with an

effective rate of 5 percent per annum. The total amount of promissory notes issued then amounted to $4.8 billion(3).

4.3.2 *Rescheduling and Restructuring of Commercial Banks' Debts*

The London club debts cover foreign trade arrears incurred through the medium of letters of credit. These debts accumulated after the first refinancing exercise in 1983. On negotiation between 1986 and 1987, about $ 2.86 billion was refinanced while $ 3 billion was restructured(3). The agreements included interest rate of 11/4 percent per annum above LIBOR with repayment over five years; provision of new money of $320 million, repayment of $1.345 billion per annum. As it is obvious, the country could not meet the high debt service obligation. Therefore, the club did not release the new money. Another attempt through the 1989 refinancing and rescheduling amendment agreement was to reduce the annual repayment from $1.345 billion to $711 million which Nigeria could still not meet(3).

In 1990, Nigeria approached the London club for restructuring of the debt over thirty years through conversion of the debts into bonds with a grace period of ten years and interest rate of 3 percent. Negotiation resulted in a list of terms including(3)

-Principal amount to be collateralised with U.S treasury zero coupon

-Interest rate of 51/2 percent per annum for the first three years and at 6.25 percent per annum thereafter

-Elected banks for the traditional rescheduling were to provide 20 percent of the amount committed to the option

The agreement was successfully closed in 1992 with Nigeria buying back 62 percent of the debt and issuing collateralised par bonds for the remaining 38 percent.(14)

4.3.3 *Paris Club Rescheduling*

Nigeria's rescheduling agreements with the Paris club were in 1986, 1989 and 1991(1). While the first two were based on conventional or traditional terms with market related interest rates, the 1991 agreement was based on terms applicable to the medium income heavily indebted countries of the lower category. The Paris club debts by December 1991 constituted about 53.6 percent of the country's total debt stock(3). Therefore, the debt service commitment resulted in high net outflow of foreign exchange. In spite of the existence of concessional terms such as were granted Toronto, Trinidad, Poland/ Egypt etc., and Nigeria's efforts to secure any of these, the Paris club has remained adamant. Rather, those offering temporary relief structures to apply only to debts maturing within a short time were granted. This has made rescheduling under the Paris club very complex and complicated.

4.3.4 *Debt Conversion Programme*

This is also referred to as "Debt Capitalisation", "Debt Equitisation", "Debt Securitisation", or "Debt Resuscitisation"(1). In its simplest form, it refers to the transformation of a debtor's obligation into equity capital in the creditor's name within the debtor's country. This was introduced by the Nigerian Government in 1988 with the objectives of reducing the external debt stock and to lighten the debt service burden, encourage capital inflows including repatriation of flight capital, assist in recapitalisation of private sector investment and the regeneration of employment opportunities. Initially, the eligible debt

was limited to promissory notes but later expanded to cover bank debts(14). As a result of substantial discounts offered and commissions paid, equity worth $2.4 billion was approved in principle and $800.1 million was actually redeemed between 1988 and 1993. The debt conversion programme has been a major vehicle for the inflow of foreign exchange investment in recent years with a significant part of the proceeds of debt conversion since 1989 being invested in many enterprises for the purpose of raising foreign equity participation in existing enterprises or establishing new companies. To date (December 1995), a total of $948 million has been redeemed through the scheme with the last auction in December 1995 yielding $15.15 million thereby reducing the country's estimated debt of $33billion by the same amount (Guardian, 27 December 1995, page 18). Tables 4.4 and 4.5 show the sectoral distribution of disbursement of debt conversion proceeds and summary of debt conversion up to December 1994 respectively.

Inspite of these debt management strategies adopted by Nigeria, the debt problem lingers on. This is because the rescheduling and restructuring of debts so far achieved through negotiations with the London and Paris clubs merely postponed repayments. It is not the panacea to Nigeria's debt problem. In the long run, only the pursuit of appropriate macroeconomic policies can guarantee the avoidance of external debt problems.

TABLE 4.4 **SECTORAL DISTRIBUTION OF DISBURSEMENT OF DEBT CONVERSION PROCEEDS**

							% of Total	Percentage Charges over Preceding Year			
Sector	1990 (1)	1991 (2)	1992 (3)	1993 (4)	1994 (5)	1990-94 (6)	(7)	1991 (8)	1992 (9)	1993 (10)	1994 (11
Agriculture	165.6	41.0	115.2	4.4	1.6	327.8	8.9	-75.2	181.0	-96.2	-63.6
Manufacturing	389.2	152.8	617.5	52.7	0.6	1,212.8	33.0	-60.7	304.1	-91.5	-98.9
Mining & Exploration	34.2	55.2	-	-	-	89.4	2.4	61.4	-	-	-
Building & Construction	46.2	155.1	321.3	31.3	4.6	558.5	15.2	235.7	107.2	-90.3	-85.3
Hotel & Tourism	149.4	244.0	120.0	3.4	-	516.8	14.1	63.3	-50.8	-97.2	-
Gifts & Grants	144.4	68.0	89.0	121.3	196.6	619.3	16.9	-52.9	30.9	36.3	62.1
Services	-	1.2	5.5	266.6	75.7	349.0	9.5	-	358.3	4,747.3	-71.6
Total	929.0	717.3	1,268.5	479.7	279.1	3,673.6	100.0	-22.8	76.8	-62.2	-41.8

All figures exclude value of debt

Source: Central Bank of Nigeria Annual report (1994) pg 67

Table 4.5 SUMMARY OF DEBT CONVERSION UP TO DECEMBER, 1994

	At Auctions		Outside Auctions		Total	
	1994	1990-94	1994	1990-94	1994	1990-1994
Amount Redeemed:						
a. US$ Million	7.78	398.17	5.56	116.9	13.34	515.07
b. =N= million	169.36	4,909.46	121.17	1,412.91	290.49	6,322.37
Discount Offered						
a. US$ Million	2.32	177.27	1.65	57.43	3.88	234.7
b. =N= million	50.57	2,166.98	35.84	719.88	86.45	2886.86
c .Average Discount %	29.89	-	29.43	-	29.66	-
Proceed:						
a. US$ million	5.46	220.9	3.91	60.31	9.37	281.21
b. =N= million	118.79	2,742.88	85.33	692.63	204.04	2,886.86
Commission Paid						
a. US$ Million	0.01	5.04	0	0.59	0.01	5.63
b. =N= Million	2.3	8.08	2.12	2.6	4.42	10.68

Transaction commission payments and Agency Fees not deducted

Source: CBN Annual report (1994) pg 68

4.4 Country Risk Elements In Nigeria

The economic environment in Nigeria is fraught with many counter productive elements. These elements imprint on the country scars that seem indelible. Various political elements have surfaced in the last fourteen years which have negated the development plans charted out for the country since independence[12]. In effect, the elements per se do

not result in risks but the management of the elements tilt them towards being opportunities or risks .

The relevant elements as it relates to Nigeria include the following:

4.4.1 Economic

Industrial Capacity Underutilisation - The problems of low productivity and capacity utilisation are traceable to the lack of adequate capital compounded by production techniques (resulting from the failure to modernise the techniques of production) on the one hand and the negative effects of certain inconsistent monetary and fiscal policies of the Nigerian government on the other hand[13].

Inflation - Inconsistencies in the monetary and fiscal policies in Nigeria have over the years fueled inflation to unprecedented levels such that on certain products, inflation rate goes as far as 1000 percent within a period of ten years. However, by Central Bank of Nigeria report, average rate of inflation over the past year is about 70 percent as at December 1995.

Unemployment /Retrenchment - The rate of unemployment in Nigeria is further heightened by the unhealthy investment environment which led to the shrinking of production capacities and hence retrenchments.

Banking Sector Participation - The changes in government financial policies, uncertainties associated with the prevailing high rate of inflation, political atmosphere brought about increased development in the banking sector in the 80s until early 90s. However, the trend is now reversed with the about one hundred and twenty commercial and merchant banks being traumatically reduced as a result of distress in the sector. As at today, Central Bank of Nigeria has classified over twenty banks as liquidated while

another seventy-eight are being tagged distressed. This obviously has discouraged both domestic and international investments in the banking sector.

Capital Flight- The outflow of money otherwise meant for investment in the economy is not only on the increase but has shot past the roof heading for the sky. Capital flight was before now due to corruption, over-invoicing among others but in the past two years, it is attributable to strain and sanctions on trade between Nigeria and other organisations, cancellation of assistance for development by the international community in addition to what obtained before. Debt servicing is increasing but inflow is decreasing.

Living Standard - The fact that the standard of living has drastically fallen in Nigeria is an understatement. Over the years, the middle class has been wiped out, the citizens can no longer afford the basics of life not even three square meals a day. Clothing has become luxury. Getting a job has turned out to be a priviledge. What else can be said to decipher it?.

Currency Value- The achievement of a stable value for the Naira is one of the cardinals of the Structural Adjustment Programme. This has haunted the various governments of Nigeria to date. The current government is still battling with the possibility of merging both the official and foreign exchange market rates. As at 1977, the exchange rate of Naira to the United State's Dollar was =N=0.67 to $1 but in 1995, the rate is as high as =N=85 to $1.

(b) Political

Instability in Government - Nigeria has undergone frequent changes in government administration since political independence[14]. This has hurt the country's prospects for attracting and enhancing foreign investment.

Human Rights - The state of human right in Nigeria can best be described by the current situations with respect to relationships with foreign organisations. Two united States banks including American Express have suspended all transactions in correspondence banking with their Nigerian counterparts ("The Guardian", December 2, 1995 pg 13). The most recent happenings in Nigeria include the mass arrest, secret trials and sentences by special military tribunals of the citizens including former Head of state and his deputy among others, hanging of nine citizens and so forth against the plea for mercy by the international community. These have led to chains of reactions from the international community.

Corruption - Corruption has eaten so deep to the point that it is almost a culture in Nigeria. The level has grown to international acclaim that it was video taped and televised in the United States of America. It is rare to get anything or even your right without having to bribe people across the hierrachy of the organisation in charge. Free movement is sometimes achieved through bribery as the law enforcement agents may harass you for "kola" to grant you passage at roadblocks.

Social Structure - The economic milieu in Nigeria has gradually blotted out the hitherto existing middle class from the social structure. What has now emerged is an ever increasing gap between the high class constituted by a few priviledged and the lower class who daily look forward to how to survive the next minute.

Ethnic and Religious Differences - Tendencies such as ethnic bigotry and religious fanaticism have heightened social and political tensions which randomly explode or erupt in fatal clashes among the different groups. These have only succeeded in fear and uncertainty in the lives of foreigners or non-indigenes.

Security of Lives and Properties - As in a vicious circle, the rate of crime in the country is of great concern stemming from the high rate of inflation, unemployment and retrenchment, falling of living standard to near nothing, high cost of education and social services etc. This is a constituent blockage to domestic and foreign investments in the country.

4.5 **Analysis of Present Situation In Nigeria**

These elements of country risk as they relate to Nigeria are numerous. However, even with the few enumerated above, their management by the various governments of Nigeria over the years has influenced the relationship of the country with the outside world. The eras of regulated, deregulated and controlled-deregulated economy have recorded various impacts on the development of the country. For instance, the Nigeria Enterprises Promotions Decree of 1971 classifying enterprises into three categories led to nationalisation of some foreign investments in Nigeria and thereby discouraged subsequent foreign investments. The post-SAP foreign investments strategies were based on five cardinal structures viz.:

-establishment of Industrial Development Coordinating Committee

-restructuring and stream lining of incentive policies

-emphasis on non-oil export stimulation and expansion

-privatization and commercialisation

-tilt in macroeconomic management towards liberalisation, deregulation and market based arrangements

In spite of the positive effects of the above policies on the inflow of foreign investments, various other factors negate their effects. Such include

-current external debt burden

-infrastructural development

- socio-economic factors

-political instability

Various ratings have been made on Nigeria by internationally recognised organisations. Such include the United Nations Development Programme ranking of 1992 which introduced human development index as an alternative measure of socio and economic progress based on the thinking that Gross Domestic Product is an incomplete measure of the relative living standards. The human development index is a cocktail of life expectancy at birth, income, adult literacy and emolument ratio in primary, secondary and tertiary education. Of the one hundred and seventy four countries rated, Nigeria ranked one hundred and thirty five and one hundred and forty based on Gross Domestic Product per head and human development respectively. In the fourth quarter of 1994, Nigeria was ranked by the Economist Intelligence Unit, a sister of the Economist, as having a country risk rating of 77 percent. This rating was based on economic and political factors(7). The implications of this rating is that the business environment in Nigeria by the last quarter of 1994 is only about 23 percent safe. It is worthy of note to state that the 1994 rating took into consideration the effects of the June 12, 1993 political event, that is, the nullification of the Presidential election considered the freest and fairest in Nigeria in some quarters.

However, the year 1995 has witnessed hard times in the relationship between Nigeria and the international world. Following the castigation of some key Nigerians and the hanging of nine citizens in November 1995, Nigeria is almost being ostracised by the

outside world as a result of the human rights policies. This followed the focus on Nigeria by the international community in the past three years. With such articles/publications as

-Nigeria: Expert In Coups (March 11, 1995)

-Little Nigeria :A Big Country Diminished By Its Military Rulers (March 25, 1995)

-Nigeria's Missing Billions (October 22, 1994)

-The Great Nigeria Scam(January 7, 1995)

-Nigeria About Turn (January 21, 1995) etc. featuring in international magazines such as "The Economist" among others and the scam documentary on Nigeria being shown in the United States on America, Nigeria's grave had been gradually dug.

The condemnation and hanging of the nine Ogoni men heightened the situation as it led to the following within one month of the execution:

-immediate suspension of Nigeria from the fifty-three member commonwealth of nations communities as a temporary measure and a promise of total extradition if the country does not return to democratic government rule within two years .

-imposition of arms embargo, aid and visas restrictions on Nigeria while holding oil embargo as a "joker" if Nigeria aggravates the matter. (A list of the European Union assistance to Nigeria totaling nine hundred and twenty ECU, equivalent of =N= 8834 billion in Appendix VI is a pointer to what impact EU assisted programme have on Nigeria and its development).

-Immediate recall of the Ambassadors to Nigeria of about twenty five countries

-Withdrawal of International Finance Corporation's participation in the Liquefied Natural Gas project in Nigeria

-Isolation of Nigeria from games with Europe/sanctions on sports

-Threat to freeze foreign assets of members of the present Military Government estimated at about $30 billion while the country owed about $36 billion.(Newswatch, November 27, 1995)

-suspension of the =N=1 billion proposed Nigerian Danish business school & result of interview for Danish scholarship (Guardian, November 20, 1995, page 2). The situation is so grave that Shell Canada lost a $850,000 contract it was bidding for in the United States due to it's continued presence in Nigeria's offshore. Even South Africa cancelled the invitation of Nigeria's soccer team to participate in a tourney in December 1995 and imposed sanctions on Nigeria. Thirty-two South African companies recently held on to their proposed investment in the mining sector totaling more than $1b. All these are in addition to the initial steps taken by the international community against Nigeria since the annulment of the 1993 Presidential election which include

- Loss of the African Development Bank's Presidential race by Nigeria.

-Withdrawal of some foreign investments in Nigeria by some multilaterals, for example, American Express Bank has suspended all it's correspondence banking activities with their Nigerian partners.

-Withdrawal of the American Airlines from Nigeria's route

- cancellation of $11m aid to the health sector by U.S .

-Withdrawal of educational aid to Nigeria by the commonwealth states .

Recently, the Organisation of African Unity summoned an emergency meeting to review and monitor the human rights situation in Nigeria which it perceives require some attention.

aids from the European Community is already grounding the transport, health, educational and other sectors of the economy. The present situation will be a piece of the iceberg if the international community decide to release their "joker " of oil embargo on Nigeria. This is because oil revenue constitutes 95 percent of Nigeria's foreign exchange earnings. The effect is that the country will have near to nothing to live on with respect to development programmes and maintenance of existing infrastructures. The international community having lost confidence in Nigeria will hold on to or divert their funds to other nations rather than Nigeria. The debt on ground will be pursued vigorously for repayment negotiation for reshedulement will not be encouraged or considered, international trade will be hampered hence blocking another source of financing the economic programmes. In essence, the existing infrastructures may collapse if not rescued. What then becomes of the nation under such circumstances? One thing is basic, no country can afford to be an Island and in a world of power politics, the weaker countries tend to be eclipsed.

Footenotes

11. The autonomy of the private sector and states after the crash in oil prices introduced the economy into debt a greater percentage of which was deadweight debt
12. The development plans of Nigeria have always been classical but implementation have been fraught with social ills such as corruption, favoritism, etc.
13. Modification of monetary and fiscal policies within short periods leading to inconsistencies and instability in business environment
14. About ten government administrations within thirty-five years of independence

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CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

No country can afford to be an Island. The world of today is such that it is interdependent. Even at that, the complexity of international relationships is such that it becomes unwise to seek to be isolated . — Segun Odesola , University of Lagos(Guardian, November 20th 1995)

5.1 Synopsis of Study

The issue of discussion and analysis in this study focuses on the impact of country risk on cross-border financing and national development.

The opening chapter gives an in-depth introduction to lending and borrowing across the borders, the reasons for such creditor -debtor relationships, the trend of such credit flow between the developed and the Third World nations, debt management strategies and the great concern of the inability of the third world nations to repay their debts. The problems, significance and scope of the study were highlighted in the chapter.

The next chapter gives a review of cross-border financing followed by International Financial Institutions, country risk as marked from credit risk and external debt management strategies in Nigeria as extracted from literature.

Assessment of country risk based on different factors by internationally recognised bodies and the basic elements of transfer and political risks form the core of the third chapter. The quantitative and qualitative assessment methods were examined .

Chapter four gives in-depth analysis of the external debt situation of Nigeria, the debt management strategies and achievements, factors constituting country risk elements in

the Nigerian environment. The current economic and political situations in Nigeria were analysed. The combined effects on the country is reflected in the country risk ratings and ranking by international bodies as well as the recent unfriendly postures of the international communities on Nigeria. These range from sanctions to threats. These have negative effects on the debt management strategies of Nigeria.

The closing chapter gives a summary of the study, concluding on the impact of country risk on cross -border financing and national development while recommendations were offered for the Nigerian situation.

5.2 **Conclusion**

Conclusively, country risk plays a vital role in the decision to grant credit on trade or loan to any individual, organisation or government across the borders of a nation. Apparently, the need for recovery is utmost on the minds of any lender. Therefore, any real or apparent obstacle is considered in the appraisal of the feasibility reports submitted by the borrower. Noting that such appraisal based on the report submitted can only take care of the financial and presumably the economic risks, a further step is taken to evaluate the political risks, which are far becoming key-success-factors to financial management.

Liquidity problems are largely political, revolving around to what extent living standards in the borrowing country can be depressed to generate enough foreign exchange to service the debt. However, the case of most borrowing nations including Nigeria is such that all formulae offered and all technical or mathematical computations point to the fact that the debt can simply not be repaid if the countries want to maintain the minimum subsistence

level. Obviously, the implications of external debt on Nigeria include financial strains and reduction in the living standards of the generality of the people; psychological fear to displease her creditors even at the risk of ruining the country or encouraging its enslavement by the West or creditors.

The recent developments in the political and economic situations have deteriorated the investment climate significantly since 1994 largely due to the economic policies and the continuing political struggles for the country's leadership. The situation is reflected in the growth of the Gross Domestic Product shown in appendix vii

In spite of the current improvements in the country's investment policies, the inflow of foreign investment is not forthcoming due to the unstable economic environment, huge external debt, political climate and security of life and private property. Given a free and virile press as in Nigeria reporting both good and bad, it should be stressed that foreigners take note of all the negative reports coming out of Nigeria. Serious investors cannot ignore them. The same is true of the international creditors who are not pleased with the situation report, they certainly will refuse to grant additional credit lines nor favourably negotiate the loan for rescheduling or refinancing not even repudiation or debt cancellation.

The situation in Nigeria is a far cry from self- sufficiency in virtually all spheres, therefore, the recent sanctions put the country in a tough opposition never precedented in her history. Nigeria cannot survive under complete international isolation and trade embargo especially at this stage when the country is in a bad shape or mildly put, the country will

hold the concerted global reprisal against her only at a great peril. The story of Ghana's experience in 1971 with the International Monetary Fund is a testimony for a country which attempts to be an Island.

5.3 **_Recommendations_**

From the analysis of the impact of country risk on cross -border financing, international trade and ultimately national development and Nigeria's recent experience in the past two months, the following are considered as measures that can address the current situation for improvement:

-strict discipline should be exercised in implementation of the investment policies. Good monitoring measures devoid of corruption, laziness and other forms of indiscipline should be put in place permanently

-infrastructural facilities should be developed and maintained to provide friendly and conducive atmosphere attractive for industrialisation both domestically and internationally as well as revitalise the ailing ones--the concept of the Nigerian Export Processing Zone Authority is in the right direction

-the league of debtor nations should go into cartelisation to team up, mapping out strategies to manage their debts

-reformation of the social milieu to guarantee safety of lives and properties as well as discipline among the Nigerian citizens through leadership by example

-resume immediately the privatisation of the government dominated parastatals such as Nigerian Telecommunications Limited, National Electric Power Authority, Water Corporation etc. to allow for efficiency in delivering their services

-granting autonomy to the Central Bank to freely manage the monetary and fiscal policies of the nation

-return of the country to democratic rule

Like with the well designed budgets and development policies in Nigeria, the crux of the failure is in the implementation. This can further be linked or traced back to indiscipline. As long as Nigerians including the leaders are corrupt, brutal, undemocratic and economically obtuse, we cannot make any headway. The fate of Nigeria however has since passed out of the hands of its colonial masters. Therefore, responsibility for success or failure lies squarely with Nigerians.

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support is ended or Crédit Lyonnais is privatised. The government reckons that this could take at least five years.

French officials maintain that the plan was necessary to avoid a run on the bank. Since Crédit Lyonnais is one of the biggest deposit-taking banks in Europe, its collapse could have caused far more damage than, say, the failure of Barings, a British investment bank recently sold to Holland's ING Group after it ran up life-threatening losses. But if governments, anxious to avoid such damage, let troubled banks off too lightly, they may store up future trouble: for other banks might take greater risks, secure in the belief that they too will be bailed out if things go wrong (see page 99). To avoid this, a rescue plan should punish the bank concerned as severely as possible.

Too sweet a pill

The Crédit Lyonnais plan fails to do this. True, the bank will receive an artificially low interest rate (7% in 1995) on its loan to the state; but the rate is still much higher than the average yield of the dud assets it is unloading, which is probably around 2%. The bank's aggrieved domestic rivals, Banque Nationale de Paris and Société Générale, reckon that this implicit subsidy could be worth FFr7 billion in the current year alone. The figure would be smaller if the CDR were to sell more assets. Hence their fury at the government's decision to leave Crédit Lyonnais itself in charge of the sell-off. The European Commission should insist that the interest rate on the loan is cut sharply; that outside managers are put in charge of the CDR's assets; and that Crédit Lyonnais sell most of its prized European banking network fast.

Better still, the French should privatise the "good" bank that will be left behind after dud assets have been shifted into the "bad" one. The government retorts that Crédit Lyonnais's market value is tiny; and it also argues that another five years of careful state ownership will vastly improve the bank's value. Since it was state meddling that created the mess in the first place, that claim beggars belief. In any case, the argument for selling the bank, exposing it to full competition with its rivals, is unaffected by what the sale might realise. Mr Peyrelevade, who—irony of ironies—doubles as a non-executive director of Barings, might find the idea of Crédit Lyonnais being sold for a symbolic coin (as Barings was) galling. But France's long suffering taxpayers would like nothing better.

Little Nigeria

APPENDIX II

A big country diminished by its military rulers

TOWARDS the end of the colonial era, as the khaki shorts and the pith helmets were about to be put away for the last time, some firm predictions were made about Africa, particularly about the two big countries south of the Sahara that had come under British rule. At some stage, though it was hard to say when, South Africa would be engulfed in a bloody revolution. Nigeria, on the other hand, black Africa's biggest country, had a bright future. It had been well prepared by its colonial masters for self-government; it was free of the hang-ups that come with settlers; and it was blessed with a sophisticated and relatively educated electorate. Forty years on, both these predictions have been proved strikingly wrong.

This week, some 11 months after an astonishingly successful election, South Africa was once more celebrating its new, generally harmonious democracy. The excuse this time was a visit from Britain's Queen Elizabeth, for whom the stench of apartheid had made the place unvisitable for 48 years. To the north, however, Nigeria's latest military despot was installing a new cabinet of placemen, having locked up one of his more respectable predecessors, General Olusegun Obasanjo (later released to the confines of his home town). No one should have been surprised. Today's general-in-charge, Sani Abacha, scarcely even pretends to be a democrat. Though he says he will arrange elections and make way for civilians, he has fixed no timetable. Political parties are banned, and General Abacha seems to spend more time either appeasing or purging the army—a plot was recently uncovered—than he does nurturing democracy.

Nigeria's generals have usually justified their monotonous hold on power by pointing to the mess made by civilians during the brief interludes of non-military rule—a total of only ten out of the country's 35 years of independence. In the early 1980s, Nigeria's politicians squandered money on a scale never before seen in Africa. After that, an African Augusto Pinochet might have won his countrymen's thanks. Yet General Abacha seems as unenthusiastic about economic reform as he is about political reform.

Nigeria's banks, according to a recent announcement, are to be taken back into government control less than two years after they were privatised. And a special petroleum trust fund, presided over by eminent Nigerians, has just been established to distribute oil money. This year some 61 billion naira ($2.77 billion, at the official rate) is due to go to this fund. It is supposed to be spent on such worthy ends as transport, health, education and welfare. If, however, it unaccountably disappears into private pockets, few Nigerians will be surprised. Nor will the IMF or the foreign donors to which Nigeria owes more than $30 billion. A deal with the IMF, which looked more likely after a deregulatory budget in January, now seems farther away again. An agreement with the Paris club to reschedule Nigeria's debts is fast receding to 1997 or beyond.

Leading from the south

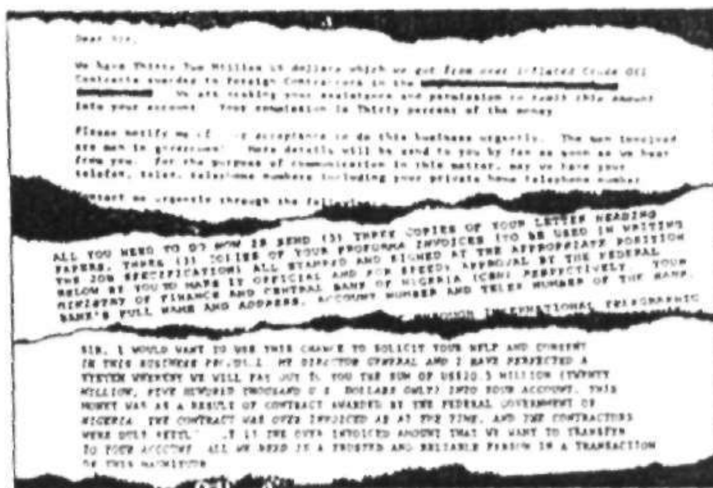
Is Nigeria incorrigible? No: it is no more predestined in the 1990s to fail than it was in the 1950s to succeed. Its fate, however, has long since passed out of the hands of its colonisers. Responsibility for success or failure lies squarely with Nigerians. Other big countries in Africa, notably Zaire, may turn out worse. But South Africa is already turning out vastly better, by showing a seriousness of purpose that continues to elude Nigeria's generals. As long as Nigeria's rulers are corrupt, brutal, undemocratic and economically obtuse, Nigerians will suffer and their country will lose influence. If there is a giant of Africa, it is not Nigeria but Nelson Mandela's South Africa.

The great Nigerian scam

APPENDIX IV

"WE ARE contacting you for a very important deal," averred a letter faxed to *The Economist* recently from an address in Lagos. "We have concluded and perfected plans to siphon the sum of $41.5m out of the Nigerian *National Petroleum Corporation's account* to a foreign-based bank account for our own personal use." All *The Economist* had to do, said the letter, was provide a foreign bank account and name the percentage cut it required.

Anyone familiar with the Nigerian "419" scams that spread in the 1980s—they are named after the section of the penal code that deals with such fraud—would have recognised the letter as a swindle. Yet the past year has seen such a resurgence of these letters, dispatched from Nigeria to Europe and beyond, that credulous foreigners have lost millions. Diplomats in Lagos say the scams are getting nastier too.



Dear Sir,

We have Thirty Two Million US dollars which we got from over inflated Crude Oil Contracts awarded to Foreign Contractors in the ... We are seeking your assistance and permission to remit this amount into your account. Your commission is Thirty percent of the money.

Please notify me of your acceptance to do this business urgently. The men involved are men in government. More details will be send to you by fax as soon as we hear from you. For the purpose of communication in this matter, may we have your telefax, telex, telephone numbers including your private home telephone number.

Contact me urgently through the following ...

ALL YOU NEED TO DO NOW IS SEND (3) THREE COPIES OF YOUR LETTER HEADING PAPERS, THREE (3) COPIES OF YOUR PROFORMA INVOICES (TO BE USED IN WRITING THE JOB SPECIFICATIONS) ALL STAMPED AND SIGNED AT THE APPROPRIATE POSITION BELOW BY YOU TO MAKE IT OFFICIAL AND FOR SPEEDY APPROVAL BY THE FEDERAL MINISTRY OF FINANCE AND CENTRAL BANK OF NIGERIA (CBN) RESPECTIVELY. YOUR BANK'S FULL NAME AND ADDRESS, ACCOUNT NUMBER AND TELEX NUMBER OF THE BANK ... INTERNATIONAL TELEGRAPHIC

SIR, I WOULD WANT TO USE THIS CHANCE TO SOLICIT YOUR HELP AND CONSENT IN THIS BUSINESS PROPOSAL. MY DIRECTOR GENERAL AND I HAVE PERFECTED A SYSTEM WHEREBY WE WILL PAY OUT TO YOU THE SUM OF US$20.5 MILLION (TWENTY MILLION, FIVE HUNDRED THOUSAND U.S. DOLLARS ONLY) INTO YOUR ACCOUNT. THIS MONEY WAS AS A RESULT OF CONTRACT AWARDED BY THE FEDERAL GOVERNMENT OF NIGERIA. THE CONTRACT WAS OVER INVOICED AS AT THE TIME, AND THE CONTRACTORS WERE DULY SETTLED. IT IS THE OVER INVOICED AMOUNT THAT WE WANT TO TRANSFER TO YOUR ACCOUNT. ALL WE NEED IS A TRUSTED AND RELIABLE PERSON IN A TRANSACTION OF THIS MAGNITUDE

A typical "419" letter is written—supposedly—on the headed writing paper of the NNPC or some other state enterprise. A supposed official cheerfully admits to some scheme to rip off his employers, and offers the foreign recipient a 30% share of the $40m-60m or so which, he says, he needs to send urgently overseas. The recipient, normally a company, simply has to send details of its bank account, invoices for fictitious services rendered to the state corporation—and some sheets of its own headed writing paper, blank but signed. Absolute secrecy is requested for a "highly classified" transaction.

Then comes the catch. To unlock the promised millions, the recipient is asked to send up-front, say, $5,000 in "fees" or "taxes" or, quite openly, to grease the alleged transaction on its way. Demands soon follow for another $5,000, then, maybe, for Rolex watches or hotel accommodation abroad. One American was asked for "three double breasted suits (large sizes)". The victim is soon short of tens of thousands of dollars.

"The object of the exercise," says Detective Inspector David Crinnion, of London's Scotland Yard, "is to get you to part with money ... They start saying 'OK, it's only another £5,000' and you are on a slippery slope." And the signed writing paper, supposedly to be used to fool the state company? In fact, it is sent to the victim's bank manager with instructions to pay a further tidy sum to an account held elsewhere by the scamster.

In a nastier version, the victims are lured to Nigeria to collect their imagined loot. The deception becomes more elaborate; experienced conmen take over. The victim has often agreed to tell nobody about the trip, and is persuaded not to apply for a visa. The fraudsters bribe immigration officials to let him in illegally. The victim has then committed a crime, is on foreign soil, and is vulnerable.

Flash cars take him from the airport to meetings with the big-time operators, who impersonate government officials supposedly authorising large payments. Victims allege that meetings are held in genuine government offices, hired for the day by the fraudsters. Then come the demands for more money. At this point, the embassies tend to get distress calls. "When we get these rescue calls, we pick up the victims and keep them in a secure house until we can get them on a flight out of here—with an armed escort to the airport," says one diplomat in Lagos.

It is surprising the scam ever works, given the plain amateurism of many letters. They are fired off from fax machines with scant attention to detail. Many are written, childlike, in capital letters. One letter supposedly written from the Central Bank of Nigeria uses a letterhead with a logo; the bank has none on its writing-paper. Another was supposedly sent by a "senior" public official from a Lagos suburb; the street turned out to be seedy, the house was boarded up and neighbours said they had never heard of the man.

Yet people do fall for the scam. One Thai woman lost $150,000; an American man lost $90,000. Police in London know of one loss of over $7m. What is reported is probably only the tip of the crookery. "There's some embarrassment," says Inspector Crinnion. "A businessman doesn't want others to know that (a) he's greedy to the point of being ready to defraud and (b) stupid."

The American government now produces a guide for businessmen heading for Nigeria that warns them against "419". The South African police recently announced that "419" had spread there too. Scotland Yard has a whole team of detectives working on the scam in London; one case is currently awaiting trial.

As for Nigeria, there is no evidence that officials of its central bank or the NNPC are involved. The bank has placed advertisements in newspapers abroad warning readers about the scam. General Sani Abacha, Nigeria's military ruler, has set up a ministerial task force to co-ordinate efforts to deal with drugs and fraud networks, which appear to be linked. So far, the Nigerian authorities have investigated 1,200 suspects, but convicted none.

Not that the scamsters are over-cautious themselves. One, rung up from London, readily discussed the mechanics of his mythical scheme without any attempt to make sure that the might-be "victim"—in fact, a journalist—was who, what, or where he claimed to be.

Nigerians have little sympathy for victims of the scam, however. Some reckon greedy and gullible foreigners are fair game. More persuasively, a recent paper by a deputy governor of the central bank argued that victims should be prosecuted: they, after all, are would-be scamsters themselves, who hoped to join in fraud on the public purse.

Some of the "419" fraudsters have even become folk heroes in their home town. The most notorious, Fred Ajudua, who now faces trial in Nigeria, used to travel with a police escort in Lagos. He argues that he is a black man's Robin Hood, getting repayment from white men for slavery and colonialism.

APPENDIX V

to accept the idea. Mr Mugabe runs a highly centralised administration, with some limited powers pushed out to village development committees. The last thing Zimbabwean nomenklatura will want is competing avenues of patronage. Its own unofficial answer to the land problem last year was—until the press exposed it—to rake out to government ministers the land it had supposedly set aside for peasants.

Nigeria

APPENDIX V

About turn

UNTIL this week, General Sani Abacha, Nigeria's military ruler, gave no hint that he cared a fig what the outside world thought about his government. Then on January 14th he unveiled a 1995 budget that was (almost) a model of economic reform and an abrupt U-turn from previous policy. Among other things, it deregulated the foreign exchange market and lifted exchange controls. What is Nigeria up to?

Anthony Ani, the acting finance minister, gave the details in Abuja, the capital, on January 16th. He ended the system by which a special committee of political appointees allocated to the private sector—most profitably to the happy recipients—foreign exchange at the official rate. Now businessmen will buy and sell currency at market rates. Mr Ani also announced repeal of the 1962 exchange-control law. This should remove all restrictions on inward and outward movements of currency.

Another bit of good news was the scrapping of the Nigerian Enterprise Promotion Decree. This placed limits on the amount of equity foreign multinationals could hold in joint ventures with Nigerian enterprises. Foreign businessmen had grumbled endlessly that the Nigerian partners they were made to recruit often failed to put up their share of the investment. Many potential foreign investors were put off; others withdrew in whole or in part, like Standard Chartered Bank and Banque Nationale de Paris, which shed some of their holdings in Nigeria's top two high street banks. "Bold steps that have improved the investment climate at a stroke," was the summary of one surprised western economist in Lagos.

Better still, General Abacha himself two days earlier had announced that he was closing the offshore "dedicated accounts" into which the government used to divert over 10% of its oil export revenues for "special projects", without any entries in its own books. The IMF has been nagging the Nigerians to stop this habit for years. Last year even the government's own panel of inquiry, chaired by one of Nigeria's most respected economists, Pius Okigbo, discovered that $12.2 billion had gone into—and out of—these accounts between 1988 and 1994, without anyone but those in charge knowing anything about the purposes or figures. Mr Okigbo urged the government to end this racket. But his report was squashed and never published.

So far, so good. The trouble is that nothing the current government has done until now in its 14 months of power gives much ground for believing it is serious about reform. Even the rest of the budget contained worrying signs. Mr Ani forecast a reduction in the budget deficit, based on an improbable 1½-fold increase in 1995 in non-oil state revenues. Last year the government forecast a balanced budget; in the event, as Mr Ani admitted, it notched up a huge deficit of $4 billion, or 12% of GDP.

Nor has the government devalued the naira, which, officially pegged at 22 to the dollar, trades on the black market at 85. And it has kept a 21% cap on interest rates, while yearly inflation is running at an official 70%, and really more like 100%.

Presumably General Abacha's half-conversion to economic reform is designed to impress his creditors. Nigeria owes some $30 billion abroad and would like relief. It will not get that until the IMF is persuaded of the seriousness of its reforms.

Do not use controls that encourage it

Mexico

Zedillo comes through smiling

JUST days ago, cover stories in the Mexican press were denouncing the impotence of President Ernesto Zedillo. "El presidente no puede", screamed the headlines. Less than two months into his administration, lacklustre leadership had plunged the country into financial crisis (see page 85). Polls showed public confidence in him lower than for any previous president. Yet by January 18th the media were singing his praises again.

The reason is that Mr Zedillo, trained in economics, seems to have a surer touch in politics, at which nobody had ever given him high marks. Many had criticised his decision to raise the stakes in the government's clash with the Zapatist rebels in the southern state of Chiapas. But when last weekend the rebels saw that he had sent no less than his interior minister, Esteban Moctezuma, to talk to them, they agreed to an indefinite extension of their ceasefire and a return to the negotiating table.

This week brought another victory for Mr Zedillo and his team: an agreement on political, notably electoral, reform reached with all the main parties. Time will show whether the reform actually happens. But to consult the opposition seriously at all is quite a novelty; and to get the rival party leaders on one platform and backing the proposals that Mr Zedillo had worked out with them was a real coup.

Still better, the reform may be genuine. True, Mr Zedillo's predecessor, Carlos Salinas, had to modify the electoral code three times, but still managed to leave untouched most of the dubious advantages enjoyed by his and Mr Zedillo's ever-ruling party, the PRI. Yet this time things look different.

The parties have agreed on a two-step approach to reform. First—though this was not made public—the results of half a dozen contentious local and governor's races in various states are to be re-examined by impartial observers. In Chiapas, the most disputed governor's race, the tainted PRI victory—thoroughly fraudulent, claim the Zapatists—will probably be annulled and an interim governor appointed. In nearby Tabasco, the PRI governor is likely to step down early to allow a fresh election.

Some see this as an unhappy climbdown from Mr Zedillo's earlier refusal to dismiss governors just to placate the opposition. No, replies Santiago Creel, a member of the electoral commission, IFE, who is a known critic of the PRI: since the ground rules were so biased in these elections, reassessing the results is the only way ahead. He says this will clear the way for the second step, a fundamental reform that has been made public: creating conditions for truly fair elections. On this, Mr Zedillo agreed to

Following the annulment of the June 12, 1993, presidential election, the EU had suspended military co-operation with Nigeria. That action led to the withdrawal of foreign technical instructors from the Nigerian War College.

The health sector, communications industry and agriculture are the main areas that will be affected immediately in the aids freeze. At present, there are at least 10 projects worth N66.13 billion being financed with the European Development Fund in the country, all having multiplier effects on the economy. Among the agricultural projects that will be affected is the more than N7 billion oil palm belt development programme from which Risonpalm in Rivers State, Adapalm in Imo State, Abia Palm and Akwapalm are benefiting. There is also the N3.6 billion North-East arid zone development programme. The Katsina afforestation programme is a key beneficiary of this scheme alongside the Mambilla Tea and Irrigation scheme. The N1.8 billion Oban hills project will similarly be affected by the sanctions like the N3.6 billion Middle Belt Programme.

Also gone with the wind of the sanctions is the N2 billion NITEL maintenance training and research programme. The sanction will worsen development in that sector. Only last Monday, Adeniyi Tajudeen Olanrewaju, a major-general and communications minister, admitted that Nigeria is indeed one of the least developed countries in the world in terms of telecommunications. Nigeria is listed

University of Nigeria, Nsukka (Lome III)	1,000
Imo State Equipment Centre	500
Obafemi Awolowo University, Ife (Lome II) environment	2,000
Bendel State University, Benin City - Coastal Erosion	1,000
Obafemi Awolowo University, Ife (Lome III) - energy masterplan	600
Administrative Staff College of Nigeria (ASCON), Lagos (Lome II)	950
Centre for Management Development (CMD), Lagos	250
National Centre for Economic Management (NCEMA), Ibadan	300
University of Ibadan, Ibadan (Lome III)	850
Ministry of Works and Housing, Lagos - store management	550
Institute of Agricultural Research, Zaria	500
Food Basket Programme, NTA, Lagos	755
National Water Resources Institute (NWRI), Kaduna	750
Seminars and Workshops	1,300
Programme management, technical assistance, contingencies	4,245
Community Development	
	000 ECU
Middlebelt Programme (MBP)	33,000
• Health and Community infrastructure programme, general activities	15,724
• Adult Education	6,209
• Primary Health Care	8,057
• Population Activities	3,010
Health Care	
	000 ECU
Rural Health Programme (RHP) in Benue, Kwara, Lagos, Ogun, Ondo and Oyo States	6,100
Imo State Health Programme	120
Oyo State STD Pilot Scheme	600
Cultural Heritage	
	000 ECU
National Museum, books on Nigerian art and architecture	410
Industrial Development	
	000 ECU
Federal Institute for Industrial Research (FIIRO), Oshodi	2,120
Survey of manufacturing sector (1978)	458
Industrial Zone Feasibility Study (1978)	101
Kaolin Industry Pre-Investment Study	137
Abakaliki Zinc Feasibility Study	1,220
Export Development Study	324
Structural Adjustment Programme Support	
Lome III, Sectoral Import Programme	10,000
Lome IV	25,000
General Studies and Reserve, Lome III	3,086
Emergency Assistance, 1976-90	1,130
Non-Governmental Organisations (NGOs)	972
Regional Programmes specific to Nigeria	
International Institute for Tropical Agriculture (IITA)	7,848
Cross River State National Park Study	290
Satellite Communications for Nigeria	620
Komadougou-Yobe River Basin Study	418
Pan African Rinderpest Campaign (PARC)	1,917
Interest Rate Subsidies for EIB Loans	
Lome I	9,023
Lome II	5,121
Lome III	21, 857
European Investment Bank (EIB)	
Loans from own resources	
Nigerian Industrial Development Bank (1978)	25,000
Lagos Power Distribution, NEPA (1980)	25,000
Nigerian Industrial Development Bank (1983)	40,000
New Nigerian Development Corporation, NNDC (1987)	30,000
Lagos Water Supply (1988)	45,000
Palm Oil, I (1989)	43,000
Programmable Assistance, Lome IV	365,000
GRAND TOTAL: 920 million ECU (8,834 billion Naira).	

APPENDIX VII

GROSS DOMESTIC PRODUCT (EXPENDITURE APPROACH) AT 1984 PURCHASERS' PRICE

(N billion)

Components	1990[1]	1991[1]	1992[1]	1993[1]	1994[2]	Percentage Share in Total 1990	1991	1992	1993	1994[1]	Annual Percentage Change (Growth Rate) 1991	1992	1993	1994
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
1. Private Consumption Expenditure	63.13	69.92	74.96	77.66	78.49	69.73	73.72	76.81	77.81	77.64	10.76	7.21	3.60	1.07
2. Government Final Consumption Expenditure	7.26	7.86	8.84	10.06	11.02	8.02	8.29	9.06	10.08	10.90	8.26	12.47	13.80	9.54
3. Gross Capital Formation	5.73	5.53	5.57	6.16	5.85	6.33	5.83	5.71	6.17	5.79	(3.49)	0.72	10.59	(5.03)
4. Export of Goods and Non-Factor Services	18.10	16.34	12.31	10.87	9.73	19.99	17.23	12.61	10.89	9.62	(9.72)	(24.66)	(11.70)	(10.49)
5. Import of Goods and Non-Factor Services	3.68	4.80	4.09	4.94	3.99	4.06	5.06	4.19	4.95	3.95	30.43	(14.79)	20.78	(19.23)
6. Gross Domestic Product (At Market Prices)	90.54	94.85	97.59	99.81	101.10	100.00	100.00	100.00	100.00	100.00	4.76	2.89	2.27	1.29

[1] Revised.
[2] FOS Estimates.

Sources: (i) Federal Office of Statistics (FOS), Lagos
(ii) National Planning Commission.