

A New Reform Agenda for Nigeria

1. A recent USAID (Nigeria) SOW on Economic Growth and Infrastructure recognizes that behavior by the Federal and State Governments of Nigeria (F&SGN) impedes faster, more evenly distributed GDP growth. The quote, "Outworn ideologies from the 1970's have never been abandoned in Nigeria," is particularly prescient. In fact, thirty years of Donor activity, grants and lending to Nigeria has done little to change this outmoded ideology. A reading of recent IMF and World Bank reports on Nigeria suggests that the IFIs are themselves prisoners of outmoded, irrelevant and incorrect ideologies.¹
2. The following are some (summarized) shortcomings in the current Donor approach to development suggested by the recent literature.
 - i) Policy reform is not effectively imposed on, or transferred by Donors, even (perhaps especially) if accompanied by large money transfers to governments. Instead, like technical change² policy reform occurs as the result of endogenous activity involving the pursuit of more income (by individuals) and more revenue (by governments). If allowed, individuals create and use domestic political and economic structures, institutions and circumstances to earn more income. They will be increasingly allowed to do so as long as, and only if, governments are dependent on growth in domestic activity for more revenue. That is, governments and individuals will only have the correct policy symbiosis when BOTH are dependent on **growth in the domestic tax base** for improving their incomes/revenue. Effective policy reform occurs along with and because of greater individual (private) political and economic freedoms and enterprise/initiative, i.e., in non-profits and NGOs such as think tanks, consulting firms and lobby groups.³ The significance of this is that grants subsidizing private initiatives, institutions and companies are likely to have more beneficial policy impact on policy than the same-sized grants to governments to stimulate policy reform.

¹ Two authors, Bill Easterly (*The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics*) and Joseph Stiglitz (*Globalization and Its Discontents*) have recently convincingly raised the specter that the World Bank and IMF are operating on the basis of failed ideologies. Two articles in *The Economist* ("Doubts Inside the Barricades," 9/28/02, pp. 63-65 and "Economic Focus: Roots of Development," 9/5/02, p. 74) are sympathetic off-takes of these authors' works. An excellent review of Bill Easterly's book ("Review of Easterly's *The Elusive Quest for Growth* by Romain Wacziarg-JEL, Vol. XL, September 2002, pp. 907-918) explicitly raises doubts about the efficacy and appropriateness of the current Donor approach of transferring or inducing policy reforms.

² The World Bank's adoption of policy-based lending has its origins in growth economists' treatment of technical change. However, growth economists have moved on, importantly to considerations of endogenous technical change, while the World Bank is stuck back in the late 1970s.

³ A defense of this is contained on my web page: www.erols.com/rmyers1. Click on "Links to Some of My Notes on Think Tanks (MS Word Files)" on the right hand side of my web page. However, given the close connection between policy reforms and technical change, it is strongly supported by the endogenous growth/technical change literature. See: Paul M. Romer, "Endogenous Technological Change," JPE, 98:5, pp. S71-S102.

- ii) There is no "correct" sequencing of policy reforms. Good policy reform occurs in small clusters rather than sequentially. This is particularly true of liberalization, which in Nigeria is virtually the same thing as political and economic **deregulation or de-escalation**. Liberalization doesn't have a beneficial impact unless it occurs on many fronts at once. Corollaries of this are:
- a) Liberalization of international trade and capital flows doesn't cause greater international trade and liberalization of the domestic economy. Instead, the reverse is true: liberalization of **domestic** trade and capital movements causes ("leads to") more international trade and capital movements. (Dani Rodrik).
 - b) Faster economic growth is not **caused** by (Donor aided) prior improvements in governance and reductions in corruption. The two occur together, particularly as a result of the onset of greater individual political and economic freedoms and faster growth in fragmented private enterprise (significantly eased freedom of "entry" and "exit").⁴
 - c) Privatization will not be beneficial without extensive prior liberalization (deregulation) of the domestic economy AND the formation of free asset markets where land, foreign exchange and financial and real income-earning assets are traded. If successful, prior liberalization will allow private enterprise competition against public sector enterprises to emerge, thus **lowering** the (asset) prices received by GON for privatized firms.⁵ However, the flow values, in terms of domestic taxes received will be higher.
- iii) The appropriate focus (objective function) for development efforts is increasing private sector employment in a competitive (rather than monopolized) setting. If private sector employment grows in a competitive setting, the resulting growth in GDP and labor productivity (technology or TFP) will be favorably distributed so as to reduce poverty. The implications of this are that well distributed development requires growth in private investment and technology, both of which will occur as individual investor freedoms (freedom of entry and exit) increase.⁶

⁴ This emerges as a result of my correspondence with Dani Kauffmann who maintains the World Bank's Governance and Anti-Corruption web site at: <http://www.worldbank.org/wbi/governance/index.htm>. My contributions can be seen on this web site under "Feedback Received" at: http://www.worldbank.org/wbi/governance/feedback_received.htm . My contributions relating to Governance and Anti-Corruption are reproduced below, on pp. 4 & 5 under the heading concerning Governance (para. 2, item vii).

⁵ With liberalization, public sector firms may also be broken up and sold as components, as in the (largely successful) privatization in the Czech Republic.

⁶ See Acemoglu, Daron, "Technical change, Inequality and the Labor Market" (*JEL*, Vol. XL, #1, March 2002, pp. 7-72) concerning the importance of private sector employment as the objective function for poverty reduction. Regarding the importance of freedom of entry and exit and the costs of restrictions, see Djankov, Simeon et al, "The Regulation of Entry," World Bank Policy Research Working Paper 2661 of 8/2001: http://econ.worldbank.org/files/2379_wps2661.pdf .

3. This short note relies on some recent development-relevant literature⁷, coupled with a good, longstanding awareness of the Nigerian political and economic situation, to suggest some new departures in the Donor approach to Nigeria's economic development. Key among these new departures is the single notion that GON adopt one primary goal: **allowing/encouraging the expansion of the private, non-oil tax base so that GON relies increasingly on domestic taxes and borrowing for public sector revenue.** Adoption of this single goal implies the adoption of several ancillary goals as follows:

i) Eschew Foreign Borrowing & Debt

Announce a policy of no more foreign borrowing by the public sector, plus an announced formula for using some oil-derived foreign exchange to service and retire the current public sector foreign debt overhang, e.g., over a period of, say, twenty years.⁸

ii) Build the Public Sector Domestic Resource Base

GON must become dependent for revenue on a growing domestic, non-oil tax base and on domestic borrowing via Naira-denominated bonds. This edict places a tremendous burden on GON to foster growth in the non-oil, private sector tax base and to improve Nigeria's tax system and administration. In addition, it requires that GON allow a domestic bond market to form and to help in its formation by selling Naira bonds in it.

iii) Increase Investor Ease of Entry & Exit Through Public Sector Deregulation & De-Escalation

GON should reduce "up-front" investor interventions to the point where the major initial requirement for starting any sort of enterprise (including financial services) is to **register with the tax authorities.** This would most quickly build the domestic tax and borrowing base. This would be with the understanding that additional public sector interventions would be applied, with cause, later on.

iv) Treat Foreign and Domestic Trade Equally and Free-up **Domestic** Trade

This inevitably involves Nigeria's exchange rate. In essence GON, including the Central Bank gives up attempting to control the exchange rate, allowing all private economic entities to borrow and trade in any currency they like. In addition, GON must begin buying foreign exchange in domestic currency markets. Also very important is to **liberalize trade and interactions between the formal and informal economies.** This is the true meaning of trade liberalization. It also involves taxing all domestically and internationally traded goods and services (except oil and gas) equally.

⁷ Most important was William Baumol's book, The free-market innovation machine : analyzing the growth miracle of capitalism; Princeton : Princeton University Press, 2002.

⁸ The best guideline for Nigeria's use of oil revenue to service and repay foreign debt is the Mexico agreement of the early 1990s. This refers to the oil-for-debt agreements, not the Brady bond bailout. The Brady bonds were essentially "enabled" by the (prior) oil-for-debt agreements. Essentially the Mexican Government took a fixed, conservatively estimated amount of oil revenue for domestic use and let the (variable) remainder be used for external debt servicing and repayment.

v) Privatize to Maximize the FLOW of Taxes From Each Sector

Public corporations are monopolies that will only fetch high, one-shot privatization revenues if sold as monopolies. GON should eschew a goal of maximizing one-shot privatization sales revenue in favor of privatizing assets in ways that will increase competition and household investor participation. This will mean accepting lower privatization sales revenues (thus reducing investor risks) so that privatized firms and competing enterprises can sell more output at lower prices and still make profits and pay quarterly taxes. Over time the flow of tax collections will far exceed the one-shot privatization revenue boost.

vi) Limit Public Sector Budgeted Expenditures to Resources Obtainable Domestically Plus (fixed amounts of) Oil and Gas Revenues

This puts a tremendous amount of emphasis on fiscal policy, particularly tax policy and administration. Surplus oil and gas revenues must be "sterilized" by first

vii) Improved Governance and Reduced Corruption Depend on a Growing Non-Oil Tax-Base and Improved Domestic Resource Mobilization

The explicit premise of the World Bank and USAID Governance web sites is that improved political, as distinct from corporate governance, will cause or "push" faster economic development. This is most probably not true. More likely is that the causality runs the other way around. Faster economic development and better corporate governance cause better political governance. That is, faster economic growth and larger tax bases are key ingredients for better political governance. Most likely and most logical is that there is no behaviorally significant direction of causality: that economic growth and better governance occur together. Given this, Donors should apply the principle of Ockham's Razor and directly stimulate faster private sector economic development as a way of improving corporate and political governance and reducing government corruption.

A plausible, operationally relevant scenario, a la Alexander Hamilton, is that the best governments are those that depend on domestic financing (taxes and borrowing) for revenue, so that they have an enhanced stake in their citizens, who in turn have an enhanced stake in them. This exact thesis is the basis of a book by James Macdonald entitled, "A Free Nation Deep in Debt: The Financial Roots of Democracy," which is reviewed on my web page at:
<http://www.erols.com/rmyers1/MacdonaldBook.htm> .