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DIRECTORATE OF
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Intelligence Memorandum

Nigeria: The War's Economic Legacy

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1971

INTELLIGENCE MEMORANDUM

NIGERIA: THE WAR'S ECONOMIC LEGACY

Introduction

1. Nigeria fought a costly civil war for two and one- half years. At the war's end in early 1970, the country faced a shortage of budgetary resources, severe inflation from war financing, depleted foreign exchange reserves, and a considerable increase in localized unemployment. The potential of the Nigerian economy for economic growth, however, is intact, and the military government has ambitious plans for reconstruction and renewed development. Moreover, the outlook for the oil industry is bright. This memorandum assesses the economic impact of the war, the postwar economic policies of the government, and prospects for the major economic sectors.

Discussion

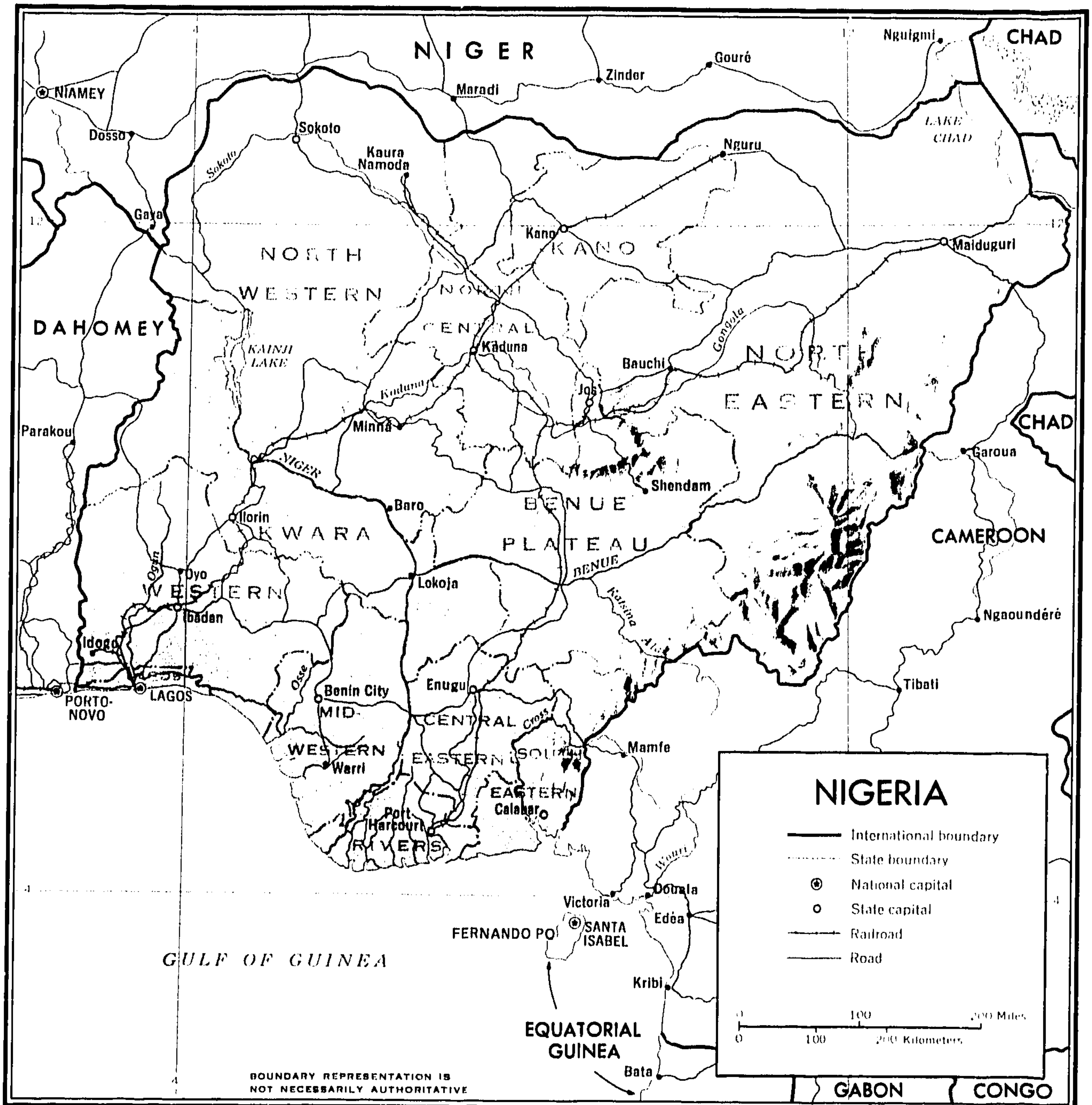
Background

2. Despite a per capita gross domestic product (GDP) of only about \$80, Nigeria (see the map, Figure 1) has substantial resources and the potential to use them. It has the largest population in Africa, 20% of the total south of the Sahara, and the largest GDP in Black Africa -- \$4.6 billion in fiscal year (FY) 1970. 1/ The country's basic source of strength always has been agriculture, which produces sufficient food for internal needs; makes Nigeria the first or second world exporter of several major

1. All dollars in this memorandum are US dollars. The conversion rate used is 1 Nigerian pound equals \$2.80. The fiscal year ends on 31 March of the year indicated.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

FIGURE 1



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commodities – cocoa, palm products, and peanuts; and employs about 70% of the labor force. Reserves of light and almost sulphur-free oil relatively near the markets of Europe and North America have made possible a growing petroleum industry of world significance.

3. From independence in 1960 until the outbreak of the civil war with its eastern region (Biafra) in 1967, Nigeria's real GDP increased an average of perhaps 5% annually, principally because of an expansion of cash-crop production. Manufacturing increased about 10% a year and was the fastest growing sector, but its share of GDP was only about 5%. Although oil was relatively unimportant in the early independence years, it was beginning to contribute materially to government revenues by the time the war began.

4. The war caused extensive damage throughout Nigeria. In the three eastern states, damage was a direct result of military action; elsewhere it was caused mostly by overuse and undermaintenance. Transportation facilities suffered the most. Railroads were crippled when a substantial amount of rolling stock was retained in the east and when thousands of Ibos – the principal tribal group of Biafra – left their jobs throughout Nigeria to return to Biafra. In addition, rail links to Port Harcourt were severed, and exports and imports had to be routed through Lagos port. This situation led to rapid deterioration of the roads and congestion at Lagos port. In the war-affected areas, almost all electricity generating units ceased to function, and industrial installations generally either were destroyed or fell into disrepair. The port facilities at Port Harcourt suffered only minor damage, but the petroleum refinery required considerable rehabilitation.

5. The economy nevertheless survived the war relatively intact. Agriculture was largely untouched except for palm-growing areas in the eastern and mid-western states. Manufacturing outside Biafra not only survived the war but profited from it. Because of Nigeria's large internal market, manufacturing flourished with the imposition of wartime restrictions on imports. The petroleum industry, hit hard early in the war, began recovering in 1968 and by 1969 provided 42% of total exports, a larger share than before the war.

Economic Impact of the Civil War

6. The war had a particularly adverse impact on the government's financial position. Defense expenditures rose from an estimated $35 million in FY 1967 to more than $500 million in FY 1970, when they represented one-half of total current expenditures (see Table 1). Despite increased tax rates and new taxes, revenues fell sharply in FY 1968 and recovered only

Table 1

Nigerian Federal Government: Revenues and Expenditures a/

Million US $

			War Years b/			
	FY 1966	FY 1967	FY 1968	FY 1969	FY 1970	FY 1971 c/
Recurrent revenue	431.5	474.9	420.3	439.3	610.4	952
Of which:						
Oil revenue	37.8	52.9	57.7	32.5	92.4	350
Recurrent expenditure d/	415.8	468.2	523.6	599.2	1,016.4	1,218
Non-defense spending	196.3	241.1	201.9	223.2	257.6	406
Defense	40.6	35.0	149.8	227.9	504.0	378
Allocated to states	178.9	192.1	171.9	148.1	254.8	434
Surplus (+) deficit (-)	+15.7	+6.7	-103.3	-159.9	-406.0	-266
Capital expenditures	138.3	133.6	99.7	105.6	89.6	112
Overall surplus (+) deficit (-)	*-122.6*	*-126.8*	*-203.0*	*-265.4*	*-495.6*	*-378*
Financed by						
Foreign loans	56.3	46.5	40.6	17.1	28.0	76
Foreign grants	1.4	3.1	3.4	3.1	--	
Long-term domestic loans	39.5	56.0	56.3	53.8	50.4	302
Short-term domestic borrowing	16.2	65.8	58.8	285.6	352.8	
Cash reserves and other e/	9.2	-44.5	44.0	-94.1	64.4	
Total	*122.6*	*126.8*	*203.0*	*265.4*	*495.6*	*378*

a. Because of rounding, components may not add to the totals shown.
b. Secession was May 1967. War ended January 1970.
c. Estimated. All except oil revenues are USAID estimates of actual budget.
d. Derived by USAID from recurrent expenditure, as carried in government accounts, plus defense expenditures from capital account, less contributions to development fund. Imports of military weapons probably are included.
e. Negative value indicates increase in cash reserves.

slightly in the following year chiefly because petroleum production fell and high-duty consumer goods imports were reduced. Recurrent budget surpluses, typical of the first six years of independence, were replaced by growing deficits despite severe restrictions on unessential civil expenditures. The deficit reached almost $500 million in FY 1970. The proportion of the deficit financed from external sources fell, and short-term borrowing from the commercial banks swelled after the government's cash balances were exhausted. The short-term internal debt more than doubled between March 1967 and December 1969, when it exceeded $1 billion.

7. Despite extensive wartime controls on non-military imports and payments abroad, Nigeria incurred balance-of-payments deficits and sizable arrears on current payments. Reserves failed to regain the 1965 level until early in 1971. The decline in reserves, however, would have been much worse, except for non-payment of bills. The small deficit in 1968 and the small surplus in 1969 were made possible only by private short-term capital inflows, mainly representing arrears on current payments, which grew to $52 million and $82 million, respectively (see Table 2). The accumulated backlog of authorized but unremitted payments reached an estimated $216 million in October 1970. In addition, some $70 million of dividend payments and profit remittances also was backlogged.

8. Foreign exchange problems are traceable to a combination of increased military imports, decreased exports, and reduced medium- and long-term capital inflows. Total payments for military equipment during the war are estimated at between $300 million and $400 million. At the same time, exports slumped during the first two war years, falling from $786 million in 1966 to $584 million in 1968, mostly because of reduced oil production but also because of the fall in exports of palm products in the former Biafran areas. Long- and medium-term net capital inflows during the war also declined dramatically and were only about 10% of the pre-war level by 1969. The government did succeed in reducing non-military imports by some $200 million between 1965 and 1968. In 1969, when oil production began to recover, exports reached around $877 million and the current account deficit fell to $140 million, about $100 million less than a year earlier.

9. Massive public spending and the resultant large internal debt, combined with import restrictions, have brought serious price inflation. After declining 4% in 1967 and holding steady in 1968, prices rose by 12% in 1969 for low-income city dwellers outside the east and by an additional 13% during the first six months of 1970. Although the increase in domestic manufacturing during the war worked to mitigate price increases, the growing demand for food -- especially in recaptured food-deficit areas and in local situations resulting from military restrictions

Table 2

Nigeria: Summary Balance of Payments a/

Million US $

			War Years		
	1965	1966	1967	1968	1969 b/
Exports f.o.b.	742.0	786.2	668.6	583.5	877.2
Petroleum	190.7	257.3	201.6	103.6	366.8
Cocoa	119.6	73.6	153.2	144.5	147.3
Peanuts	106.4	112.6	99.1	106.4	100.8
Palm products	112.3	93.5	25.4	28.9	29.1
Other	213.0	249.2	189.3	200.1	233.2
Imports c.i.f. c/	-749.0	-702.0	-611.5	-535.1	-640.9
Trade balance	-7.0	84.3	57.1	48.4	236.3
Services and transfers (net)	-243.3	-342.2	-289.5	-283.9	-376.3
Current account balance	-250.3	-257.9	-232.4	-235.5	-140.0
Capital (net)	265.7	170.0	163.2	217.6	100.2
Private medium- and long-term	195.4	175.3	138.3	170.2	20.4
Private short-term	20.2	-4.5	5.9	51.5	81.5
Official	50.1	-0.8	19.0	-4.2	-1.7
Errors and omissions (net)	18.2	63.3	-33.9	10.9	54.0
Overall balance	*33.6*	*-24.6*	*-103.0*	*-7.0*	*14.3*
Net contribution of the oil sector	91.3	121.5	136.4	80.6	156.5

a. Because of rounding, components may not add to the totals shown.
b. Provisional.
c. Not reflecting military imports, which are probably reflected in increased service transactions (government payments) and in the errors and omissions.

on civilian movement – had the opposite effect. Increased prices for scarce imports also added to inflation; consumer goods fell from 43% of total imports in 1965 to 35% in 1969.

Postwar Economic Problems and Policies

Government Finances

10. Recurrent government expenditures have continued to increase and can be expected to remain at a high level. Federal ministries, which had been under wartime ceilings, will now be allowed to expand, and new ministries may be created as government reorganization is carried out. Replacing the four former regional governments with twelve state governments and responding to local demands for more social services will also add to costs. In addition, public sector salaries were increased in April 1970 and probably will be raised further in 1971.

11. Military costs, too, will remain a major expense. The military establishment was 25 times the pre-war level, growing from less than 10,000 to about 250,000 troops. Defense's share of total recurrent expenditure rose from less than 10% before the war in FY 1966 to about half in FY 1970. In FY 1971, however, defense expenditures declined -- although perhaps less than shown in the budget estimate -- and began to consist of largely local expenditures to support a peacetime force (such as barracks construction) instead of wartime imports of munitions and equipment. To avoid adding to unemployment, the government has decided against a rapid early demobilization. Planned demobilization of 100,000 men probably will take four or five years.

12. Large current expenditures have made the financing of development difficult, but rapidly increasing petroleum revenues are beginning to close the gap. The Second National Development Plan (FY 1971-74) includes planned investments of almost $4.5 billion, of which the public sector share is almost $2.2 billion. Public savings, in the form of government budget surpluses and operating surpluses of public corporations, are slated to provide $1,559 million. Foreign aid is budgeted at $423 million, and domestic borrowing is to make up the residual of more than $200 million.

13. In the first year of the plan (FY 1971), state and federal governments had difficulty financing planned investment from domestic sources, but foreign loans and grants helped fill the gap and will be relied on in future plan years as well. In 1970 the International Bank for Reconstruction and Development agreed to spend some $35 million as part of a continuing commitment, and assistance totaling about $50 million was

expected from the United States, the United Kingdom, Canada, West Germany, and Japan. This assistance was insufficient to compensate fully for the shortfall in government savings, and further domestic borrowing was required in FY 1971, although at a lower level than in the previous year.

14. In the second year of the plan (FY 1972), rapidly rising petroleum revenues will alter the situation markedly. In the draft budget for FY 1972, petroleum revenues are projected to $625 million, almost half of total revenues. They will, however, be considerably higher -- probably more than $800 million -- as a result of recent agreements on new tax terms, and thus the government may be able to eliminate domestic borrowing later in the year.

15. Reconstruction costs are estimated to be as much as $840 million in the public sector and $658 million in the private sector. They are concentrated in the first two years of the Development Plan period and will amount to about three-fourths of federal and state non-military investment spending during this time. The plan emphasizes restoring the transport sector but also includes programs to provide employment for war-displaced individuals, to reconstruct damaged or destroyed industrial facilities, and to rehabilitate the power and telecommunications systems in the eastern states. In early 1971, major roads generally had been put back into commission, railroad transport largely had recovered, and some electric power had been restored. It will be some time, however, before the eastern region is fully reintegrated into the economic life of the country.

Balance of Payments

16. The backlog of authorized but unremitted foreign exchange payments to the private sector continues to expand. Between November 1970 and the end of February 1971, the backlog increased by $235 million and now totals more than $400 million. This growth is due in large measure to lower than anticipated earnings from traditional exports (particularly because of smuggling) and a sharp increase in non-military imports. In the FY 1972 budget message released in March 1971, the government announced almost total lifting of import restrictions to increase the supply of commodities to fight inflation and to promote development. At the same time, a new foreign exchange budgeting system, effective 1 April, was announced to authorize payment for essential consumer goods within 90 days of receipt and for other goods, except capital goods, within 180 days. Capital goods are to be financed over periods of one to seven years. Furthermore, on 5 April 1971, Lagos temporarily froze the backlog of all unpaid requests for foreign exchange filed before 31 March. Consequently, transfers are allowed now only for a few specific items like shipping charges, student allowances and fees, basic travel allowances, and profits and dividends.

17. Nevertheless, sources of foreign exchange do exist to meet eventually the pent-up demand for imports. Growing petroleum production holds the most promise, but the revival of other exports also will provide much of the needed foreign exchange. Prospects for the capital account also appear promising. Foreign private capital is encouraged with tax holidays, import duty relief, and tariff protection. In addition, the government announced that, in FY 1972, it will allow the transfer of 40% of backlogged dividends and profits outstanding as of 31 December 1970. Consequently, many foreign investments postponed during the war are likely to be revived.

Prices, Wages, and Employment

18. Large expenditures on reconstruction and war-delayed development, as well as military expenditures required during the transition to a peacetime army, will continue to exert pressure on both prices and wages. A Price Control Board, established in July 1970 to set price ceilings for selected commodities, has been ineffective, and workers are clamoring for higher wages and salaries. Public sector salaries had remained unchanged since 1959 and wages, since 1964. With the increasing cost of living, salary and wage control resulted in a drop in real wages. In practice, however, government salaries and wages compare favorably with those of the private sector [redacted] In 1969, 25X6
Lagos issued a decree, now valid through December 1971, imposing compulsory arbitration, banning strikes and lockouts, and prohibiting salary and wage increases without its approval. In April 1970, however, Lagos set up a Wages and Salaries Review Commission for the public sector, as it had promised during the war. For public sector workers earning less than $1,400 a year, the commission has made an interim award of $5.60 a month for monthly-paid workers and 21¢ a day for daily-paid workers, retroactive to 1 April 1970. The private sector also has been required formally to pay a similar cost-of-living increase, although its wages (set by bargaining between unions and employers) have risen somewhat in recent years. Some unions and workers, impatient with waiting for the final decree and in spite of the ban on strikes, have instigated demonstrations, slowdowns, and other disturbances, which probably will plague the government for some time.

19. Unemployment is a serious problem, especially among the hundreds of thousands of Ibos who make up a large part of the skilled and professional manpower of Nigeria. Before the war started, many Ibos throughout Nigeria returned to their home states – at least 350,000 returned from northern Nigeria alone. The resultant surplus manpower, combined with the destruction of businesses, has resulted in severe unemployment in former Biafra. In other states, army recruitment and the availability of positions formerly held by Ibos have limited unemployment.

Inevitably, some Ibos are beginning to seek employment outside their home states. The jobs they left behind, however, have been filled, and few Ibos have capital to set up new businesses. Whereas the vast majority of Ibos previously in the north were in trade, those presently resident there are mainly professionals and semiprofessionals employed by state governments, private firms, and statutory corporations. In most states, if they are able to find jobs, Ibos are accepted readily, but in some areas, particularly the Rivers State, they are not welcome and probably will not be for some time.

Sectoral Prospects

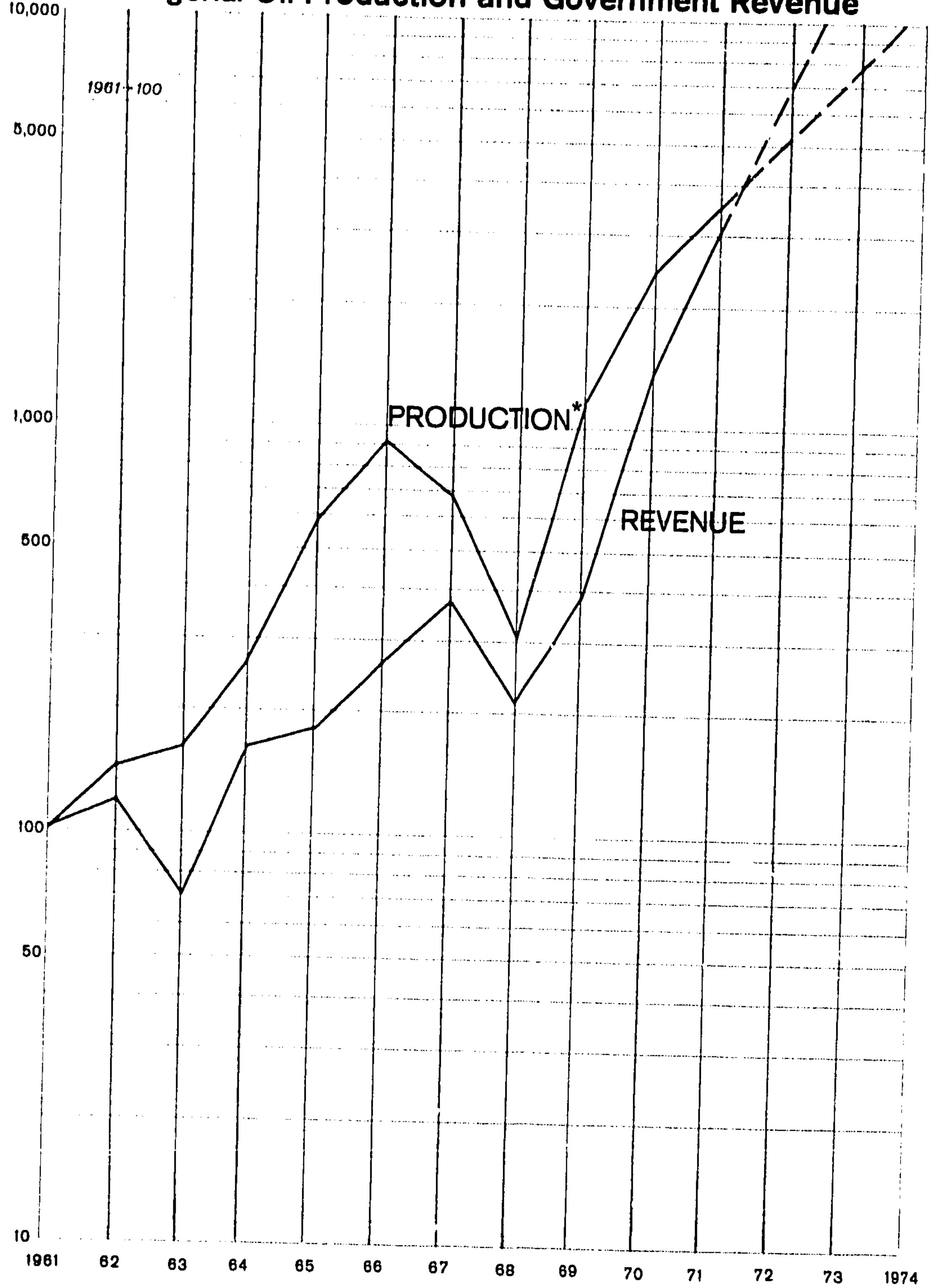
Petroleum

20. The brightest feature of Nigeria's postwar economic scene is the rapid rise in oil revenues. After being hit hard in the early years of the war, the industry since has expanded dramatically (see the chart, Figure 2), making Nigeria one of the ten largest oil-producing countries in the world. Paradoxically, the civil war played a major role in stimulating new production. With the known oil-producing areas of eastern Nigeria cut off, the oil companies intensified production in the mid-western region and offshore, and these areas currently are more important than the east. Total production reached 1.4 million barrels per day in January 1971, and may be as high as 3.4 million barrels daily by 1975. Production and resulting payments to the government in recent years are given in the accompanying tabulation.

Year	Production a/ (Million Barrels)	Payments to the Government (Million US $)
1965	99.4	36.0
1966	152.4	53.2
1967	116.5	75.6
1968	51.9	44.8
1969	197.2	78.4
1970	395.7	280.0
1971	620.5 b/	600.0 b/

a. Excluding production from the eastern states for the period April 1967 - September 1968.
b. Estimated.

Nigeria: Oil Production and Government Revenue



*Excluding production from the eastern states for the period April 1, 1967- September, 1968.

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21. Of a dozen international oil companies now operating in Nigeria, five are producing. Shell-BP owned by Royal Dutch Shell and British Petroleum, is by far the largest, producing about 1 million barrels per day. Following Shell-BP are Gulf, Mobil, ENI/Phillips, and Texaco/Chevron. In addition, concessions have been awarded tentatively to five other companies for off-shore drilling. Although the terms of the off-shore contracts have not been agreed on, the Nigerian government has demanded majority participation in the ventures as well as production bonuses and educational donations. Moreover, the government awarded only about half of the available off-shore area, reserving the rest for a national oil company (see the map, Figure 3).

22. Government oil revenues, which rose from $78 million in 1969 to $280 million in 1970, will be increased substantially in future years by new tax agreements. In November 1970 the oil companies operating in Nigeria announced a $0.25-per-barrel increase in the posted prices of crude oil retroactive to 1 September. This increase should add about $100 million to revenue in 1971 and proportionate increases in subsequent years. Furthermore, in April 1971, financial arrangements were revised further to increase the tax rate, raise the posted price, and speed up tax payments. The government take per barrel is now more than $1.50, compared with about $0.80 a year ago. The new terms, combined with increased production and accelerated payments, could result in government revenues of more than $600 million in 1971. Although not yet a member of the Organization of Petroleum Exporting Countries (OPEC), Nigeria can be expected to continue to exact price increases similar to those granted to OPEC countries. While company plans are not known, petroleum output will certainly continue increasing after 1971. With revenues per barrel also rising and the lags between earnings and receipts being reduced, government revenues are almost bound to surpass $1 billion by 1973.

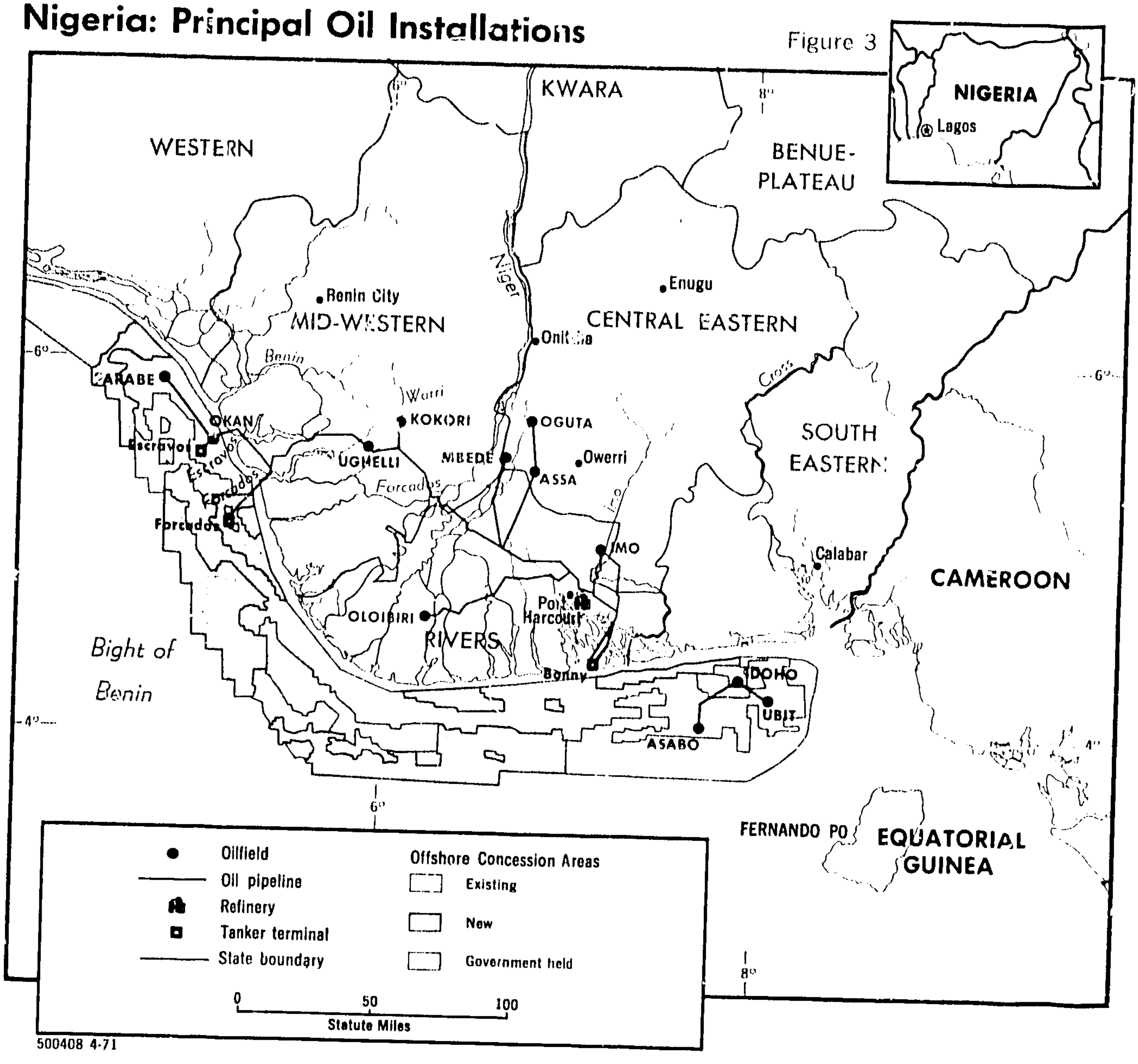
23. Domestic refinery output also is expanding. In 1967 the refinery near Port Harcourt was processing 31,000 barrels a day, which met Nigeria's domestic needs for petroleum with a little left over for Chad and Niger. At this rate, net foreign exchange benefits to the economy were more than $36 million a year. The refinery was badly damaged and was forced to close in July 1967. It re-opened in May 1970 and by August 1970 was producing 40,000 barrels a day. After full restoration, production is expected to reach 55,000 barrels a day, enough to meet domestic demand for the next few years.

<u>Agriculture</u>

24. Despite a ranking of highest priority in the Development Plan, agriculture for Nigeria as a whole apparently is being left to fend largely

Nigeria: Principal Oil Installations

Figure 3



for itself. With land more or less plentiful, production will increase mainly with the increase in population. For the Development Plan period, agricultural growth is projected at only about 2.4% a year – a little less than the population growth rate. Expansion of cash crop production, a specific Development Plan objective to increase and diversify foreign exchange sources, is promoted by adjusting producer prices set by government marketing boards – an extension of the wartime practice of manipulating crop prices to reduce smuggling and to promote desired crops. Since FY 1970 the export duty on cash crops has been 15%. Despite the recent lifting of most import licensing requirements, imposed during wartime to encourage domestic production, the importation of most bulk agricultural commodities still will require a specific license. A few foreign-financed projects are under way to improve production of corn, rice, and millet.

25. Although former Biafra no longer has a significant food problem, the current harvest of food crops there is still smaller than normal because of a shortage of agricultural tools, seed, and capital. Consequently, some supplemental feeding will be necessary until the fall of 1971. The "World Food Program" of the United Nations will have provided about 28,000 tons of food by July 1971, and UNICEF has a special preventive feeding program for children.

Manufacturing

26. Opportunities for manufacturing expansion are good, although some shift from the wartime concentration on import substitution probably will be necessary. With its large population and relatively well developed transportation system, Nigeria offers one of the largest markets in Africa. In addition, the well-paid army, the expanding number of urban industrial workers, and a rising farm income from increased agricultural marketing have expanded the retail consumer goods market. Consequently, manufacturing for the domestic market will probably increase even though it puts a drain on the balance of payments for imports of capital goods, intermediate goods, and raw materials. Although manufacturing came to a halt in the east during the war, it expanded dramatically in the rest of the country. The manufacturing index increased from 166 (including the east) in 1966 to 216 (excluding the east) in 1969. Substantial growth took place in production of footwear, beer and soft drinks, and paints, varnishes, and lacquer, all of which increased by nearly 50%. Textile output grew by 13%. Since most import licensing requirements have now been removed, the more uneconomic domestic industries may well founder. However, slightly higher duties on some items and lower rates of import duties on raw material for domestic industries will still afford some protection.

27. Further expansion of manufacturing, especially processing primary products, also offers Nigeria an opportunity for additional long-run growth

in export proceeds and a chance for diversification of sources of foreign exchange and domestic revenue. Since indigenous private capital and management expertise are in short supply, much of this growth no doubt will have to come from foreign investment. Although increased foreign investment in manufacturing is being encouraged, Lagos is demanding expanded Nigerian ownership and employment. The current development plan specifically requires government ownership of at least 55% of planned petrochemical and fertilizer industries, petroleum firms (especially those in local distribution), and a basic iron and steel complex. Other proposed large and medium-scale industries, according to the plan, will be run as mixed ventures with government and private indigenous participation of at least 35%.

Conclusions

28. The civil war had adverse effects on Nigeria's internal and external financial position. The cost of war financing was substantial and largely was responsible for growing deficits in Nigerian government budgets. The deficits were financed by short-term domestic borrowing, which resulted in rapid increases in the internal debt. Military expenses, along with reduced exports and capital inflows, contributed greatly to a drain on external reserves. Despite limitations on unessential imports, and the accumulation of considerable arrears on current payments, substantial balance-of-payments deficits were incurred. The combination of large domestic borrowing by the government and restrictions on consumer imports has resulted in serious price inflation since 1969.

29. Government spending has continued to increase since the war and probably will remain at a high level. Because a rapid demobilization is not planned, military expenditures will continue at a high level for some time. Moreover, transfers to the states and other non-defense spending rose substantially in 1971 and probably will continue to grow in importance as reconstruction and recovery activities are carried out. On the other hand, current revenues, and especially petroleum revenues, also are expanding rapidly.

30. Since the war the government has announced ambitious plans for reconstruction and renewed development. So far, budget surpluses have not materialized for financing the projects, and actual investment in the first year of the plan (FY 1971) apparently was less than planned despite continued extensive domestic borrowing. By 1972, however, petroleum revenues probably will have increased enough to more than cover current government expenditures, leaving a small surplus for development spending.

31. Nigeria has considerable resources for economic development -- a booming petroleum industry, a diversified agriculture, a large domestic

market, a growing manufacturing sector, and a relatively well-developed infrastructure. Nevertheless, it is still a poor country and its prospective petroleum earnings are not large in relation to a population of some 55 million. By about 1973, annual petroleum earnings in excess of $1 billion should finance government development expenditures of some $500 million, or around $10 per capita. This is an average rate of investment by African standards. However, it is far too small to affect significantly the way of life of most Nigerians for many years, even though the modern sector of the economy may grow rapidly.