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# Economic Newsletter

## Ajaokuta Steel Project and the National Asset Question

### The Ajaokuta Schools of Thought

Analysts have long struggled on a meaningful definition of the Ajaokuta Steel Company project (Ajaokuta). Overtime, Ajaokuta has become a knotty national discourse with two major schools of thought. The first school of thought defines Ajaokuta as a national asset while the second argues, that it is simply a national folklore.

Students of the first school portray the Ajaokuta Steel Project as a national asset which represents the fulcrum of Nigeria's industrialisation. These proponents have long argued that Nigeria's manufacturing ambitions will come to naught without the support of the Ajaokuta Steel Project to provide the requisite steel for production. These ideologues have pushed the rhetoric that such a great national asset should be completed even at the risk of widening the fiscal deficit to accomplish that ambition.

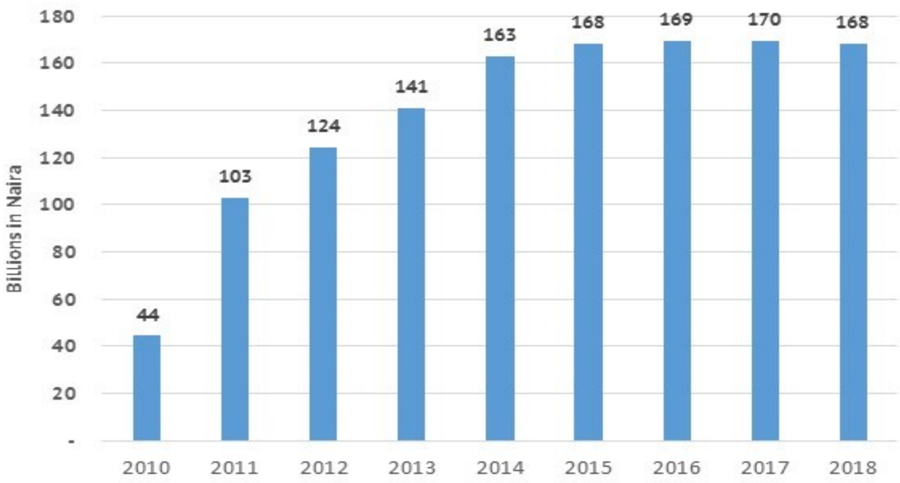
The second school is driven by cynicism on the prospects of the project based on the benefit of hindsight. These analysts argue that Ajaokuta was poorly conceived as a white elephant project from its inception and all remedial efforts have failed. For these analysts, Ajaokuta simply represents a folklore and argue that Nigeria will be better off not increasing its investments in the steel complex.

### The Ajaokuta Steel Completion Fund

Driven by nationalist intents, over 300 hundred members of the National Assembly passed a bill in 2018 seeking to create the Ajaokuta Steel Company Completion Fund, aimed at appropriating cash for the steel project. The bill sought to draw a billion dollars from excess crude revenues amongst other appropriations as well as borrowings to fund the completion of the Ajaokuta Steel Company's production facilities. The Bill was sponsored by over 300 members of the parliament, an indication of its broad partisan support and acceptance by parliamentarians.

However, President Buhari in a rare feat of an uncharacteristic hawkish fiscal stance, rejected the bill citing "competing priorities with long term social and economic impact that the funds can be attentively deployed towards", amongst other factors. Had President Buhari assented to this bill, it would have created another fiscal sore—amidst several—that would have worsened the current financial condition of the country. Worse still, the fine prints of the bill tacitly delay the privatisation or concession of the Ajaokuta project until it reaches a 50% threshold in production capacity. This milestone has not been achieved in over three decades and thus could imply that Ajaokuta may remain a State-Owned Enterprise (SOE) for another generation.

**Figure 1: Steel Industry GDP**




*Source: NBS*

*"Nigeria is saddled with an unhealthy number of underperforming and inefficient SOEs that hurt the country's fiscal position."*

## *The National Asset Question*

The Ajaokuta Steel Company Completion Bill 2018 actually brings to the fore, the debate on "National Assets", a new cliché in the country's diction. The National Asset debate has been quite thorny, driven by sentiments and ideologies which have become the underbelly of macro reforms in Nigeria. Nigeria is saddled with an unhealthy number of underperforming and inefficient SOEs that hurt the country's fiscal position in three significant ways.

Firstly, these SOEs are a drain on the government's expenditure position as they largely operate on budgetary allocations. Secondly there's a significant opportunity cost arising, as the budgetary allocations and expenditure to these inefficient SOEs implies the country has less to spend on critical social overheads such as health and education. Thirdly, the unprofitable financial positions of most of these SOEs implies that their returns to the government's tax purse are meagre, if at all.

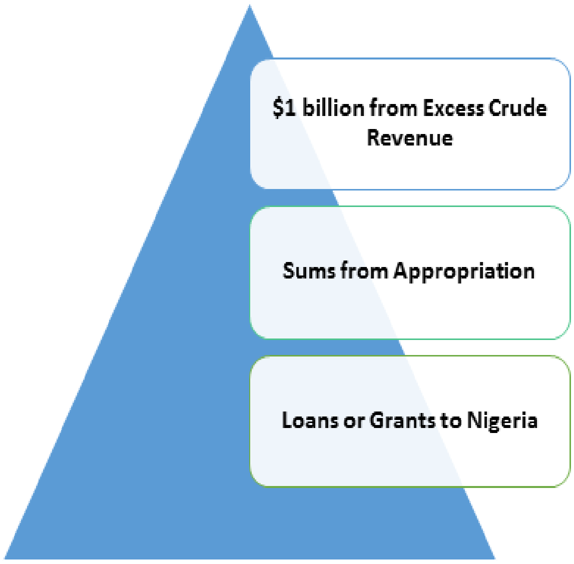
## *What the Steel Industry needs today*

The Nigerian Steel Industry has grown significantly in spite of the failings and absence of the Ajaokuta Project. Despite the frailties of the Steel Industry, long-term trends reflect significant upsides. In about a decade (2010—2018), the Steel Industry grew by about 280% in GDP mainly on the back of recycling scrap metal into finished products such as steel roofing sheets, pipes and reinforced steel bars. The Steel Industry currently has about 18 operational steel firms producing about 2.8 million metric tonnes (mmt). However, this is less than 30% of the annual steel consumption of the country which is estimated at about 20 mmt.

Nigeria has Africa's second largest iron ore deposit with over two billion tonnes in reserves. However, the Nigerian steel industry today is entirely dependent on the imports of rolled steel and wire coils and then scarp metal for local production. Structural weaknesses in mining leading to poor investments in iron ore extraction, caps the potential of the steel industry which could grow to about $15 billon from its current market size of about $3 billion.

To unlock the steel sector, Nigeria needs to pursue two major institutional reforms. The first reform should aim at stimulating investments into the mining of iron ore. While the second should promote the trade of scrap metal. We believe these reforms will help drive investments into the value chain of the industry.

**Figure 2: Funding Sources for the Ajaokuta Completion Fund**




*Source: Agusto & Co., NASS*

*"A public quotation will ensure the assets remain within the commonwealth, while creating opportunities to mobilise savings for long-term capital formation and wealth creation"*

## *The Way Forward on National Assets*

The privatisation of SOEs in Nigeria has proven to be politically unpopular. The main reason privatisation is viewed negatively in Nigeria is cronyism, which leads to a transfer of these SOEs to politically exposed persons (PEPs) who more often than none lack the requisite capital and expertise to create value from these assets. This has led to an inertia by the government to divest from these assets even in the face of enormous fiscal pressures. However, the downsides of the process should not become a permanent deterrent.

To mitigate the risks of giving up SOEs—especially capital-intensive firms—to cronies, Agusto & Co. recommends two principal measures. Firstly, rather than an undue emphasis on selling SOEs to bidders with the highest financial offer, there is a need to divest assets on the basis of a notional price. This concept of notional price implies that the government's focus will be on the ability of the acquirer to make defined and quantified investments and not just the bid price. We believe this will mitigate the risk of selling assets to acquirers who do not have the financial capacity for the required CAPEX, post-acquisition.

The second recommendation from Agusto & Co. would be to promote public ownership of these SOEs even after divestment by the government. To achieve this, the government's divestment program must incorporate a listing plan for the SOEs. A public quotation will ensure the assets remain within the commonwealth, while creating opportunities to mobilise savings for long-term capital formation and wealth creation.

Overall, Nigeria's current dire fiscal straits currently imply that the country has reached the limits to which it can push good money into bad projects. In life, we lose some and win some. Sadly, on Ajaokuta, Nigeria has lost. It's a grim verdict the country must accept. Nigeria must now cut its losses—by paring back investments in the project—and move on. Thus, we would recommend that—in the face of the burgeoning fiscal deficit—Nigeria need not inject additional capital into the Ajaokuta project. Now is the time to divest.

Notes:
Ministry of Solid Minerals Development: Unlocking Opportunities in the Iron & Steel Sector in Nigeria
Thisday: Amadi: We've had four wasted years in Power Sector
Nigerian Bureau of Statistics: Sectoral VAT: Q1-Q4 FROM 2013—2017

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**UBA House (5th Floor),**
**57 Marina Lagos**
**P.O. Box 56136, Ikoyi**
**Tel: (234) 270 7222—3**
**E-mail: info@agusto.com**
**Website: www.agusto.com**

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