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BHM 779

Public Financial Management

Module 4

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Course Developer/Writer
Mr. E. U. Abianga, National Open University of Nigeria

Course Editor
Dr. I. D. Idrisu, National Open University of Nigeria

Course Coordinator
Mr Agbebaku, Henry Usiobaifo (Course coordinator) – NOUN

Programme Leader
Dr (Mrs) Ayodele O. Fagbemi, National Open University of Nigeria

Credits of cover-photo: Henry Ude, National Open University of Nigeria

National Open University of Nigeria - 91, Cadastral Zone, Nnamdi Azikiwe Express Way, Jabi, Abuja, Nigeria

www.nou.edu.ng centralinfo@nou.edu.ng
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Module 4 Government Debts, Enterprises and Multi-Nationals

Unit 1 Government (Public) Debts

1.0 Introduction

In this unit, we will discuss public debt and the management of the public debt. You will be led into debt financing gaps that led to the national indebtedness and the agencies thereof.

2.0 Objectives

At the end of this unit, you should be able to:

- define public debt
- identify sources of public debt
- discuss public debt management.

3.0 Main Content

3.1 Public Debt

The short-fall between domestic savings and the desired level of investments in most countries (especially developing ones) has led to both internal and external borrowings to fill the gaps. These led to financial liabilities (public debt) by government to individuals and institutions within and outside the country. In a developing country like Nigeria, the Central Bank on behalf of the government borrows money from both internal and external sources. **Public debt** therefore is the amount of money owed by the government to institutions, governments and individuals' resident in or outside Nigeria. **Deficit financing** is the creation of extra purchasing power by government which then utilises it for purchasing away resources from the market.

It could also be defined as the net increase in the amount of money in circulation where such an increase result from a conscious government policy designed to encourage economic activities which ordinarily would not have taken place; and from another angle amounts to domestic credit creation which is not off-set by increased taxation, more restrictive bank credit policy and similar deflationary measures. This involves running down the government accumulated cash balances, net borrowing from the banking system, issuing of new currency by the central bank, net borrowing from abroad and drawing down of foreign assets There is no single approach to economic development; multi-frontal attack on social, economic, political, cultural and attitudinal obstacles to it, which deficit financing is one tool. On the whole, you should note that there can be no deficit financing without deficit budgeting.

Self-Assessment Exercise

Define public debt.

3.2 Sources of Public Debt

In both developing and developed countries, sources of internal debt are diverse. They are commonly incurred through monetary instruments like treasury bills/certificates and government development stocks which can be contracted through:

Banks- as part of their investment portfolio banks invest in these debt instruments

Non-bank public- like state/local governments, savings institutions, insurance companies, statutory boards/corporations and individuals

Central bank- as the bank of last resort which absorbs the unsubscribed portion of government securities floated in the primary market. Instrument of domestic debt carry different maturities terms- short, medium and long.

These public debts are classified along the purpose for which the debt was incurred as follows:

Internal debt- domestic debt-money owed citizens, raised within the economy. Repayment is by local currency by tax revenue transfer to the creditors.

External debt- creditors are foreigners-money borrowed by government of one country from the government or non-governmental institutions of other countries.

Trade Debt- when Nigeria trades with other countries and is unable to pay for the goods and services supplied

Balance of payment support loan- overall economic transactions between one country and other countries classified as current and capital accounts and the official settlement balance, constituting the balance of payment which may be favourable when it is deficit.

Project- tied loans- viable projects to accelerate economic growth and development may lead to government contracting project-tied loan-a self liquidating investment.

Socio-economic needs' loans- government borrows to finance provision of socio-economic amenities like infrastructure, health, education, recreation facilities etc.

Funded and non funded debts- funded are debts of which sinking funds have been provided-loan with lesser risk of default as redemption at maturity has been provided. While the unfunded debts are without any specific provision for redemption-debts with high risk of default.

Marketable and non-marketable debts- securitised loans which can be resold by the existing debt holder to willing buyer is marketable; while loans to debt-holder which cannot be resold in the secondary market are non-marketable

Loan pooling and consolidation- the acquisition of loans from various sources in order to execute a particular project is loan pooling; while the gathering or consolidation of loans before utilisation is loan consolidation.

Self-Assessment Exercise

What are the sources of Pubic debt?

3.3 Public Debt Management

The classical principles of loan finance rationalise loans to provide intergeneration equity, pay-as-you-use, capital formation, old-age insurance, self-liquidating projects, adjusting distribution and reduction of tax friction. Borrowing can be considered as a second best alternative to money creation during the period of unemployment. Foreign loan is seen as a means of filling domestic savings gap, especially in the face of dwindling government revenues from domestic sources. It is particularly so, during fluctuating prices of primary commodities/exports and hence dwindling foreign exchange earnings.

External borrowing also enables a developing country increases its rate of real investment, just as it is seen as an engine of growth. In this sense, it increases per capita Gross National Product (GNP) (Cairncross, 1961); hence, debt acts as a source of capital formation. Public internal borrowing acts as an anti-inflationary measure by mobilising surplus money in the people's hands. Such resources can be diverted from unproductive channels e.g. jewelry, real estate to productive ventures. Once incurred, debt must be serviced through the payment of interest and amortisation charges as and when due. Government incurs a larger debt through continual net borrowing as the interest rate increases. If the entire amount of the interest charges were to be paid with tax revenue then the actual amount of tax collection must also rise continually. As a result, this imposes a burden on the public.

In Nigeria the Central Bank of Nigeria is statutorily with the responsibility of debt management in conjunction with the Federal Ministry of Finance and other agencies and the state counterpart. Recent development has witnessed the establishment of Debt Management Office under the supervision of the Vice President's Office.

4.0 Conclusion

We have defined public debt and identify the sources. Public debt management is explained as the technical, operational and government agencies arrangements engaged in managing a country's liabilities so that the debt stock and the debt service burden are contained at a tolerable and sustainable level.

5.0 Summary

In this unit, attempts have been made to define public debt, deficit financing, identify sources of public debt and discuss debt management strategies. There is a difference between public debt and national debt. In the next unit, national debt will be explained to expose the difference.

6.0 Self-Assessment Exercise

1. Identify sources of public debt in a developing country.
2. Discuss public debt management in Nigeria.

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Unit 2 National (Public) Debt Management

1.0 Introduction

In this unit, we will discuss national debt and management. You will be led into the gaps that led to the national indebtedness and the agencies thereof.

2.0 Objectives

At the end of this unit, you should be able to:

- explain national debt
- discuss national debt management.

3.0 Main Content

3.1 National Debt

As stated in the summary of last unit, there is a difference between public debt and national debt. The former is the debt owned by the Federal Government, while the later comprises the debts of federal, state, local governments and public corporation. That means national debt is the total amount of debt owed by all tiers of government- federal, states and local.

Some of the debts owed by and negotiated for by the state government and guaranteed by the federal government with foreign interest as well as those with domestic contractors/investors. The local government constitutional scope for debt negotiation is domestic. It is at the collating point that all the indebtedness is summed as national debt.

Self-Assessment Exercise

Define national debt.

3.3 National Debt Management

Every country has its own way of managing its national debt and for this purpose, a number of policy instruments with different objectives have over time evolved. Debt management policies are, for the most part, designed to go in tandem with the broader macroeconomic objectives of stabilisation and growth. It is important to note that debt management strategies relate largely to the question of repayment and reduction of domestic as well as foreign debts.

From the last unit we deduced that debt management is the technical, operational, and institutional arrangements engaged in managing a country's liabilities and in this stage, the debt management include that of all tiers of government.

- The technical aspect focuses on the need to determine the level of external debt required and to ensure that terms and condition of those borrowings are in consonance with the future debt service capacity of the country.

Institutional arrangements include the administrative, organisational and monitoring aspect of managing both new borrowings and the total stock of debt. Nigeria has made efforts by successive government administration to restructure the county's debt over the years. Measures adopted include, refinancing, rescheduling, restructuring of debt arrears and out right payment/settlement of the debt.

Internal (domestic) debt management

The Federal Ministry of Finance (treasury) manages government domestic debt; while federal government loans, publicly, issued in Nigeria is issued and managed by the Central Bank by:

- advising the government on timing of floating debt instruments and terms of issue
- advertising for public subscription to the issues
- collecting the proceeds of issues on government behalf
- supervising the issue of certificates and warrants
- paying principal and interest on matured debts and in addition manages the sinking fund that facilitates redemption.

The authority controlling the above responsibilities could underwrite the unsubscribed portion and provide a secondary market where the divestment of public holdings could be carried out at a discount as it is done in Nigeria. Thus, adequate guarantee is provided for debt instruments. The Federal Ministry of Finance (a controlling agency) manages other domestic debts such as contractual debts and organises the mode of payment through appropriate consultation with the Federal Government and the Central Bank.

Acquisition of domestic debts

The Central Bank of Nigeria advises government as to the timing of floatation of debt instruments and terms of issue. Advertisements are usually put up and subscription made through the banks and acceptance houses. The duty lies on the CBN to maintain appropriate books and accounts of such transaction.

Restructuring of domestic debts

The Central Bank of Nigeria accommodates government short term financial shortfalls through the provision of overdraft facility by Ways and Means Advances.

Servicing of domestic debts

The CBN makes the interests and principal payments of domestic debts which fall due. It provides discount as well as rediscount facilities in respect of debt instruments held by its customers. This later function is however being transferred to the Discount Houses. In the case of development stocks, the CBN publishes due dates for redemption of maturing stocks through redemption schedule statements and payment forms.

External (foreign) debt management

External debt management is a conscious and carefully planned schedule of loans acquired either for development purposes or to support the balance of payment. It incorporates estimates of foreign exchange earnings, sources of finance, the projected returns from the investment and the repayment schedule. It also includes the assessment of the countries capacity to service existing debts and whether further loans could be contracted. Nigeria's external debt management strategies have varied from time to time since independence and measures were set out with the following policy objectives:

- to evolve strategies increasing foreign exchange earnings thereby reducing the need for external borrowing
- to set out the criteria for borrowing from external sources and determine the type of projects for which external loans may be obtained
- to outline the mechanism for servicing external debts of the public and private sectors
- to outline the role and responsibilities of various organs of the federal and state governments as well as the private sector in the management of external debt.

These policy objectives motivated the Nigerian government desire to reduce the burden of external debt. The following steps were developed over the years-even states and local governments were prohibited over the years on considering loan- whether domestic or foreign.

Embargo on new loans-to check un-manageable hike in debt stock leading to preventing more debt burden. This is used to prevent a situation where the public debt becomes unmanageable as a result of unnecessary increases. The federal government directed in 2001 that no applicant for external loans, whether a state or federal government agencies, was allowed to borrow more than US$500m for any projects unrelated to poverty alleviation.

Limit on debt service payments- to encourage the use of a particular proportion of our external earnings to service the external debt.

Debt restructuring- outstanding debts are converted into another type of debt.

Re-financing of trade arrears is a new loan that is procured by a debtor to pay-off an existing debt if it involved short-term trade debt. This relates to procurement of a new loan by a debtor country in order to pay off an existing debt especially when it involves short term trade debt. There are two processes involved in re-financing of trade arrears. They are: debt rescheduling and debt buy back.

Debt conversion- the exchange of monetary instruments like promissory notes for tangible assets or other financial instruments. In simple terms, it means exchange of monetary instrument e.g. promissory notes for tangible assets or other financial instruments. It is designed for the reduction of a country's external debt burden by changing the character of the debts. Debt conversion could be of various types including debt for equity, and debt for cash. The debt conversion exercise involves the sale of an external debt instrument for a domestic debt of equity participation in domestic enterprises. This is practiced in Nigeria.

Collaterisation – under this arrangement, the yield of a bond collaterised within a specified period is expected to offset or pay off a collaterised amount referred to as the zero coupon option.

Debt swap – this is a loan that could be paid for by other means like crude oil.

Debt servicing – this is paying interest on loan.

Debt settlement – this implies paying up the debt which Nigeria did in 2005.

The government of the day determines the strategy thereof. In this democratic dispensation, the necessary due process is taken to manage the national debt, collectively, with the consent of the states as well as local government representatives with a consensus. The public and national approaches to debt management are intertwine and related. The difference is that the public concentrates on the debt incurred solely through and by the federal government while the national debt include the aggregation of debts through and by federal, state and local governments.

Self-Assessment Exercise

List measures adopted by successive government in Nigeria to restructure the county's debt.

4.0 Conclusion

National debt management is shown as the technical, operational and institutional arrangements engaged in managing a country's liabilities. This is performed by the agencies of government be it internal or external debts.

5.0 Summary

In this unit, attempts have been made to define national debt and discuss national debt management as a summation national strategy on solving the debt situation as it affects all tiers of government.

6.0 Self-Assessment Exercise

1. Explain national debt.

2. Discuss national debt management strategies in Nigeria.

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Unit 3 Government Enterprises

1.0 Introduction

In this unit, we will consider government organisations as product of growth of services needed and expected to satisfy the community. This is when the government is tilted towards welfare and the main thrust for state involvement is usually public interest.

2.0 Objectives

At the end of this unit, you should be able to:

- identify government enterprises
- state the objectives of public enterprises.

3.0 Main Content

3.1 Government Enterprises

You have to note as a student of public administration that as there are different types of government, so is the approach to addressing people's aspiration and public interest. If the arm of governance cannot provide for certain need for urgent services to the community which cannot be provided for by entrepreneurs, the government with welfare at the focus will be responsive to its duties and provide essential services.

State enterprises in Nigeria

The British Colonial government administration introduced state enterprise system in Nigeria in 1898 by establishing:

- the railway transport project
- coal mining corporation
- electricity (Electricity Corporation of Nigeria)
- marine services

In the 1950s, public corporation growth became remarkable. Owing to the adoption of a federal system of government the number of government owned enterprises increased so much as the regional government established theirs and the subsequent state creation multiplied the enterprises. Most of them are moribund or dilapidated sowing to political influence which usually overrides the goal set for them to achieve.

The Nigeria economy has graduated over the years to a mixed economy ideology where the private and public sector compete in contributing to the mainstay of the economy.

Public enterprises are government sector made of mainly government and its enterprises- federal, state or local. They are economic agent, acting on behalf of citizen and major engineer of economic progress with action taken in the public interest. This is the opposite of private enterprises. The economic system of a particular country determines the importance of each of these sectors. In capitalist economies, the private sector is in the fore-front of development with government in providing only rules and regulations.

The reverse is the case in socialist/communist economies the public sector takes the central seat as the dominant sector. The private sector is played down as no individual owns means of production as government see to most economic question regarding production. The Nigeria economy is tilted towards a mixed economy. It will be interesting for you to note that it took time and assessments to arrive at this position.

Over the years, there has been a controversy on the relevance of the public sector in the Nigerian economy. Despite the abysmal performance of the public enterprises they are still needed because of development stride. The objectives of public enterprise include:

- distribution of certain products and services as government assistance/intervention
- checking efficiency in the allocation of scarce resources
- bridging the gap between the haves and have not.

The negative effect of public sector enterprises is ascribed to the attitude of economic planners which is charted toward promoting economic development and this phenomenon involves much more than economic growth. The inequality in income distribution is the bane of economic growth in Nigeria and has contributed to the ineffectiveness of the government owned enterprises.

Self-Assessment Exercise

List the objectives of government enterprises.

4.0 Conclusion

In this unit, we have seen that the arms of government can provide for certain needs of the community which cannot be provided for by entrepreneurs. Government enterprises can produce services needed and expected to satisfy the community. This is when the government is tilted towards welfare.

5.0 Summary

In this you we have attempted identify government (public) enterprises and their objectives. In the next unit, you shall be introduced to multi-national institutions.

6.0 Self-Assessment Exercise

1. Identify government enterprises.

2. State the objectives of public enterprises.

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Unit 4 Multi-National Institutions

1.0 Introduction

In this unit, you would be introduced to the role of multi-lateral institutions that help in underwriting external debt of nations in international trade and enhancing the expansion and development of the respective economies thereof. Their functions with regard to lending/borrowing, especially, to developing countries will be discussed.

2.0 Objectives

At the end of this unit, you should be able to:

- identify different multi-national institutions
- state the functions of multi-national institutions.

3.0 Main Content

3.1 Multi-National Institutions

Here, let us consider the following.

World Bank (International Bank for Reconstruction and Development)

The World Bank is a multi-lateral institution which provides loans to needy counties.

It was established as International Bank Reconstruction and Development (IBRD) in 1945 under the Bretton Wood Agreement of 1944, after the World War II, to mid-wife reconstruction and development from Wartime to peace time.

Functions

1. To partake in the development of territories of it members by facilitating the investment of capital for productive purpose and to that of less developed countries.
2. To promote private foreign investment by means of guarantees on participation in loans and other investment made by private investors
3. To promote long-range balance growth of international trade and maintenance of equilibrium in the balance of payments of member countries by encouraging international investment for the development of their productive resources.
4. To arrange the loans made or guaranteed by it in relation to international loans through other channels so that more useful and urgent small and large projects are prioritised.

The memberships consist of financial members of International Monetary Fund (IMF). If a country resigns it shares the assets and liabilities of the bank as at that time.

Borrowing and lending activities of world bank

The World Bank capital is subscribed by members. It finances its lending operations from its medium and long-term borrowings in the international capital markets and Currency Swap Agreements (CSA). In these agreements, the proceeds of a borrowing country are converted into a different currency and simultaneously a forward exchange agreement is executed providing for schedule of future exchange of two currencies in order to recover the currency converted. The Bank's mode of lending to member countries takes any of these ways.

1. Marketing or participating loans out of its own funds;

2. Making or participating in direct loans out of funds raised in the market of a member or otherwise borrowed from the bank;

3. Guaranteeing in whole or in part loans made by private investors through the usual investment channels.

The Bank guarantees, participates in or makes loans to its members on different conditions as follows.

1. If it is satisfied that in the prevailing market conditions, the borrowers would be unable to obtain the loan under conditions which the Bank presumes is reasonable to the borrowers.

2. Loans are for specific developmental projects or deemed to be so implied.

3. If the member in whose territory the project is located is not itself the borrower, the member or its central bank fully guaranteed the repayment of the principal, the payment of interest and other charges on the loan.

4. The project in question has been duly recommended by a competent committee in the form of a written report after a careful appraisal of the proposal.

5. The borrower or the guarantor is in a position to meet its obligation under the loan.

The World Bank Facilities to member countries varies according to needs and circumstances.

Structural Action Programme (SAP)- Started in 1983 to strengthen World Bank's ability to assist member countries in adjusting to current economic environmental realities with the following elements:

- an expansion of lending for high-priority operations that support structural adjustment, policy changes, production for export, optimal use of existing capacity and maintenance of crucial infrastructure

- accelerated disbursements under existing and new investment commitments to ensure timely implementation of nigh priority projects

- expanded advisory services on the design and implementation of appropriate policies

- enlisting familiar efforts by other donors for fast disbursing assistance in support of programme of the Bank and International Monetary Fund (IMF).

Structural Adjustment Facility (SAF) – Introduced in 1985 to borrowing countries in order to reduce their balance of payments deficits while maintaining their economic growth potency. The funds are used to finance general imports with a few exceptions of luxury military imports. They are released based on stiff conditions of the Bank and it spans between 5 to 7 years.

Enhanced Structural Adjustment Facility (ESAF) –It was set up to increase the availability of concession resources to low-income member countries totaling Special Drawing Right (SDR) 6 billion financed by special loans and contribution from developed and Oil Producing and Exporting Countries. Like others it helps in addressing positively the borrowing nation balance of payments problems and enhances growth and development.

Self-Assessment Exercise

Name the facilities provided by the World Bank to member countries.

International Monetary Fund (IMF)

The IMF is one of the multi-lateral institutions; an affiliate of the World Bank, involved in the act of providing loans for needy nations. It is established by different countries after the World War II with the objective of providing exchange stability throughout the world and increasing liquidity to enhance balanced multilateral trade through the cooperation of the member nations.

Objectives of IMF

The main purposes of the IMF, summarised in the article of agreement, are as follows.

- To promote international monetary cooperation through a permanent institution that provides the machinery for consultation and collaboration on international monetary problems.

- To facilitate the expansion and balanced growth of international trade and to contribute to the promotion and maintenance of high levels of employment and real income and to the development of productive resources of all members economy.

- To promote exchange stability, to maintain orderly exchange arranges among member and to avoid competitive exchange depreciations.

- To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

- To give confidence to members by the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures inimical to national or international prosperity.

- In accordance with the above, to shorten the duration and lesson, the degree of disequilibria in the international balance of payments of members.

International Development Association (IDA)

The International Development Association (IDA) was established in 1960 as an affiliate to the World Bank. There are many projects such as irrigation, railway construction, education, public health, housing etc. in under-developing countries which are vital to general economic development, with long gestation period and insufficient yield returns to meet the amortization charges. The IDA was established to supplement the World Bank's development assistance and to make available loans to the developing countries on soft terms and for long period. That is, IDA is 'Soft Loan Window of the World Bank.'

Objectives of IDA

1. To provide development finance to the less developed counties on easy and flexible terms

2. To promote economic development, increase productivity and improve the standard of living in the developing countries

3. To supplement the objectives and activities of the World Bank

Self-Assessment Exercise

List the objectives of International Development Association.

International Financial Corporation (IFC)

International Financial Corporation (IFC) was established in July 1956 as an affiliate of the World Bank to provide finance to the private sector. You may note that, conventionally, World Bank loans are to governments of the member countries; or it provides loan capital to the private enterprises with the guarantee of the member governments. Moreover, the World Bank does not offer risk capital. The IFC was with specific purpose of providing risk capital to the private sector/enterprises in the developing countries without government guarantee.

IFC investment policy

The main features of the IFC investment policy are as follows.

- It considers predominantly industrial enterprises which contribute to economic development of the country.

- The project to be financed must be in the productive, private sector.

- The IFC affirm that the enterprise has experience and competent management.

- The loan must not be more than half of the capital needed for the enterprise.

- The minimum investment to be made by the IFC to a single enterprise is fixed at $100,000:00 with no upper limit.
- The rate of interest for the loan is determined by mutual negotiation, depending on the degree of risk involved and other terms of investment.
- The loans are disbursed in lump-sum or in installments and are repayable in a period of 5 to 15 years.

Parish Club and London Club

These are some of the sources of external debt contraction.

Paris club of creditor

This consists of mainly credit guaranteed by government. It is made up of United Kingdom, Federal Republic Government, The United States, Canada and France, who guarantee the export activities of their nationals through their official export credit agencies. If the recipient nation's government is unable to pay the foreign exchange equivalent of the domestic currency cover paid by the importer, it becomes public debt owned to the creditor nations. The Club commenced meeting in Paris in 1956.

London club of creditors

This consists of mainly commercial banks in industrial countries where credit are extended by commercial banks to citizens of debtor countries, largely un-insured and un-guaranteed. It was in 1976 the first meeting was held in London.

African Development Bank (ADB)

The African Development Bank was established under the auspices of Economic Commission for Africa (ECA) in 1966.

Functions (as express in the statute establishing ADB) are as follows.

1. Use the resources at its disposal for financing of investment projects relating to the economic and social development of its members
2. Undertake and participate in the selection, study and preparation of projects enterprises and activities contributing to such development
3. Mobilise both within Africa and outside Africa, resources for the financing of such investment programme
4. Promote investment in Africa of public and private capital in projects or programme
5. Provide such technical assistance as may be needed in Africa for the study, preparation, financing and execution of development project or programme
6. undertake such other activities and provide such other activities as may advance its purpose

Self-Assessment Exercise

List the functions of the African Development Bank.

4.0 Conclusion

We have identified different multi-national institutions and have stated their functions, depending on need and the level of the developing country.

5.0 Summary

In this unit, we have attempted to identify the different multilateral institutions mentioning their functions.

6.0 Self-Assessment Exercise

1. What are the functions of the World Bank?

2. List three multi-nationals and their functions.

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