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NIGERIA

BI-ANNUAL ECONOMIC UPDATE: --- FRAGILE RECOVERY



No. 1 - April 2017

NIGERIA **BI-ANNUAL** **ECONOMIC UPDATE:**

FRAGILE RECOVERY



Cover photo: Female Nigerian Trader at a textile market in Lagos, Nigeria. Credit: **Olufunke Olufon**

Acronym List

BDC	Bureau De Change
BOP	Balance of Payments
CBN	Central Bank of Nigeria
CPI	Consumer Price Index
CY	Calendar Year
DISCOs	Power Distribution Companies
DMO	Debt Management Office
ECA	Excess Crude Account
ERGP	Economic Recovery and Growth Plan
FCT	Federal Capital Territory
FEC	Federal Executive Council
FGN	Federal Government of Nigeria
FRA	Fiscal Responsibility Act
FRL	Fiscal Responsibility Law
FSP	Fiscal Sustainability Plan
GDP	Gross Domestic Product
GENCOs	Power Generation Companies
IOC	International Oil Companies
JV	Joint Venture
LCU	Local Currency Unit
mbpd	Million barrels per day
MDAs	Ministries, Departments, and Agencies
MTEF	Medium Term Expenditure Framework
N	Naira
NASS	National Assembly
NBS	National Bureau of Statistics
NEC	National Economic Council
NNPC	Nigerian National Petroleum Corporation
NTB	Non-Tariff Barriers
OAGF	Office of the Accountant General of the Federation
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PPP	Purchasing Power Parity
PPPs	Public-Private Partnerships
SLGs	State and Local Governments
SWF	Sovereign Wealth Fund
TFP	Total Factor Productivity
USD	US Dollars
VAT	Value Added Tax
WEF	World Economic Forum

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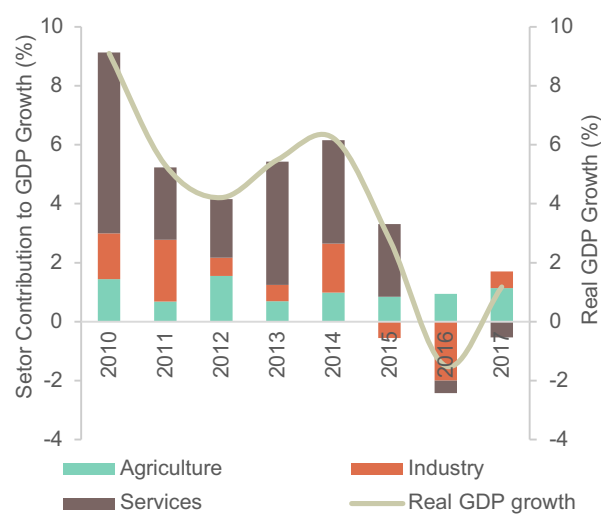
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EXECUTIVE SUMMARY

Chapter 1 provides an overview of recent developments in the Nigerian economy. In 2016, Nigeria experienced its first full-year of recession in 25 years. Global oil prices reached a 13-year low and oil production was crushed by vandalism and militant attacks in the Niger Delta, resulting in severe contraction of oil GDP. While the oil sector represents only 8.4 percent of GDP, the lower foreign exchange earnings from oil exports had significant spillover effects on non-oil sectors, especially industry and services, which are dependent on imports of inputs and raw materials. Compounded by inadequate policy responses, these challenges caused the overall real GDP to contract by 1.5 percent.

Low oil revenues and the lack of major tax policy reforms to significantly increase non-oil revenues led to large revenue shortfalls at all levels of government in 2016. Consequently, the Federal Government budget was under-executed,¹ especially on capital spending, and the fiscal deficit widened despite progress made in rationalizing recurrent expenses. Although the consolidated public debt-to-GDP ratio remains low (17 percent of GDP), the World Bank's estimate of the interest payments-to-revenue ratio for the Federal Government is as high as 59 percent for 2016.² The fiscal deficit was largely domestically financed, although the Federal Government successfully marketed USD 1.5 billion worth of 15-year Eurobonds in February and March 2017. The subnational fiscal crisis continued in 2016 despite the first financial bailout in mid to late 2015, and the states' public spending has been curtailed significantly, given their reliance on statutory transfers. The Fiscal Sustainability Plan, the condition for the second financial bailout, is a significant achievement, as the Federal Government and states have agreed to a

Figure 1. Sectoral contribution to GDP growth Aggregate Supply



Source: National Bureau of Statistics

number of important reforms to improve fiscal transparency, accountability and sustainability at the state government level.

Monetary policy remained accommodative, with broad money growth at 18.5 percent, driven by increased lending from the Central Bank to the Government to finance the budget deficit. The combination of the rising costs of power and transport, increases in petrol prices, the depreciated Naira and the growth in money supply resulted in average inflation of 15.6 in 2016. Together with rising unemployment, this hurt private consumption, which fell by 6 percent in Q2 2016.³

After a sharp depreciation of the exchange rate following the June 2016 liberalization of the Naira, the Central Bank of Nigeria (CBN) maintained the interbank exchange rate at around N 305 per USD. To increase foreign exchange reserves, the Central Bank limited its supply of foreign exchange in the

¹As of the end of calendar year 2016.

²Unlike Federal Government accounts, World Bank' measure of revenue excludes inflows in the fiscal accounts which should be considered financing items. IMF further excludes unbudgeted revenues and estimates debt-service-to-revenue ratio at 66 percent (IMF Article IV, 2017).

³Latest available data, as the demand side GDP figures are published with longer lags than supply side data.

interbank market and introduced a number of foreign exchange allocation/utilization rules. Subsequently, imports declined even faster than exports, yielding an estimated current account surplus of 0.6 percent of GDP in 2016. The shortage of foreign exchange from the interbank and Bureau de Change (BDC) channels increased demand for foreign exchange on the parallel market, leading to the parallel market rate rising, by February 2017, to more than N 500 per USD, and creating round-tripping opportunities and distortions in the economy. After foreign reserves recovered to USD 29.6 billion, the Central Bank increased its supply of foreign exchange into the interbank market and BDC channels, and the parallel market rate appreciated steadily, reaching just under N 400 per USD at the end of March 2017.

Chapter 2 describes the World Bank's view on Nigeria's economic outlook for 2017. Economic growth is expected to recover slightly, to above 1 percent in 2017, driven mainly by the restoration of oil production to normal levels (2.1 million barrels per day) due to the Government's efforts to resolve the fragile Niger Delta situation, as well as higher oil prices and continued strong growth in agriculture. However, sustaining and building on the oil-driven recovery will require strengthening the macroeconomic policy framework by (a) addressing the exchange rate and foreign exchange issues that have severely affected the private sector; and (b) implementing the structural reforms needed to diversify the economy and breakout of the oil boom and bust cycle. The Government has outlined an ambitious set of infrastructure programs and structural reforms in the Economic Recovery and Growth Plan (ERGP) 2017-2020, which was released in early March 2017. Successful implementation of the ERGP relies on strong coordination with the subnational governments, and on mobilizing domestic and

foreign private investment and external financing to complement public financing. Private sector financing will, in turn, hinge on restoring investor confidence through further monetary, exchange rate and fiscal policy adjustments to lower inflation, increase access to foreign exchange and increase fiscal revenues.

The credibility of the ERGP will depend on evidence of concrete progress in implementing the reform program. A positive start to ERGP implementation is the approval of the Power Sector Recovery Plan in March 2017, which aims to optimize the delivery of at least 10GW of operational capacity by 2020. Restoring financial viability to the sector is crucial to ensure sufficient investment in the sector, and this will require tariff adjustments over the medium term.

Chapter 3 summarizes the findings of a forthcoming Bank report *Toward Sustainable Growth in Nigeria: Empirical Analysis and Policy Options*, which analyzes the patterns of economic growth in Nigeria; the underlying determinants of growth from both a macro and micro perspective; and policy priorities to support higher growth. Over the last four decades, Nigeria's GDP growth rate failed to keep pace with those of more developed economies, reflecting an all-too-common experience among commodity exporters. Oil continues to dominate the country's growth pattern, but the volatility of oil-dependent growth imposes substantial welfare costs that impede progress on the country's social and economic development objectives. A cross-country analysis of the determinants of growth carried out for the report underscores the importance of sound macroeconomic management and stability for growth; while confirming that inflation, government consumption and currency misalignment (overvaluation) are negatively correlated with

growth. Policies and reforms to promote capital investment and trade are positively associated with growth. While oil and other natural resource rents tend to positively impact growth in the short term, this effect is greatly diminished by the impact of poor governance of these rents on the quality of public institutions. Investment in education is also found to be a significant determinant of growth, and particularly important in Nigeria to increase factor mobility from less

productive to more productive sectors. In addition, analysis of constraints to doing business and the impact of current trade policies highlights the need to improve access to finance, improve the reliability of power supply, and adjust trade policies to promote productivity growth.

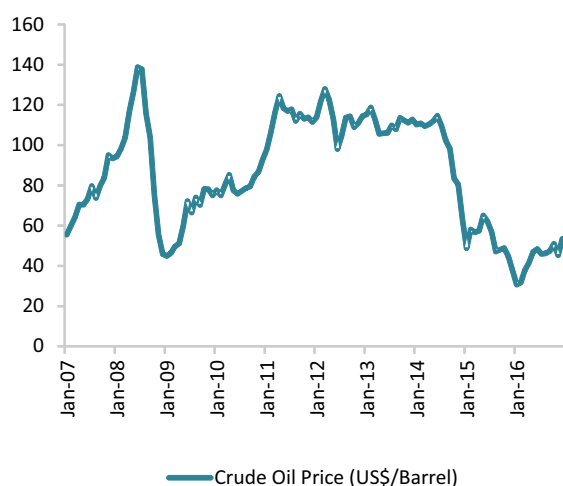
Chapter 1: Economic Update

1.1 Real Sector

Gross Domestic Product: Aggregate Supply

1. Nigeria's real economic growth collapsed to -1.5 percent in 2016, marking the first full year of negative growth in more than two decades. The recession was driven by a large contraction in the oil sector. In addition to the global price of crude oil falling to a 13-year low in January 2016 (Figure 1.1), Nigerian oil production declined as a result of vandalism and militant attacks on oil installations in the Niger Delta. Production averaged only 1.7 and 1.6 million barrels per day (mbpd)⁴ in Q2 and Q3

Figure 1.1 Crude Oil Price (US\$/Barrel)

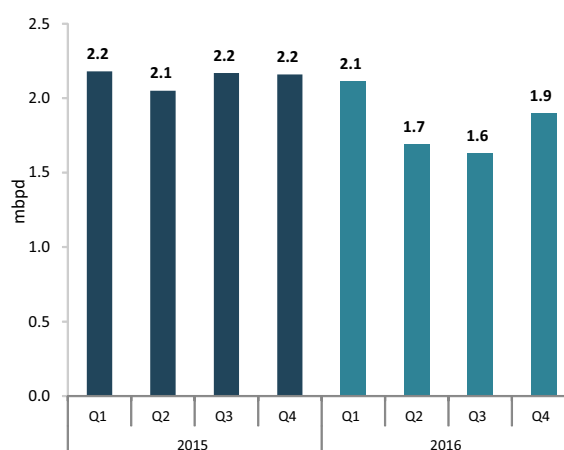


Source: National Bureau of Statistics

2. While the oil sector represented only 8.4 percent of GDP in 2016 (Table 1.2), the lower foreign exchange earnings from oil exports had significant spillover effects on non-oil sectors dependent on imports of inputs and raw materials, in particular manufacturing and trade.

2016, respectively, compared to 2.2 mbpd in 2015 (Figure 1.2). Despite the Government's efforts to address security challenges in the Niger Delta, which restored the oil production to 1.9 mbpd by the end of 2016,⁵ oil production averaged only 1.9 mbpd in 2016, compared to 2.1 mbpd in 2015. As a result, oil GDP contracted by 13.6 percent throughout 2016 (Table 1.1).

Figure 1.2: Oil Production (in millions of barrels per day)



Source: National Bureau of Statistics

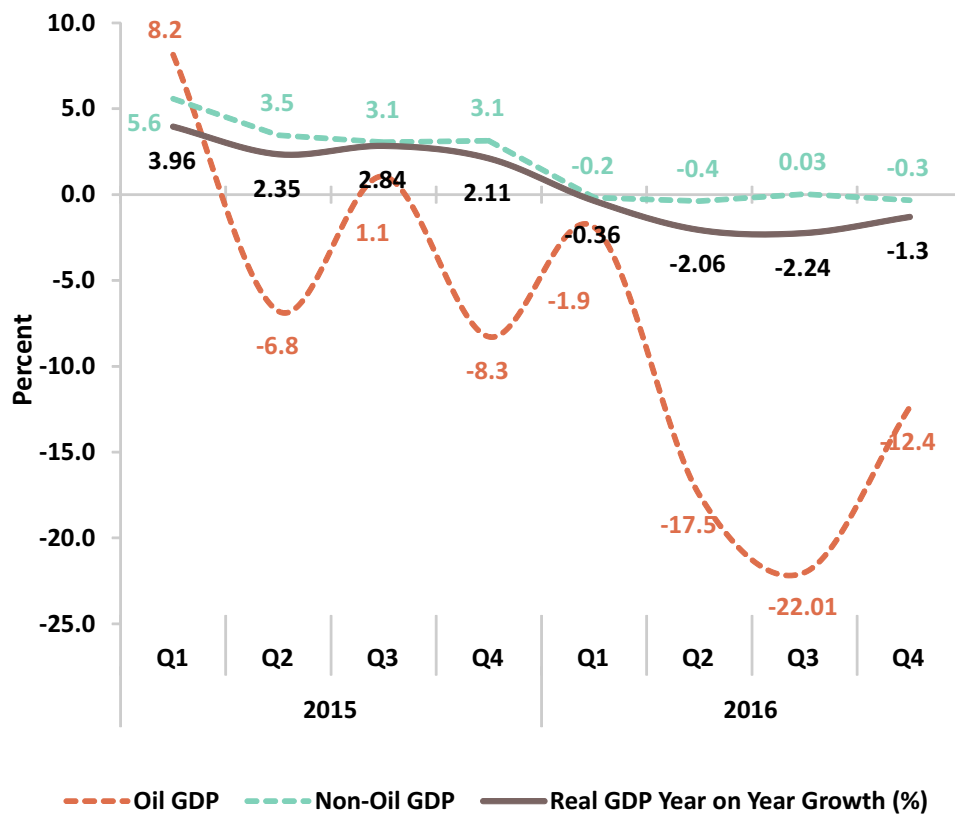
Furthermore, lower resource rents reduced public and private consumption, reducing aggregate demand and thus further negatively affecting the non-oil sectors, especially real estate and other services. These negative

⁴The oil production definition according to NNPC, which the sum of crude oil and condensate. The publicly available OPEC numbers are for crude oil only.
⁵NBS data as published in February 2017.

spillover effects were magnified by uncertainty around the Government's exchange rate policy and foreign exchange restrictions, which created severe foreign exchange shortages at the interbank rate. As a result, manufacturing contracted by 4.3 percent overall in 2016, with a particularly sharp drop at the beginning of the year (-7.0 percent in Q1 2016; Table 1.1). Construction contracted more gradually, with quarterly declines oscillating around the 2016 average of -5.9 percent. Services, the largest sector of the Nigerian economy (53.6 percent of GDP) and normally the strongest driver of economic growth (Executive Summary Figure 1), also recorded

negative growth (-0.8 percent) in 2016. However, performance among its sub-sectors was varied: for example, trade (17.7 percent of GDP) contracted by 0.2 percent, real estate by 6.9 percent, finance and insurance by 4.5 percent, while ICT grew by 2 percent. Agriculture, which contributes 24.4 percent to GDP (Table 1.2), recorded solid and accelerating growth, driven by strong crop performance in favorable weather conditions and also reflecting the impact of Government's strong support to the sector.

Figure 1.3 Real Oil & Non-Oil GDP YOY Growth



Source: National Bureau of Statistics

Table 1.1: Real GDP growth by sector and selected sub-sector, aggregate supply (y-o-y, percent)

Activity Sector	Annual			Quarterly			
	2014	2015	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Total GDP	6.2	2.8	-1.5	-0.4	-2.1	-2.2	-1.3
<u>Agriculture</u>	4.3	3.7	4.1	3.1	4.5	4.5	4.0
<u>Industry</u>	6.8	-2.2	-8.5	-5.5	-9.5	-12.2	-6.7
Oil & gas	-1.3	-5.4	-13.6	-1.9	-17.5	-22.0	-12.4
Manufacturing	14.7	-1.5	-4.3	-7.0	-3.4	-4.4	-2.5
Construction	13.0	4.4	-5.9	-5.4	-6.3	-6.1	-6.0
<u>Services</u>	6.8	4.8	-0.8	0.8	-1.3	-1.2	-1.5
Trade (wholesale & retail)	5.9	5.1	-0.2	2.0	0.0	-1.4	-1.4
Accommodation & food services	18.3	2.3	-5.3	-7.4	-6.4	-4.9	-2.7
Information & communication	7.0	6.2	2.0	4.1	1.4	1.1	1.4
Arts, entertainment & recreation	14.9	9.4	3.7	8.4	1.8	2.0	2.0
Finance & insurance	8.1	7.1	-4.5	-11.3	-10.8	2.6	2.7
Real estate	5.1	2.1	-6.9	-4.7	-5.3	-7.4	-9.3
Public administration	2.5	-12.3	-4.6	-4.4	-6.1	-3.6	-4.1
Oil GDP	-1.3	-5.4	-13.6	-1.9	-17.5	-22.0	-12.4
Non-oil GDP	7.2	3.7	-0.2	-0.2	-0.4	0.0	-0.3

Source: National Bureau of Statistics

Table 1.2: Sector and selected sub-sector shares in Nigeria's GDP, aggregate supply (%)

Activity Sector	Annual			Quarterly			
	2014	2015	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Total GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<u>Agriculture</u>	22.9	23.1	24.4	20.5	22.5	28.7	25.5
<u>Industry</u>	24.9	23.7	22.0	24.3	22.6	21.1	20.3
Oil & gas	10.4	9.6	8.4	10.3	8.3	8.2	7.2
Manufacturing	10.0	9.5	9.3	9.5	9.4	9.2	9.0
Construction	3.8	3.9	3.7	4.1	4.3	3.1	3.4
<u>Services</u>	52.2	53.2	53.6	55.2	54.8	50.2	54.2
Trade (wholesale & retail)	16.6	16.9	17.2	18.2	17.6	16.4	16.7
Accommodation & food services	1.0	0.9	0.9	1.1	0.7	0.9	1.0
Information & communication	10.8	11.2	11.6	12.0	12.7	10.1	11.6
Arts, entertainment & recreation	0.2	0.2	0.2	0.3	0.2	0.2	0.2
Finance & insurance	3.0	3.1	3.0	3.1	3.0	2.9	2.9
Real estate	7.7	7.6	7.2	6.5	7.6	7.2	7.6
Public administration	2.8	2.4	2.3	2.3	2.4	2.1	2.4
Oil GDP	10.4	9.6	8.4	10.3	8.3	8.2	7.2
Non-oil GDP	89.6	90.4	91.6	89.7	91.7	91.8	92.8

Source: National Bureau of Statistics

Gross Domestic Product: Aggregate Demand

3. Final household consumption contracted in the first half of 2016⁶ after stagnating in 2015 (Table 1.3). This contraction in the largest expenditure component (Table 1.4) accelerated from an estimated -1.1 percent in the first quarter of 2016 to -6 percent in Q2. The decline in household consumption was driven in part by a severe contraction in real wages paid to employees: after

contracting 8.8 percent in 2015, the decline in the wage bill accelerated to -10.7 and -17.6 percent in 2016 Q1 and Q2, respectively, in response to economic recession and high inflation. The reported positive growth of exports and imports reflected depreciation of the Naira rather than an increase in volumes (see next section).

Table 1.3: Real GDP growth by expenditure and income

Components (y-o-y growth rates)	Annual		Quarterly	
	2014	2015	2016 Q1	2016 Q2
GDP by Expenditure	6.3	2.7	-0.4	-2.2
Final consumption expenditure of household	2.0	0.0	-1.1	-6.0
Final consumption expenditure of non-profits serving households	3.0	1.4	5.3	-12.8
Final consumption expenditure of general government	5.6	-22.4	-22.6	6.2
Changes in inventories	5.1	-5.7	-6.9	-7.8
Gross fixed capital formation	13.4	-1.3	-7.2	3.1
Exports of goods and services	15.6	7.0	1.0	8.1
Less imports of goods and services	6.7	-27.4	-26.3	16.5
GDP by Income	6.3	2.7	-0.4	-2.2
Compensation of employees	2.2	-8.8	-10.7	-17.6
Operating surplus	7.5	7.2	3.1	3.8
Consumption of fixed capital	9.1	2.8	-0.5	-3.5
Other taxes on production (net)	17.0	8.7	6.1	1.7
Net taxes on products	13.9	-8.2	-6.1	-18.4

Source: National Bureau of Statistics.

Table 1.4: Expenditure and income shares in Nigeria's GDP aggregate demand (%)

Sector Contribution to GDP (%)	Annual		Quarterly	
	2014	2015	2016 Q1	2016 Q2
GDP by Expenditure	100.0	100.0	100.0	100.0
Final consumption expenditure of household	64.3	62.6	58.1	58.6
Final consumption expenditure of non-profits serving households	0.4	0.3	0.5	0.2
Final consumption expenditure of general government	6.9	5.2	4.5	5.1
Changes in inventories	0.8	0.7	0.7	0.8
Gross fixed capital formation	15.5	15.0	15.7	17.7
Exports of goods and services	22.6	23.6	27.5	26.3
Less imports of goods and services	10.5	7.4	7.0	8.7
GDP by Income	100.0	100.0	100.0	100.0
Compensation of employees	25.8	22.9	21.3	21.1
Operating surplus	67.0	69.9	71.6	71.5
Consumption of fixed capital	5.2	5.2	5.2	5.7
Other taxes on production (net)	0.9	0.9	1.0	0.9
Net taxes on products	1.2	1.1	0.9	0.8

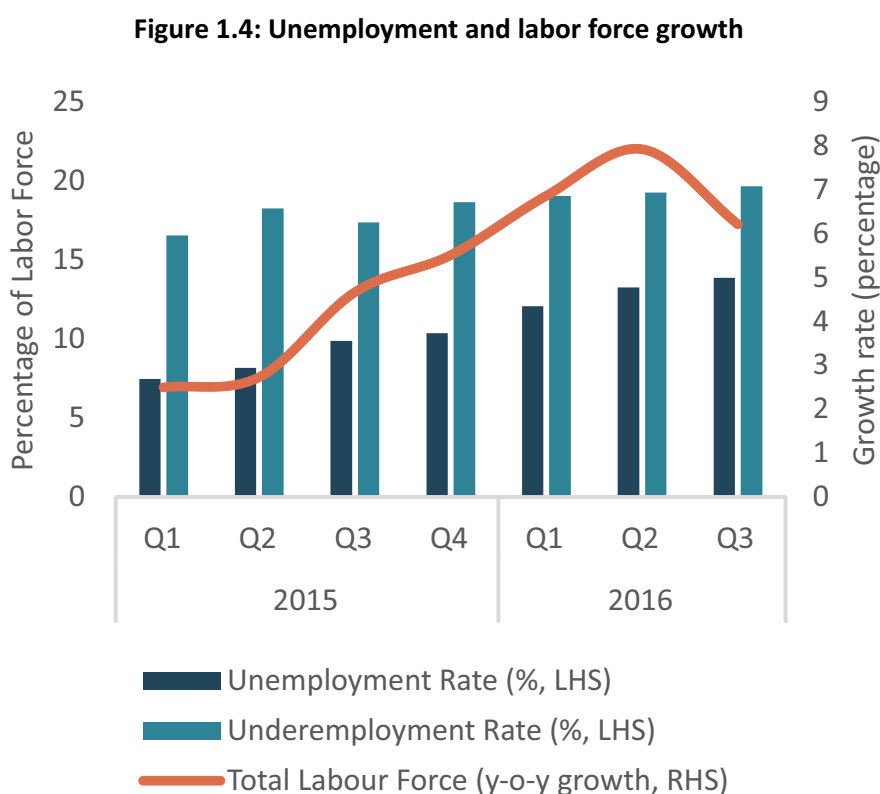
Source: National Bureau of Statistics.

⁶Demand-side GDP data are released with longer lag times than supply-side data. The latest available demand-side data are for 2016 Q1 and Q2.

4. The strong negative effect of recession on private consumption has worrisome implications for poverty. Poverty increased slightly in 2015 as a consequence of the slowdown in GDP growth and steadily growing population, and continued to rise in 2016. The share of the population living below the USD1.9 PPP poverty line increased from 49.4 percent in 2015 to about 50.2 percent in 2016. The high growth rates enjoyed by Nigeria before the current crisis had been driven by the coastal and capital areas but with limited trickle down to the rest of the country; the good overall economic performance concealed the limited inclusiveness of growth. Insecurity and displacement in North East Nigeria led to low farming and production, substantial destruction of basic services and infrastructure, depleted household food stocks and reduced purchasing power, with several million people facing food security crisis.

Unemployment

5. Unemployment and under-employment rates continued to increase in the first three quarters of 2016 (Figure 1.4). By the third quarter, 13.9 percent of the Nigerian labor force was unemployed and 19.2 percent was under-employed. The labor force itself grew by a staggering 7 percent in the first three quarters of 2016 compared to the same period of 2015, and together with the negative economic growth, contributed to increasing unemployment and under-employment rates.



Source: National Bureau of Statistics.

1.2 External Sector: Balance of Payments and Exchange Rate Developments

Exchange Rate and Foreign Exchange Policy

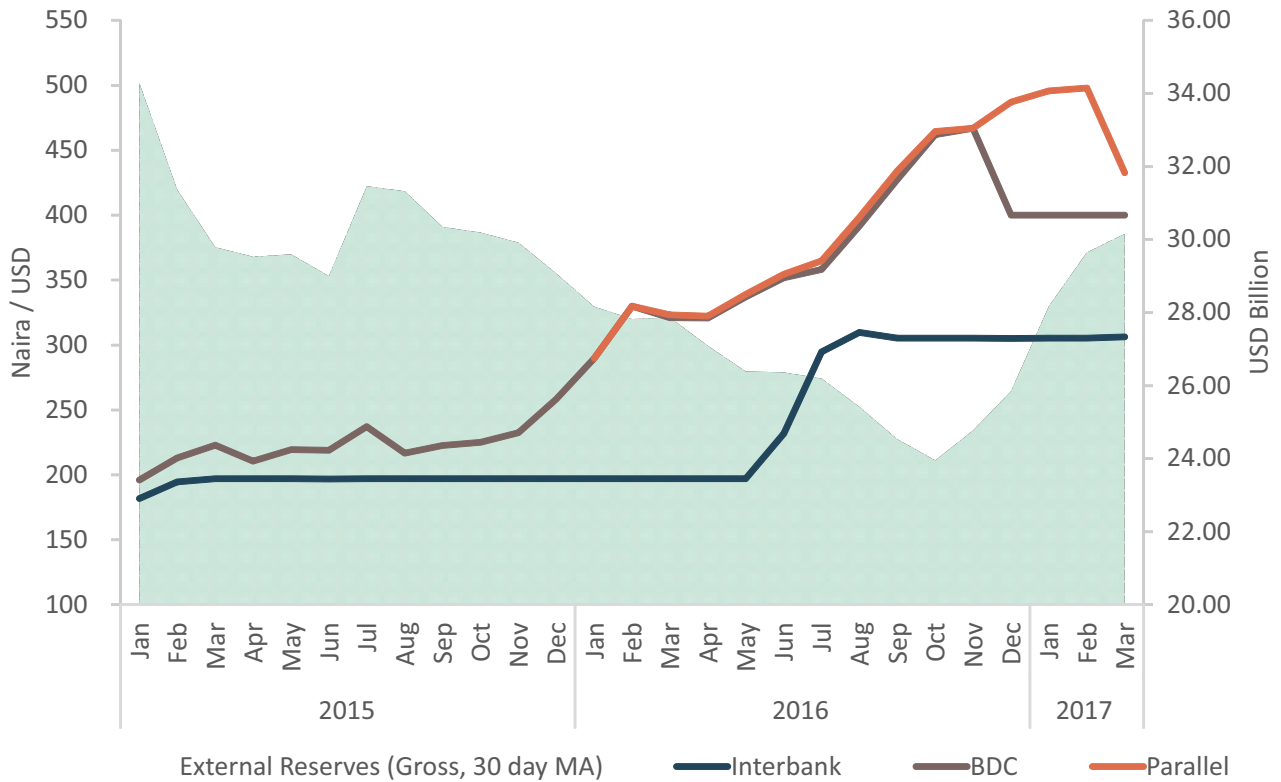
6. The exchange rate depreciated sharply from N197/USD to N282/USD after liberalization of the Naira in June 2016, and progressively to around N305/USD by September 2016. Since then, the interbank exchange rate has been fixed at around N305/USD. To improve foreign exchange reserves—which declined steadily from August 2015 to USD 24 billion in October 2016 – the Central Bank limited its supply of foreign exchange into the interbank market and imposed several foreign exchange allocation/utilization rules. These included the mandate that the banks had to allocate at least 60 percent of all their foreign exchange sales to the manufacturing sector (the 60/40 rule). The Central Bank also retained the restrictions on foreign exchange access for 41 import products. As the gap between the interbank and parallel rates widened (Figure 1.5), in November 2016 the CBN capped the Bureau De Change sell rate at N400/USD, (although not all BDCs fully adhered to this rate).

7. The shortage of foreign exchange from the interbank and BDC channels increased demand for foreign exchange on the parallel market, leading to the parallel market rate rising – to above N500/USD by February 2017 (Figure 1.6) – and creating round-tripping opportunities and distortions in the economy. That same month, and after foreign reserves recovered to USD 29.6 billion, the CBN started to use its foreign exchange reserves to take more aggressive measures to narrow the gap between the official and parallel market rates. These measures include providing additional foreign exchange to banks for “invisible” transactions (personal and business travel, medical and education fees) at 20 percent above the interbank market rate; and “visible” transactions (goods imports). The CBN also abolished the 60/40 rule; however, the restrictions on foreign exchange access for 41 imports remained.

The CBN backed the articulated policy change by increasing its weekly spot foreign exchange offerings(USD 6 million on February 20th 2017, compared to the usual USD 1.5 million), as well as forward sales. As a result of increased liquidity in the

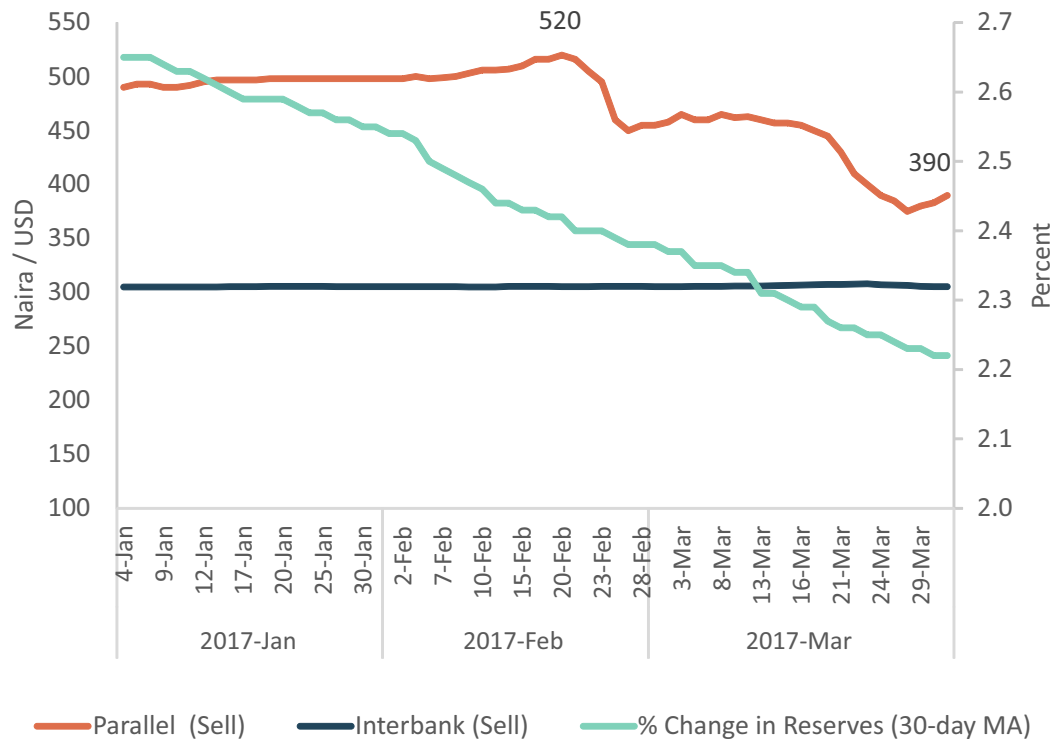
interbank market, the parallel market rate appreciated steadily, reaching just under N400/USD at the end of March.

Figure 1.5 Exchange Rates and Foreign Reserves (Monthly Averages)



Source: Central Bank of Nigeria, abokiFX online platform.

Figure 1.6 Exchange Rate and Foreign Reserves (Daily Movement)



Source: Central Bank of Nigeria, abokiFX online platform.

Balance of Payments

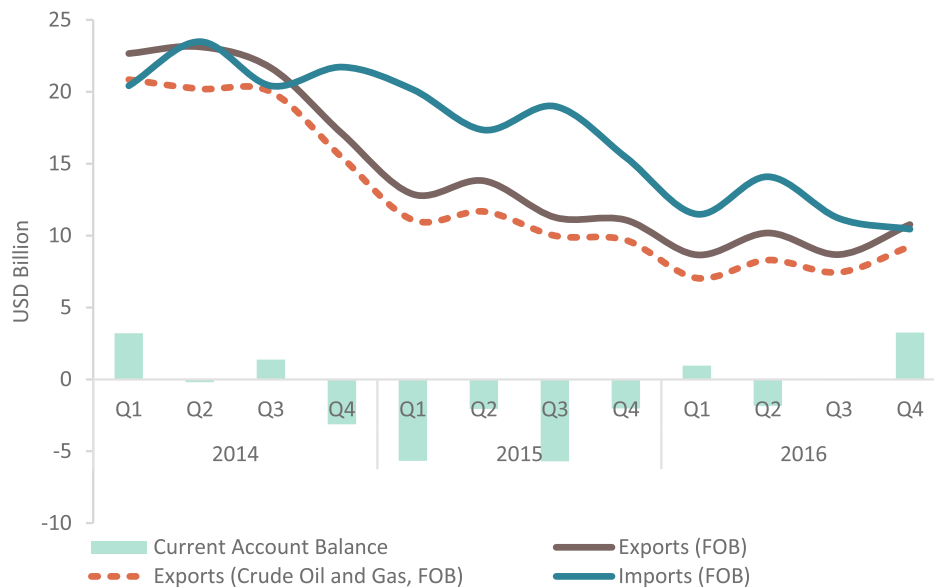
8. The value of goods and services exports continued to decline in 2016 (USD 38.3 billion compared to USD 49 billion in 2015 and USD 97.5 billion in 2014). As oil and gas exports constitute more than 80 percent⁷ of Nigeria's exports (Figure 1.7), this decline was driven by low crude oil prices and reduced oil production from the vandalism in Niger Delta. Consequently, with lower foreign exchange earnings, amplified by policies restricting access to foreign exchange, imports of goods⁸ and services contracted even more sharply (from USD 106.2 and USD 72 billion in 2014 and 2015, respectively to 47.2

billion in 2016) than exports. This effect was particularly strong in the last quarter of 2016, when a positive quarterly goods and services trade balance was recorded, the first since Q3 2014. As a result, the current account balance was positive in three out of four quarters of 2016, with an overall Current Account surplus of USD 2.3 billion.

⁷Down from over 90 percent before the drop in oil prices.

⁸Please note these are preliminary CBN numbers.

Figure 1.7: Exports and imports (goods and services) and current account balance (USD billion)



Source: Central Bank of Nigeria

9. The Financial Account improved substantially since 2015, reverting to a small overall surplus of USD 0.8 billion in 2016 (Table 1.5) as the outflows of all types of investments slowed down. The Net Direct and Portfolio Investment also recovered to 2014 levels; however, both inflows and outflows largely continued to decline in both 2015 and 2016.

10. The drawing on foreign reserves also slowed down substantially, from USD billion 5.9 in 2015 to USD 1.0 billion in 2016, with the last quarter recording an accretion to reserves and reflecting largely, the Central Bank's use of foreign exchange restrictions to rebuild foreign reserves, as discussed above. Net errors and omissions, which swung substantially in the preceding years, stood at USD -4.1 billion in 2016, reflecting lower levels of unrecorded capital and informal trade movements in Nigeria.

Table 1.5: The Balance of payments of Nigeria (USD billion)

	Annual			2016 Quarterly			
	2014	2015	2016	Q1	Q2	Q3	Q4
CURRENT ACCOUNT BALANCE	1.3	-15.4	2.3	1.0	-1.8	0.0	3.2
Trade Balance	21.0	-6.4	-0.5	-0.8	-1.8	-0.1	2.3
Exports (fob)	82.6	45.9	34.7	7.6	9.3	7.9	9.9
o/w crude oil & gas	76.5	42.4	32.0	7.0	8.3	7.4	9.2
Imports (fob)	-61.6	-52.3	-35.2	-8.4	-11.1	-8.0	-7.7
Services(net)	-22.5	-16.5	-8.4	-2.0	-2.1	-2.4	-1.9
Credit	2.0	3.2	3.6	1.1	0.9	0.8	0.9
Income(net)	-19.2	-12.7	-8.6	-1.8	-2.3	-2.1	-2.4
Current transfers(net)	21.9	20.2	19.9	5.6	4.3	4.6	5.3
FINANCIAL ACCOUNT BALANCE	4.7	-6.7	0.8	-8.3	6.7	5.0	-2.6
Net Direct Investment	3.1	1.6	3.1	0.6	0.6	1.0	0.9
Outflows	-1.6	-1.4	-1.3	-0.3	-0.3	-0.4	-0.3
Inflows	4.7	3.1	4.4	0.9	0.9	1.4	1.3
Net Portfolio Investment	1.8	0.9	1.7	0.2	0.5	0.7	0.3
Outflows	-3.4	-1.7	-0.2	-0.1	-0.1	0.0	0.0
Inflows	5.3	2.5	1.9	0.2	0.6	0.8	0.3
Net Other Investment	-0.2	-9.2	-4.1	-9.1	5.6	3.2	-3.8
Outflows	-10.9	-10.3	-3.0	-9.6	6.4	1.0	-0.7
Inflows	10.7	1.0	-1.1	0.6	-0.8	2.2	-3.1
CHANGE IN RESERVES (positive number indicates reserve spending; i.e., reduction in reserves)	8.5	5.9	1.0	0.7	0.8	2.7	-3.3
NET ERRORS AND OMISSIONS	-14.4	16.3	-4.1	6.6	-5.7	-7.6	2.6

Source: Central Bank of Nigeria

1.3 Fiscal Accounts

Federally Collected Revenue

11. Net⁹ revenue accruing to the Federation Account includes all oil and gas revenues and some non-oil revenues (customs revenue, corporate taxes, and solid minerals revenue); and is the main revenue stream for all tiers of Government. The revenues are distributed to the three tiers of government as follows: 52.68 percent accrues to the Federal Government (of which FGN retains 48.5 percent after transfers to special funds and the FCT), 26.72 percent to the 36 state governments, and 20.6 percent to the local governments. In addition to the revenues accruing to the Federation Account, VAT is also federally collected and then distributed to the Federal (15 percent, of which 14 is retained), state (50 percent), and local (35 percent) governments.

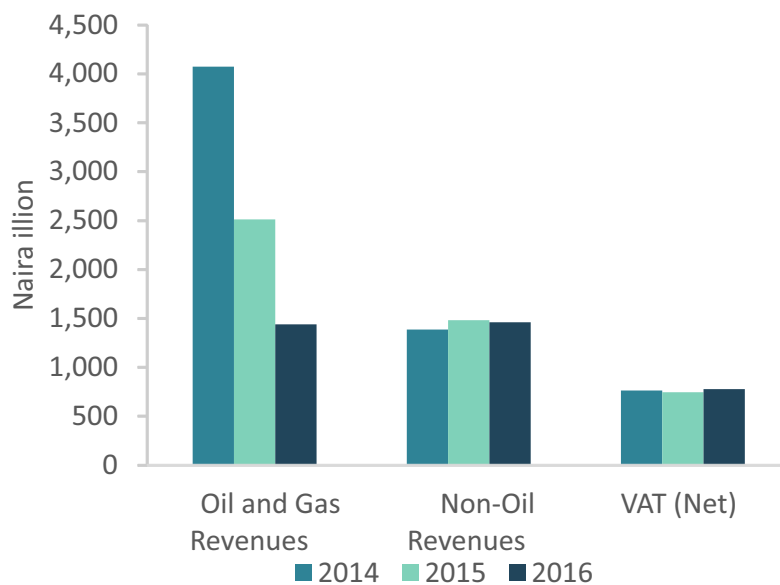
12. Reflecting Nigeria's over-reliance on oil revenues, the net Federation Account revenue has decreased dramatically, from N5,462 billion in 2014 to N2,902 billion in 2016 (a decline of 47 percent in nominal terms). This sharp drop has entirely been driven by the decline in oil and gas revenues in response to (a) the decline in global oil prices (from USD53/bbl in 2015 to USD45.2/bbl in 2016); and (b) the lower oil production in 2016

(Figure 1.8 and Table 1.6). In the first two months of 2017, oil revenues started recovering, as the price of Nigerian crude oil increased to USD56/bbl, on average.

13. While the decline in Federation revenues during 2014 and 2015 was driven by falling oil revenues, the 2016 revenue shortfall relative to budget targets was due to the under-collection of non-oil revenues and VAT, which stagnated throughout the recession period. The targets for non-oil revenues in 2016 had been increased ambitiously; but without any changes in tax policy or tax rates, actual revenues did not increase, despite many efforts to strengthen tax administration. Only 56 percent of the budget amount of non-oil revenues was collected, compared to 97 percent of oil revenue collections. Only 55 percent of the budgeted VAT amount was collected. The under-collection of these revenues translated to significant revenue shortfalls at all tiers of government in 2016.

⁹From gross revenue items such as revenue agency cost of collection, 13 percent derivation to oil producing states, JV cash calls, revenues in excess of specific targets and transfer to Excess Crude Account, and any subsidies are deducted to arrive at the net measure, which is then distributed according to the formulae described.

Figure 1.8: Net Federation Account Revenues and VAT (Actual)



Source: OAGF

Table 1.6: Federation Account revenues

	2014	2014	2014	2015	2015	2015	2016	2016	2016
<i>Naira Billion</i>	Budget	Actual	Budget perform.	Budget	Actual	Budget perform.	Budget	Actual	Budget perform.
Net Federation Account Revenues	6,234	5,462	88%	5,557	3,994	72%	4,304	2,902	67%
Oil & gas Revenues	4,360	4,076	93%	3,377	2,512	74%	1,479	1,439	97%
Non-oil revenues	1,871	1,386	74%	2,162	1,483	69%	2,605	1,463	56%
Other revenues	3	0	0%	17	0	0%	219	0	0%
VAT (Net)	812	762	94%	1,232	748	61%	1,416	779	55%

Source: OAGF

Note: Other revenues include balances in special accounts and other items not directly attributable/disaggregated to oil or non-oil revenue.

Federal Government's Budget and Policy

14. The Federal Government of Nigeria has experienced a significant revenue shortfall in 2016, with only 76 percent of budgeted revenues and inflows actually collected (Table 1.7). In addition to federally collected revenue shortfalls,

only 16 percent of the Federal Government's Independent Revenue,¹⁰ which was budgeted to account for about 39 percent of its inflows, was realized.

¹⁰The Government's Independent Revenue includes the Personal Income Tax of the Foreign Service, Armed Forces and Police; operational surpluses of government-owned enterprises; and revenues of ministries, departments and agencies (MDAs)

15. Following the revenue shortfalls, the Federal Government budget was under-executed,¹¹ especially on capital spending, for which allocations in 2016 budget targets had been increased. At the end of the calendar year and representing 7 months of execution, only 33 percent of capital expenditures budgeted for 2016 were executed. Despite the Government's progress in rationalizing recurrent expenses, certain recurrent expenditure items (overhead costs and other service-wide votes, including the Presidential Amnesty Program) exceeded the budgeted limits by 79 percent. Consequently, the fiscal deficit widened from 2.1 percent to 2.5 percent of GDP. Given the delayed budget approval by the National Assembly (NASS), the capital budget will continue to be implemented until May 2017. While this will allow for higher capital expenditure implementation, it is likely to further increase the deficit.

16. The Federal Government's plan to finance 29 percent of the deficit from external sources faced delays, and the bulk of the deficit was financed domestically, likely with crowding-out effects on private sector credit. NASS declined to approve the medium-term external borrowing plan submitted by the Executive in November 2016, delaying the fulfillment of any international loans. While the first tranche (USD 600 million) of the budget support from the African Development Bank was approved and disbursed in December 2016, there was no disbursement from the World Bank in 2016.

17. The Federal Government's offering in February 2016 of USD 1 billion in 15-year Eurobonds at 7.875 percent yield to finance the 2016 FGN budget was eight times oversubscribed despite the uncertainty over exchange rate policy and foreign exchange management. This most likely reflected investors' search for yields in the high-liquidity global environment. Subsequently, the Federal Government sought the National Assembly's approval for an additional Eurobond issue of USD 500 million. Approved in March 2017, this 15-year Eurobond was issued at 7.5 percent yield. As the yields are lower than the cost of borrowing domestically, this will help improve the Government's debt service cost, but it increases exchange rate-related risks.

18. While the consolidated debt-to-GDP ratio (17 percent in 2016) remains low by international standards, the debt service-to-revenue ratio has risen sharply. The Federal Government's interest payment-to-revenue ratio increased from 34 percent in 2015 to 43 percent (if all Federal Government inflows are included, as accounted by the Office of the Accountant General of the Federation), or to 59 percent (if transfers between FGN consolidated and capital accounts and other non-revenue inflows are excluded).¹²

¹¹ As of the end of calendar year 2016.

¹² The World Bank's calculation of the Government's interest payments-to-revenue differs from the Government's numbers in two aspects: first, the World Bank separates out interest payments from the debt service (which includes principal payments); and second, the World Bank's calculation of revenues excludes inflows in the fiscal accounts, which it considers to be financing items. IMF further excludes unbudgeted revenues and estimates debt service-to-revenue ratio at 66 percent (IMF Article IV 2017).

Table 1.7: Key Federal Government fiscal indicators (FGN definitions)

	2016 Budget	2016 Actual
Total FGN revenue and Inflows (%GDP)*	3.8	2.9
o/w oil and gas revenue (%GDP)	0.8	0.7
Total expenditure and outflows (%GDP)	5.9	5.4
o/w FGN interest payments (%GDP)	1.3	1.2
Fiscal deficit (%GDP)	2.1	2.5
Consolidated public debt (%GDP)**		17.0
Debt service (%total revenue and inflows)***	35.3	44.6
o/w interest payments (%total revenue inflows)***	34.0	42.7
Capital expenditure (%total expenditure)	26.2	9.5
Capital expenditure (%fiscal deficit)	72.0	20.2

Source: OAGF, DMO.

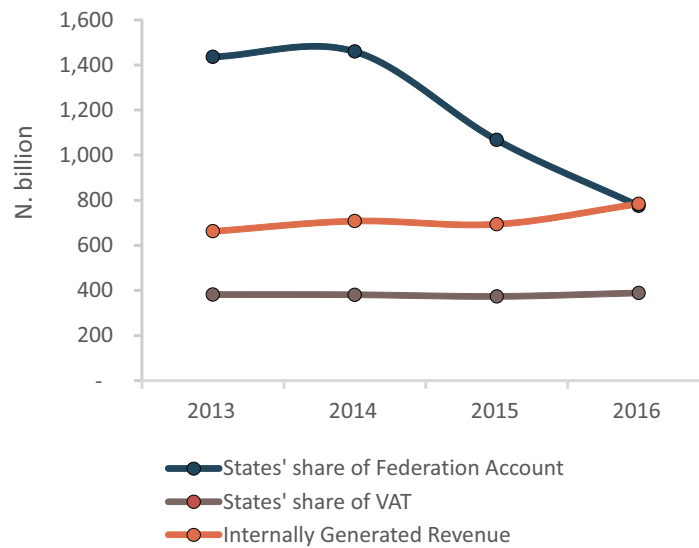
Note: The numbers are calculated using FGN definitions. Capital expenditures include disbursements only (not releases) up to the end of December 2016, and exclude capital expenditures in 2017 for 2016 budgeted programs. * Revenue includes any inflows as defined in the 2016 approved budget. ** as of 2016 Q2. *** FGN definition of debt service includes interest and principal payments.

Sub-national Government Fiscal Developments

19. With most states relying heavily on Federation Account transfers (Figure 1.9), a reduction in oil revenue since mid-2014 has lowered revenue transfers from the Federation Account to state governments. This has led to indebtedness among numerous states and their inability to pay salaries to civil servants, cover overhead costs, and honor debt service obligations. In response to this crisis, the first financial bailout by the Federal Government in July 2015 was aimed primarily at assisting distressed states to pay salary arrears and meet other critical expenditure

obligations. The package included three components: budget top-up, commercial bank debt restructuring, and soft loans from the CBN. However, the first bailout did not require state governments to make any fiscal adjustments. As oil revenue continued its downward trend, some states experiencing negative cash flows requested additional short-term relief.

Figure 1.9: 36 States' Major Revenues (before deductions)



Source: OAGF, NBS.

20. The second financial bailout– the “Budget Support Facility”- was approved by the National Economic Council (NEC) in May 2016, and was conditional on the implementation of a 22-point Fiscal Sustainability Plan (FSP) agreed to by the Federal Government and the states. The objectives of the FSP reform agenda are to: improve accountability and transparency; increase public revenue; rationalize public expenditure; improve public financial management; and ensure sustainable debt management. Implementation of the FSP is expected to take 18 months to complete, while the bailout funds will be disbursed over a 12-month period. The new bailout loans are financed by government bonds sold to the private sector and guaranteed by the Federal Government. The loans bear a 9 percent interest rate. If successfully implemented, the FSP should increase fiscal transparency, accountability and sustainability in the state governments. However, it is unclear how much progress states have made in implementation to date

(monitoring is currently underway), and whether the reform efforts will be fully sustained once the disbursement is complete.

1.4 Monetary Sector: Inflation, Monetary and Credit Aggregates and Financial Market Indicators

Money and Credit

21. Broad money continued to grow at double digits in 2016 (Table 1.8), reflecting monetary authorities' prioritized focus on supporting growth rather than addressing rising inflation. Net domestic credit to the public sector more than doubled in 2016, albeit from a small base relative to net credit to the private sector. After slow growth in 2015, net credit to the private sector growth picked up in the second half of 2016 and averaged 19 percent for the entire year, but remains crowded out by bank lending to the public sector.

22. The monetary policy rate was increased to 14 percent in the third quarter of 2016, up from 12 percent since March 2016 and 11 percent at the beginning of the year. This slight monetary tightening, however, has not been sufficient to curtail the accelerating inflation (see below).

23. The main international rating agencies lowered Nigeria's long-term foreign and local currency sovereign credit ratings on the basis of weakened GDP growth; rising debt servicing cost as a

percentage of general government revenues; lack of transparency; and uncertainty about macroeconomic policy developments. Standard & Poor's downgraded the sovereign's rating by one notch, from "B+" with a negative outlook to "B" with a stable outlook, reflecting that the risks to the country's credit rating are currently balanced. Moody's downgraded Nigeria from Ba3 to B, and Fitch downgraded it from BB- to B+.

Table 1.8: Monetary and financial indicators

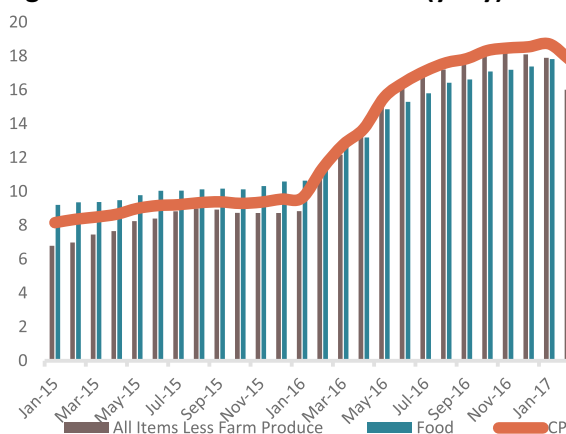
	2015	2016
Monetary policy indicators (% growth, end of period y-o-y)		
Broad money	6%	18%
Narrow money	24%	33%
Net foreign assets	-19%	57%
Net domestic credit	12%	26%
o/w to the Federal Government (net)	152%	66%
o/w to the private sector (net)	3%	19%
Monetary policy rate (period average)	12.7	12.8
Exchange rates (period averages)		
Exchange rate (LCU/USD)	195.5	253.5
Real effective exchange rate index (Nov 2009=100)	70.8	78.7
Financial market indicators (end of year)		
Stock market index	28,642	26,875
Fitch sovereign long-term foreign Debt Rating	BB-	B+
Moody's sovereign long-term foreign debt rating	Ba3	B1
S&P sovereign long-term foreign debt rating	B+	B

Sources: Central Bank of Nigeria, Fitch, Moody's, S&P, Bloomberg.

Inflation

24. Inflation reached double digits in February 2016 and accelerated to 18.6 percent (y-o-y) in December 2016, averaging 15.6 percent in 2016 (Figure 1.10) – well above CBN's long-term target of 6-9 percent. It was fueled by a combination of the rising cost of power and transport, an increase in the price of petrol, the growth in money supply (driven by increased lending to the Government to finance the budget deficit), the depreciated Naira (interbank, BDC and parallel market values), and the pass-

Figure 1.10: Consumer Price Index (y-o-y)



Source: National Bureau of Statistics.

through to imported final consumer goods. Food, which accounts for 50.6 percent in Nigeria's Consumer Price Index (CPI), registered accelerating price growth of 17.4 percent over the course of 2016. Although overall inflation recorded a much-

celebrated decrease in February 2016, food inflation has actually continued accelerating.

Chapter 2: Economic Outlook for the Rest of 2017

2.1 Outlook

25. The Nigerian economy is expected to start recovering in 2017 from the recession and the other macroeconomic imbalances that have plagued it since late 2014. Economic growth is forecast to return to positive territory, largely on the back of recovery in the oil sector. The average Bonny Light oil price in the first quarter of 2017 was 56 percent higher than in the corresponding period of 2016. For the same reason, fiscal revenues accruing to the Government are expected to be higher, and the current account of the balance of payments should strengthen. However, given that the expected recovery hinges on the oil sector, the recovery has a high degree of fragility and risks.

Growth

26. Economic growth is expected to recover slightly to above 1 percent in 2017, driven mainly by the restoration of oil production (to 2.1 mbpd)¹³ and supported by continued strong growth in agriculture. The recovery of non-oil industry and services will depend to a large extent on the sustained supply of foreign exchange to the markets, as scarcity of foreign exchange had constituted a major constraint during 2016. In line with its new foreign exchange policy measures unveiled on February 20, 2017, the CBN has significantly increased its supply of foreign exchange to the markets (supplying more than USD2.0 billion between February 21 and March 21, 2017). However, the sustainability of such levels

of foreign exchange supply is uncertain in the absence of a foreign exchange policy regime that is transparent, supports the free flow of autonomous capital flows, and is able to mitigate external shocks. Any new shock to the oil price or to Nigeria's oil output under the current policy regime will threaten the country's external reserves and limit CBN's ability to keep up the buoyant foreign exchange supply.

27. Although the CBN intends to restrain the growth of narrow money in 2017, in line with its monetary growth benchmarks, inflation expectations remain high in the short term. Consequently, private consumption is expected to deteriorate further in 2017 before slowly recovering in the medium term. Government spending will be constrained in 2017, as ambitious non-oil revenue targets (although slightly less ambitious than in 2016) are unlikely to be met by tax administration measures alone in the absence of tax policy reforms. The Federal Government intends to increase capital spending further in 2017 (30 percent over the 2016 budget and almost 300 percent over actual spending as at December 2016). In addition, sub-national governments will likely continue to settle their domestic arrears. Therefore, current government consumption is expected to decline further before recovering ahead of the 2019 elections.

¹³ The forecast for oil production of 2.1 mbpd in 2017 is based on the current efforts of Government to restore peace and stability in the Niger Delta region, which has reportedly yielded some result so far – oil production has been restored from 1.5 mbpd in August 2016 to almost 2.0 mbpd in January–February 2017. Furthermore, the recent agreement between the Government and the international oil companies (IOCs) to settle joint venture (JV) cash call arrears and establish a new funding mechanism for JV arrangements is expected to stabilize production from the JV contracts.

28. Exports will likely recover in 2017 due to increased oil production, as oil and gas exports constitute over 80 percent of Nigeria's exports. Imports, which were initially constrained by the foreign exchange shortages in January and parts of February, may recover on the back of increased foreign exchange availability. However, as noted above, the sustainability of this increased supply of foreign exchange is in question. Growth in total capital investment will be limited in 2017 as increased capital spending by the Federal Government is offset by uncertain private investment. Despite the increased foreign exchange supply since February 21, 2017, private investment will likely be slow and measured in the short term, as the private sector seeks clarity on the certainty and sustainability of foreign exchange supply.

Federal Government Fiscal Operations

29. The Federal Government's total revenue in 2017 is projected to grow significantly to 3.5 percent of GDP, up from 2.1 percent¹⁴ in 2016, largely on account of improved revenues from oil and gas. The share of net oil and gas revenues accruable to the Federal Government from the federation account is expected to grow from 0.9 percent of GDP in 2016 to 2.3 percent in 2017 on account of both higher oil prices and output, as well as a modestly depreciated Naira in 2017, while non-oil and other revenues are projected to modestly increase from 1.2 percent of GDP in 2016 to 1.3 percent in 2017, as the Federal Government intensifies its non-oil GDP revenue administrative reform efforts.

30. While the excess oil revenue derivable from a higher-than-benchmarked oil price is assumed to be saved, the fact that oil output is still

lower than budgeted and non-oil revenues come in lower than budgeted implies that revenues accruing to the Federation Account and available for distribution to the tiers of Government may come in lower than budgeted. To the extent that this happens (and this has been the case so far in the first quarter of 2017), all net oil revenues will be distributed and nothing would accrue to the Excess Crude Account (ECA). In other words, the oil price-based fiscal rule is being applied as a revenue rule, rather than just an oil price rule.

31. The fiscal deficit is not expected to narrow significantly, if at all. Despite the recovery in oil production and price, a shortfall in fiscal revenues compared to the budget target is still expected in 2017. Faced with a revenue shortfall, the Federal Government may choose to go beyond its targeted deficit of 2.1 percent (proposed budget) to protect expenditure, especially if it is related to implementation of the Economic Recovery and Growth Plan 2017–2020 (see below).

Balance of Payments and the Exchange Rate

32. Also on account of projected higher oil output and prices in 2017, Nigeria's current account balance is expected to improve from an estimated surplus of 0.6 percent of GDP to 3.0 percent of GDP in 2017. Both imports and exports of goods and services will increase, but exports (mainly oil exports) will likely increase at a faster pace, from an estimated 9.3 percent of GDP in 2016 to around 13 percent of GDP in 2017. Imports are expected to recover more slowly due to uncertainty around the foreign exchange policy regime. On the basis of improved foreign exchange supply as a result of foreign reserves growth, imports will increase from an estimated 11.5 percent of GDP in 2016 to 12.8 percent in 2017.

¹⁴ The figure excludes inflows that are financing items rather than revenue/inflows.

2.2. Government Policy Response: The Nigeria Economic Recovery and Growth Plan (ERGP)

33. In recognition of the deep weaknesses of the economy and the potential for further weakening, the Federal Government has developed an Economic Recovery and Growth Plan (ERGP) for the period 2017–2020. Released on March 7, 2017, the ERGP lays out the Government's strategy for achieving the Government's vision of sustained and inclusive growth. The Plan aims at economic recovery in the shortterm, and structural reforms aimed at diversifying the economy to set it on a path toward sustained and inclusive growth over the medium to longterm. The process for developing the ERGP was broadly consultative and involved engagement with a range of stakeholders, including academics and other economic experts, the organized private sector, civil society groups, organized labor, sub-national governments, international development partners

(including the World Bank, International Monetary Fund and African Development Bank), the National Economic Council (NEC) and the National Assembly.

34. The ERGP serves as an umbrella' framework that incorporates 60 strategies, of which 12 – including infrastructure, industrial and power sector development – have been identified as priorities (boxes 2.1 and 2.2). The Federal Ministry of Budget and National Planning is coordinating the development of action plans containing the detailed activities, milestones, timelines and key performance indicators and targets for each of these strategies. The detailed action plans are due to be unveiled by the end of April 2017. A delivery unit will be set up in the Presidency to oversee implementation of the ERGP alongside the Ministry of Budget and National Planning.

Box 2.1: The Nigeria Economic Recovery and Growth Plan 2017 -2020

The three broad strategic objectives of the ERGP are to (a) restore growth;(b) invest in human capital; and (c) build a globally competitive economy. The 12 strategic priorities for executing the Plan fall into five main categories:

- a. Stabilizing the macroeconomic environment**
 1. Align monetary, trade and fiscal policies
 2. Accelerate non-oil revenue generation
 3. Drastically cut costs
 4. Privatize selected public enterprises/assets
- b. Achieving agriculture and food security**
 5. Deliver on agricultural transformation
- c. Ensuring energy sufficiency (power and petroleum products)**
 6. Urgently increase oil production
 7. Expand power sector infrastructure
 8. Boost local refining for self-sufficiency
- d. Improving transportation infrastructure**
 9. Deliver targeted high priority transportation projects
 10. Enable private sector financing of infrastructure
- e. Driving industrialization, with a focus on small and medium-size enterprises**
 11. Improve the ease of doing business
 12. Accelerate implementation of the National Industrial Revolution Plan.

35. The ERGP sets the ambitious target of 7 percent real GDP growth by 2020, initially driven by the oil sector and then increasingly by strong non-oil sector growth (agriculture, manufacturing and services). From the negative growth of -1.5 percent recorded in 2016, Nigerian authorities project that real GDP will accelerate to 7.0 percent in 2020 (Table 2.1). Strong recovery and expansion of crude and natural gas production is expected by FGN in 2017, as challenges in the oil-producing areas are overcome. Investment in the sector is also expected to begin to increase. The Federal Government estimates the average price of crude oil at USD 42.50–52.00 over the Plan period, while output is forecast to rise to 2.5 mbpd by 2020. The ERGP has a strong focus on agriculture, which is expected to continue to play an important role in

Nigeria's growth story, and sets a growth target for the agriculture of over 8 percent by 2020. The authorities also anticipate strong growth in the manufacturing sector, particularly in agro-processing and in food and beverage manufacturing. Ongoing strategies to improve the ease of doing business are expected to boost other manufacturing sector activities, including light manufacturing. Overall, the ERGP estimates an average annual growth of 8.48 percent in manufacturing between 2018 and 2020, rising from -5.8 percent in 2017 to 10.6 percent by 2020. Furthermore, services, already the largest sector in the GDP, are expected to grow at an average annual rate of 2.5 percent during the Plan period.

Table 2.1: Nigeria Economic Recovery and Growth Plan Projections (Federal Government)

Implement the ERGP	2017	2018	2019	2020
Growth Scenario				
GDP growth (percent)	2.2	4.8	4.5	7.0
Oil Production (mbpd)	2.2	2.3	2.4	2.5
Oil Price Benchmark (USD)	42.5	45	50	52
Inflation (percent)	15.7	12.4	13.4	9.9
Per capita GDP (USD)	2,542	2640	2,731	2,854
Unemployment (percent)	16.32	14.51	12.90	11.23
Net job creation (million)	1.5	3.8	4.3	5.1
Poverty	Poverty rate decline from to 50-55 percent by 2020			

Source: ERGP

36. Considering the severe and multifaceted challenges that Nigeria faces, the ERGP is an important step forward. It is a reform strategy that seeks to be comprehensive in addressing the country's challenges. The Plan contains a generally frank assessment of Nigeria's economy, its vulnerabilities and the underlying structural weaknesses (dependency on oil for revenues and exports) and governance challenges, recognizing the role of 'previous economic policies, deplorable infrastructure, corruption and mismanagement of public finances'. In addition, it leverages, and is generally consistent with other plans and strategies, including the National Industrial Revolution Plan, the

Nigeria Integrated Infrastructure Master Plan, the Medium-term Expenditure Framework (MTEF), the "7 Big Wins" in the Oil and Gas Sector Initiative and the Power Sector Recovery Plan (Box 2.2) that has recently just been approved by the Federal Executive Council (FEC). Central to the sustainable economic recovery and growth, the Power Sector Recovery Plan is promising, with strategies to restore financial viability to the Nigerian Power Sector, improve transparency and service delivery. Furthermore, the Plan sends some positive signals on further policy adjustments to ensure much-needed macroeconomic recovery.

Box 2.2: The Nigeria Power Sector Recovery Program

The Ministry of Power, Works and Housing and the Ministry of Finance are committed to taking urgent and decisive actions that are needed to put the power sector on a track of sustainable development. Three years after privatization, the power reform program has not yet delivered substantial improvement in electricity services and the sector is in a state of emergency. The privatized Generation Companies (GENCOs) and Distribution Companies (DISCOs) may be insolvent. Unless power sector market failures are addressed, there could be further deterioration in power supply and the power sector reform program itself may not deliver the anticipated results. This would have a calamitous impact on the country's ability to revive growth and restore confidence for private investments. In view of the urgent need to address the dire challenges within the power sector, a Power Sector Recovery Program (PSRP) has been developed.

The Federal Executive Council (FEC) of the Federal Government of Nigeria (FGN) approved the Power Sector Recovery Program on March 22, 2017. The PSRP approved by FEC will be further elaborated in the coming months as implementation details are defined. It will be adjusted as necessary to take account of changing circumstances during its implementation.

Key objectives of the Program

The objectives of the PSRP are to restore the sector's financial viability; to improve power supply reliability to meet growing demand; to strengthen the sector's institutional framework and increase transparency; to implement clear policies that promote and encourage investor confidence in the sector; and to establish a contract-based electricity market.

Components of the Recovery Program

The plan outlines specific strategies for achieving the above objectives. These are presented under the following components:

- Eliminate of cash deficits that have accumulated in the past through to December 2016, including through the full disbursement of the Central Bank's Nigerian Electricity Market Stabilization Facility (“NEMSF”)
 - Implement an end user tariff trajectory that ensures cost reflective tariffs in the next 5 years
 - Funded payment of future sector deficits
 - Ensure DISCO performance and accountability, including through the enforcement of commitments made in Performance Agreement signed with the Bureau of Public Enterprises (BPE) and reflected in the tariffs at privatization
 - Ensure grid stability by attaining effective and dependable generation and distribution of at least 4,000MW in order to build confidence with consumers
 - Ensure that accumulated MDA electricity debts are paid and implement payment mechanism for future bills, including through the introduction of a system where bills are paid centrally on behalf of MDAs and deducted from their budgetary allocations
 - Improve sector governance, including through the appointment of vacant boards in all the sector institutions
 - Increase electricity access by implementing off grid renewable solutions
 - Develop and implement an FX policy for the power sector
 - Make contracts effective where penalties are imposed on sector participants that fail to fulfill their contractual obligations
- Implement a comprehensive communication strategy that results in buy-in of all sector stakeholders and Nigerians into the PRSP

37. However, certain aspects of the ERGP appear more challenging, especially on growth targets, the financing of the plan and the subnational governments' support and contributions. Firstly, the GDP growth targets are very optimistic, given the weaknesses of the current macroeconomic policy framework and the implementation risks associated with the structural reforms in the ERGP. The growth scenario presented in ERGP assumes full oil sector recovery, macroeconomic stabilization and full implementation of ERGP strategies, including fiscal stimulus, major infrastructure investment and other structural reforms. On the macroeconomic front, the ERGP contains insufficiently detailed commitments on further policy adjustments to fully restore credibility and confidence among the private sector and investors; for example, the ERGP discusses the need to move to a more market-determined, competitive exchange rate, but contains no firm policy commitments and time frame for removal of remaining foreign exchange restrictions. The Bank estimates that without adjustments in monetary and exchange rate policies, and some substantive tax policy reforms¹⁵ and mitigation of the implementation risks of the structural reforms, real GDP growth would only recover to just above 2 percent by 2018 and remain at around 2-2.5 percent through the medium term.

38. Secondly, the ERGP also contains little discussion on the estimated costs and financing sources for implementing the Plan. The various financing sources (public financing through the budget, development financing programs and private sector financing) need to be assessed, including the

potential amounts derivable from each source. The effectiveness, governance and sustainability of current development financing schemes, including CBN directed financing at priority sectors, need to be evaluated and improved before appropriately expanded. Increasing private sector financing will require restoring investor confidence and establishing the necessary regulatory and institutional frameworks, especially for Public-Private Partnerships (PPPs).

39. Lastly, the strategy for engaging and incentivizing sub-national governments in delivering the outcomes of ERGP implementation is not fully articulated. Many of the ERGP strategies, in particular strengthening fiscal transparency and sustainability, improving the business environment, governance and local service delivery rely on state and local governments (SLGs) to implement reforms at the subnational level.

40. The credibility of the plan – whether it can restore confidence in the government and economy - depends heavily on its implementation. Rapid identification and expedited delivery of some “quick wins” will be very useful to establish credibility. The credibility of the ERGP will depend on showing concrete progress in implementing the reform program. A positive start to the ERGP implementation is the approval of the Power Sector Recovery Plan in March 2017, a major milestone in achieving one of the 12 priorities.

¹⁵ For example, rationalization of existing tax incentives, raising of selected tax rates such as standard VAT rates or excises on tobacco and alcohol.

2.3 Risks to Economic Outlook

41. The risks to the economic outlook presented above are significant. Nigeria's economic recovery in the short term is highly dependent on recovery of the oil sector, both directly through oil revenues, and indirectly through spillovers (especially through foreign exchange availability) on non-oil sectors and revenues for all tiers of government. Oil production (projected at 2.1 mbpd in 2017 by the World Bank) is susceptible to downside risks, including from unrest in the Niger Delta, which is not yet fully stabilized; and from barriers to implementation of Joint Venture cash call arrangements. Any shock to global oil prices or domestic production can derail the fragile economic recovery.

42. In the absence of a foreign exchange regime that promotes a predictable inflow of foreign exchange, Government's foreign reserves constitute the main source of foreign exchange to the economy. The CBN has used the rising reserves (which grew from USD23.9 billion at end-October 2016, to USD25.8 billion at end-December, and then to USD29.6 billion¹⁶ at end-February 2017) to pump considerable volumes of foreign exchange into the markets. However, this method of improving liquidity is not a sustainable long-term strategy, as it

relies on favorable external conditions. Further policy adjustments, including removal of remaining foreign exchange restrictions, and improving the transparency and functioning of the interbank exchange rate is needed.

43. The budget remains dependent on oil revenues; significant revenue shortfalls would lower government capital spending as well as consumption. This would jeopardize important development spending, including for the ERGP. The Government needs to continue its efforts to improve non-oil revenues by complementing tax administration initiatives with selected tax policy reforms.

44. Incomplete implementation of the structural reforms outlined in the ERGP would affect the ability of the Government to set the economy on the path of sustained and inclusive growth over the medium to long term. Therefore, the Government must begin to vigorously implement the reforms contained in the ERGP to ease the constraints on the non-oil sector, which is expected to drive growth over the medium to long term, starting with identified high-impact quick wins.

¹⁶ Thirty-day moving average.

Table 2.2: Key economic indicators and short-term projections

	2014	2015	2016 e	2017 f
Real GDP growth, at constant market prices	6.3	2.7	-1.5	1.2
Private consumption	0.6	1.4	-0.8	-1.3
Government consumption	-7.0	-11.9	-20.9	-4.6
Gross fixed capital investment	13.4	-1.3	-13.0	0.1
Exports, goods and services	24.1	-0.3	-5.2	10.6
Imports, goods and services	6.0	-26.9	-31.7	3.1
Real GDP growth, at constant factor prices	6.2	2.8	-1.5	1.2
Agriculture	4.3	3.7	4.1	4.7
Industry	6.8	-2.2	-8.5	2.6
Services	6.8	4.8	-0.8	-1.0
Inflation (CPI)	8.1	9.0	15.6	16.5
Current account balance (% of GDP)	0.2	-3.2	0.6	3.0
Fiscal balance (consolidated government, % of GDP)	-1.8	-3.5	-4.7	-5.0
Debt (consolidated government, % of GDP)	12.5	13.2	17.0	21.5
Poverty rate				
Poverty rate (\$2.5/day PPP terms)	49.4	49.4	50.2	50.5
Poverty rate (\$4/day PPP terms)	73.7	73.7	74.3	74.5

Source: World Bank and IMF staff projections

Chapter 3: Economic Growth in Nigeria: Past Determinants and Future Prospects¹⁷

3.1 Aggregate Growth Patterns and the Impact of Oil on the External and Fiscal Sectors

45. Over the last four decades, Nigeria's GDP growth rate did not keep pace with those of more developed economies, reflecting an all-too-common experience among commodity exporters. In 1970, Nigeria's per capita GDP was equal to 5 percent of the OECD average, but by 2014 it had fallen to 3 percent. Many other commodity producers, including Venezuela, Gabon, and Mexico, experienced a similar relative decline, but some, such as Botswana, Chile, Indonesia, and Colombia, managed to narrow the GDP gap with more advanced economies. The literature has identified two critical determinants of economic success among commodity exporters: institutional quality and productivity growth in the non-resource sectors.¹⁸ Previous analyses have found that Nigerian oil exports heightened the country's exposure to macroeconomic volatility, crowded out the production of other tradable goods (Dutch disease), increased inequality, and contributed to violent conflict.¹⁹

46. Oil continues to drive the country's growth pattern, despite representing only 14.5 percent of GDP in the past decade, as it continues to dominate export earnings and public revenues. Nigeria began producing oil in the late 1950s. In the 1960s, Nigeria was a major producer of palm oil, palm kernels, groundnuts, cocoa, and rubber; together, agricultural exports generated about 75

percent of its foreign-exchange earnings.²⁰ By 1970, however, oil had become the country's largest export, and by 1975 it comprised 94 percent of total goods exports—a share that has remained broadly unchanged until now. From the 1970s through 2012, the oil sector accounted for about 80 percent of total Federation receipts.²¹ However, in 2015 and 2016, the simultaneous decline in oil prices and production caused this share to fall to 63 percent. While GDP growth averaged 5.7 percent between 2006 and 2016, volatile oil prices drove the growth rate to a high of 8 percent in 2006 and to a low of -1.5 percent in 2016.

47. Because oil exports represent the overwhelming majority of Nigerian exports, the inherent volatility of global oil prices is transmitted directly to the external balance (Figure 3.1). Although oil prices recovered after the global financial crisis, Nigeria ran only a small current account surplus between 2010 and 2014. The substantial decline in oil prices led to a current account deficit in 2015 for the first time since 1998. With falling capital inflows, Nigeria's foreign reserves declined. In response to the oil production shocks in 2016, import compression policies (including restrictions on foreign exchange allocations) were adopted to bring the current account back into a small surplus by the end of

¹⁷This chapter summarizes the findings of a forthcoming World Bank report: *Towards Sustainable Growth in Nigeria: Empirical Analysis and Policy options* (Authors: Santiago Herrera et al., forthcoming)

¹⁸Acemoglu and Robinson (2014) focus on institutional quality, while much of the literature highlights the role of productivity growth in accounting for differences between successful and unsuccessful resource exporters. See Casseli, 2005, and Klenow and Rodriguez-Clare, 1997.

¹⁹Ross, 2003. Fesnke and Zurimendi, 2015.

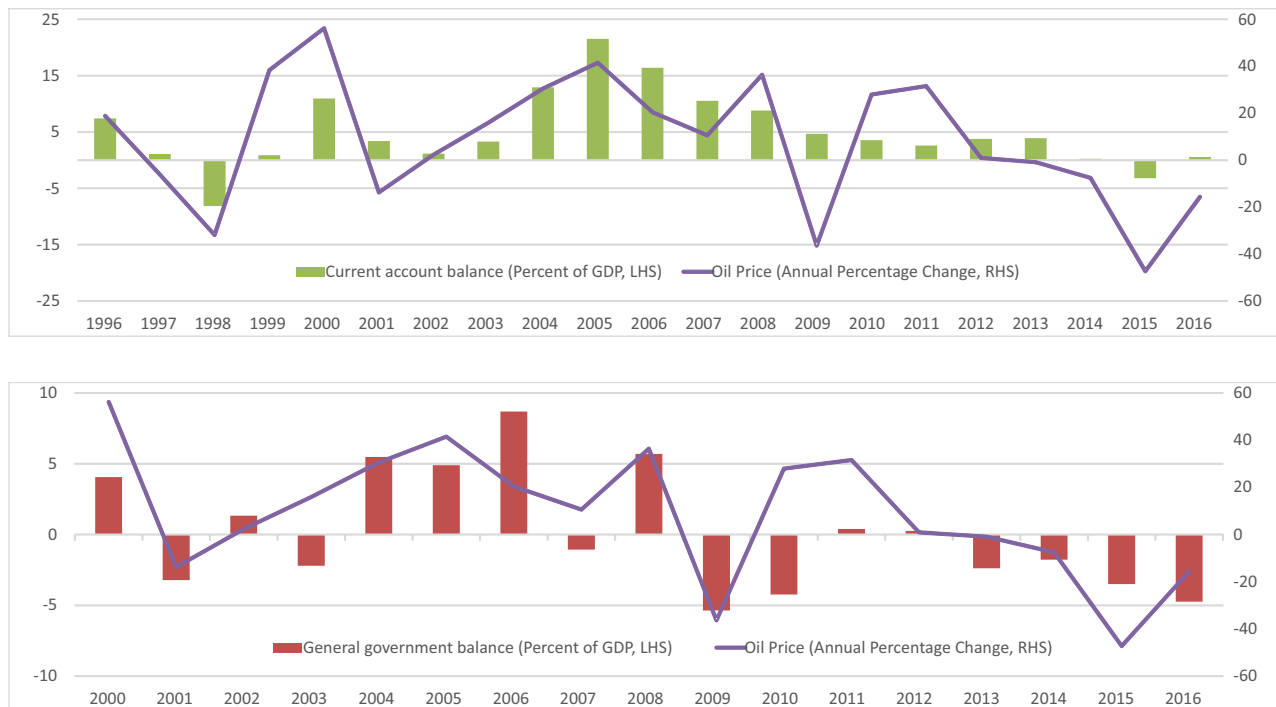
²⁰Akindele, 1986.

²¹Budina and VanWinbergen (2008) report oil revenue for the 1970s and 1980s.

2016. These policies had a significant negative impact on the growth on non-oil sectors reliant on

imported inputs, including manufacturing and retail trade.

Figure 3.1: Global oil prices and Nigeria's current account balance (1996-2016) and fiscal balance (2000-2016)



Sources: World Development Indicators, Central Bank of Nigeria, IMF.

48. Revenue from oil is extremely volatile, and if this volatility is directly transmitted to government spending (Figure 3.1) fiscal policy becomes pro-cyclical. In Nigeria, the standard deviation of oil revenue is seven times larger than that of non-oil revenue.²² Prior to 2010, the consolidated fiscal balance tracked changes in the oil price, with rapidly rising prices accompanied by significant fiscal surpluses before the oil price decline in 2009. After 2009, despite recovering oil prices, the fiscal balance did not significantly improve.

49. Nigeria has made some progress towards counter cyclical fiscal policy by adopting several fiscal savings and stabilization mechanisms, including the Excess Crude Account (ECA), the Fiscal Responsibility Act (FRA), and the Sovereign Wealth Fund (SWF). However, these mechanisms are not fully effective. In 2004, the Government established the ECA to stabilize oil revenues going into the budget by accumulating

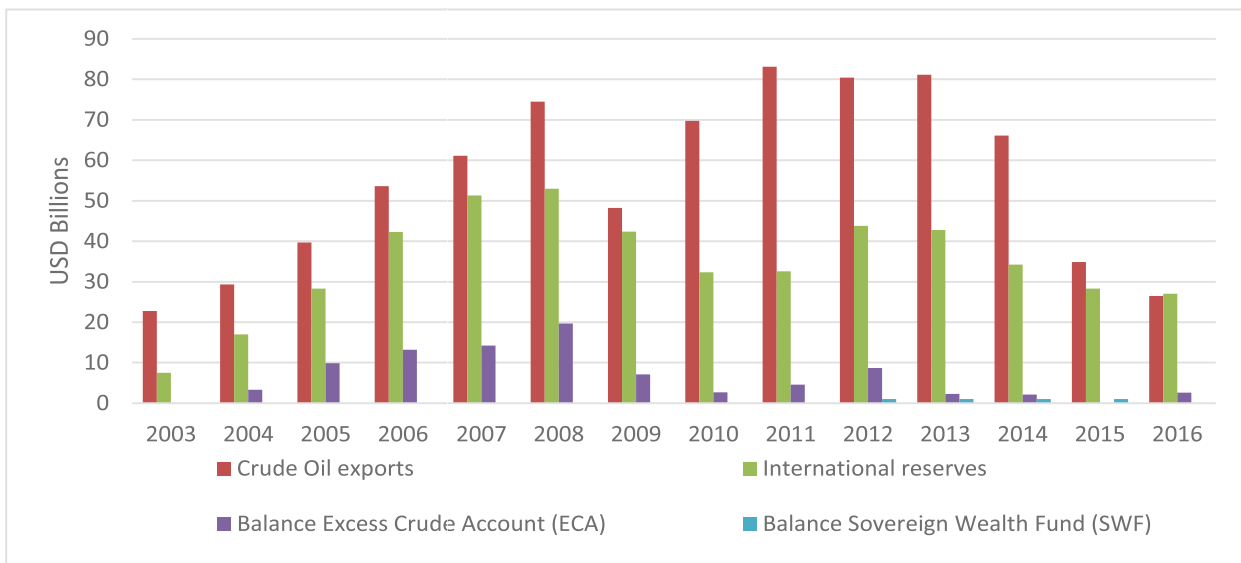
savings when oil prices were high and then using the savings to supplement revenues when oil prices were low. The FRA was adopted in 2007 and the SWF in 2011. The ECA balance increased from USD3 billion in 2004 to USD20 billion in 2008 (Figure 3.2). In 2009, international oil prices fell, and unrest in the Niger Delta region disrupted output. Crudeoil exports dropped from USD75 billion in 2008 to USD48 billion in 2009. The Government successfully used the ECA as a fiscal buffer and its international reserves as an external buffer. However, the ECA was almost exhausted by 2010, and its balance was never fully replenished even as oil prices rebounded and reached all-time highs in 2011-13. A number of factors played into this: (a) the slight decline in oil production from 2012 despite high oil

²²IMF, 2015.

prices; (b) the growth in cash calls financed directly from oil revenues; and (c) most importantly, the escalating costs of fuel subsidies in 2011-2014, financed directly from oil revenues outside of the budgetary and fiscal responsibility framework. The absence of a robust legal framework for the operation of the ECA gave rise to political controversy and

intensified expenditure pressures. The adoption of the FRA in 2007 and an Act establishing the SWF in 2011 largely failed to remedy this situation, and the balances in the ECA and SWF rose only marginally.

Figure 3.2: Crude oil exports, international reserves, ECA and SWF balances



50. The volatility of spending is associated with volatility of consumption, which imposes welfare losses. Household consumption volatility imposes significant welfare costs because consumers prefer smooth consumption paths rather than uncertain and volatile ones.²³ Poor households are especially vulnerable to consumption volatility, and their risk management strategies often include extreme measures such as reducing calorie intake, foregoing healthcare, or withdrawing children from school to contribute to household labor, with deeply negative implications for long-term consumption and welfare. Hence, the gains from reducing volatility will disproportionately benefit lower-income households. In addition, public expenditure volatility

is detrimental to growth because it disrupts the implementation of investment projects with long lead times, including investments in infrastructure and human capital development.

51. The international literature shows that pro-cyclicality is associated with lower rates of economic growth.²⁴ Over the past five decades, Nigeria's fiscal policy has been among the most pro-cyclical in the world,²⁵ with increases in revenue during economic expansions tending to increase expenditures.²⁶ Avoiding the voracity effect requires strong fiscal rules governing revenue increases, but Nigeria's legal framework for fiscal savings and counter cyclical stabilization remains inadequate.

²³ For a review of the literature, see: Loayza, Rancierre, Serven and Ventura, 2007.
²⁴ Fatas and Mihov, 2013.
²⁵ Frankel et al., 2013.
²⁶ Talvi and Vegh, 2005.

3.2 Growth and Productivity Decomposition

52. The linkage between the quality of public institutions and the impact of oil on overall GDP during the past four and a half decades can be demonstrated from a decomposition of Nigeria's historical GDP growth during three sub-periods (Table 3.1). The first (1971-1984) corresponds to Nigeria's initial oil boom, when oil prices were high and production was rising rapidly. The second (1985-1999) coincides with

a prolonged downturn in oil prices, and the third (2000-2014) reflects the more recent commodity boom of the 2000s, when oil prices rose as the global economy rapidly expanded. The analysis uses a standard growth decomposition, in which GDP growth is attributed to underlying increases in human capital, physical capital, or Total Factor Productivity (TFP).

Table 3.1: Nigeria Growth Decomposition, 1971-2014 (annual average % change)

	GDP Growth	Human Capital	Physical Capital	TFP
1971-2014	0.9	0.2	0.5	0.2
• 1971-1984	-2.2	-0.4	2.5	-4.3
• 1985-1999	0.7	0.5	-0.9	1.2
• 2000-2014	3.9	0.4	0.3	3.2

Source: Herrera et al., forthcoming.

53. During Nigeria's initial oil boom of 1971-1984, physical-capital accumulation was the primary driver of growth, while TFP growth was deeply negative and overall GDP contracted. Previous studies have found that the oil boom in Nigeria caused an extreme increase in economic inefficiency, as the capacity utilization rate fell from about 80 percent in the mid-1970s to 40 percent by 1984.²⁷

54. By contrast, the commodity boom during the 2000-2014 period was characterized by rapid TFP growth, supported by more modest gains in human and physical capital. This period marked Nigeria's return to democracy and the launch of major economic and governance reforms, including the privatization of state-owned enterprises, civil service reforms, enhanced banking sector supervision, and trade reforms.²⁸ Capital utilization also increased and

most governance indicators moderately improved during this period, underscoring the importance of institutional quality.

55. Aggregate TFP data can obscure important productivity changes arising from the movement of resources among sectors with different productivity levels. The existence of large productivity gaps among sectors implies an inefficient allocation of productive resources. As these resources, especially labor, shift from less productive to more productive sectors, overall productivity increases and growth accelerates.²⁹ Recent research shows that gaps in productivity among sectors are common worldwide,

²⁷ Sala-i-Martin et al., 2012.

²⁸ Okonjo-Iweala et al., 2007.

²⁹ McMillan and Rodrik, 2011.

but that these gaps tend to be larger in poorer countries. Narrowing these productivity gaps can boost per capita growth in developing countries by an estimated 50 percent.³⁰

56. Recent sectoral growth studies have revealed a vast disparity in labor productivity between Nigeria's resource and non-resource sectors, as well as significant productivity gaps within the non-resource economy.³¹ The non-resource sectors with the highest labor productivity are services, including wholesale and retail trade, finance, insurance, and real estate, and construction; while productivity is lowest for utilities, the public sector, and agriculture. These disparities are large by international standards (Table 3.2), and they suggest that reallocating resources, labor and capital from the least productive sectors to the most productive ones could yield significant gains in overall productivity.

57. While shifts in employment among sectors

have contributed to Nigeria's economic growth, this effect is entirely explained by productivity differences between the resource and non-resource sectors. Minor employment gains in the resource sector, coupled with large differences in productivity between the resource and non-resource sector, accounts for the improvement in overall productivity. When the resource sector is excluded from the analysis, the positive effect vanishes, and the increase in productivity from labor reallocation becomes insignificant. Increasing the productivity-enhancing effect of reallocation would require a policy framework that reduces both domestic and international barriers to the mobility of factors. Barriers to factor mobility typically include trade policy (tariffs and non-tariff barriers), inadequate labor force skills and low access to finance – all of which are present in Nigeria, as shown in the next sections.

Table 3.2: Ratio of maximum to minimum labor productivity by sector, Nigeria and comparators, 1974-2011

Country or Aggregate	9 Sectors*	Excluding Resources
High-Income Countries	30	
Upper-Middle-Income Countries	48	
Lower-Middle and Low-Income Countries	174	
Nigeria	1,803	29
Indonesia	72	17
Mexico	64	26
South Africa	19	19
Kenya	22	22

Source: Lennon, 2016.

³⁰Sinha, 2016.

³¹Lennon, 2016.

3.3 Determinants of Economic Growth – Cross-Country Analysis

58. This section presents the main findings of a 151-country empirical analysis covering the period of 1970 to 2014 on the determinants of GDP growth.³² The analysis looked at the correlation with growth of education, government consumption, inflation, currency misalignment, trade openness, investment, institutional quality, and natural resource rents.

59. The results underscore the importance of macroeconomic management and stability for growth: inflation and government consumption were highly significant in all model specifications, as were investment and trade openness. Inflation and government consumption are inversely correlated with growth, while trade openness and investment are directly correlated with growth. Currency undervaluation is positively associated with growth, consistent with the findings of previous analytical work³³. The model estimates that a 25percent currency overvaluation would reduce growth by 1.25 percentage points versus the counterfactual.

60. Education is positively associated with growth, with returns to investment in education higher in developing economies such as Nigeria.³⁴ Despite improvements since 1999, two-thirds of Nigeria's population still had no secondary education in 2011³⁵ and the quality of educational services remains low. The World Economic Forum ranks Nigeria last among all countries surveyed in terms of public health and primary education. This result is confirmed by micro-level data, which find that firm

productivity is directly associated with worker education. A better-educated labor force increases not only labor productivity but also labor mobility, which facilitates structural transformation.

61. Abundant natural resources can be either a blessing or a curse; when institutional quality is accounted for in the model, natural resources make a modest but positive contribution to growth. Natural resources can affect a country's long-term growth and development through both macroeconomic and political economy channels. Large-scale resource exports can lead to an appreciation of the real effective exchange rate, eroding the competitiveness of the non-resource tradable sectors through a common phenomenon known as “Dutch disease.” The empirical analysis showed an ambiguous relationship between natural resources and growth, with a positive relationship for the entire sample group of countries but a negative relationship in Nigeria. However, after controlling for both the rule of law and corruption in Nigeria, natural resources appear to have had a positive and statistically significant effect on growth. This highlights the importance of developing strong and resilient institutions to ensure that natural resources are a blessing and not a curse.

62. However, the analysis also confirms the negative association between natural resources and institutional quality found in other studies, so developing strong institutions in a resource-rich setting is likely to be challenging. Natural resource rents can represent an enormously valuable income stream.

³²Raggl, 2016 using standard cross-country panel framework. The model's growth determinants included the level of GDP per capita at the beginning of each period to control for conditional convergence effects. Human capital was proxied by the share of the working-age population with tertiary education. To reflect relative trade openness, the model included the ratio of imports plus exports to GDP.

³³Rodrick, 2008.

³⁴In particular, the coefficient of this variable in the case of Nigeria is not only statistically significant, but significantly larger than the coefficient for the complete sample.

³⁵Beegle et al., 2015

63. Without an adequate system of checks and balances, competition among interest groups vying for control of these resources can promote patronage and clientelism, encourage political corruption, or even fuel armed violence. These detrimental effects on the institutional environment can discourage productive investment and inhibit the long-term growth of the non-resource sectors, especially the domestic financial market, further intensifying the economy's dependence of natural resources.³⁶

64. Increases in physical capital investment, gains in education, and improvements in institutional quality would have a more substantial impact on growth than high oil prices. The sensitivity of Nigeria's growth rate to these determinants in the medium to long term has been simulated. Figure 3.3 shows 4 potential scenarios for growth in per capita GDP over the period 2015 to 2040:

- **Scenario 0 is the baseline scenario**, which assumes that current trends in the determinants of growth (i.e., no change) will persist over the medium term. Per capita GDP growth rate is projected to **reach 2.2 percent per year by 2025**.

- **Scenario 1 shows the impact of an increase in oil revenue** (from 8.2 percent of GDP to 11.8 percent by 2025) due to recovery in oil price over the medium-term.³⁷ This has limited impact on growth, **boosting per capita GDP growth rate by only 0.3 percent a year by 2025**, revealing the oil sector's limited potential to drive medium-term growth.
- **Scenario 2 uses the same higher oil price projections as Scenario 1 and assumes that educational indicators will improve,³⁸ government consumption will decline,³⁹ physical capital investment will increase,⁴⁰ and the economy will become more open.** Given these assumptions, the per capita GDP growth rate is expected to accelerate rapidly, **reaching 3.8 percent by 2025, 1.2 percent higher than in Scenario 1.**
- **Scenario 3 incorporates the same assumptions as the second scenario and adds improvements in institutional quality.** Under this scenario, Nigeria's rule-of-law indicators would improve and corruption indicators would fall.⁴¹ Nigeria's per capita GDP growth rate would **reach 4.3 percent by 2025, 0.5 percent higher than**

³⁶ Raggl, 2016; Lane and Tornell, 1996; Holder, 2006; Mehlum et al., 2006; Badinger and Nindl, 2014; Beck et al., 2000.

³⁷ World Bank, 2016. Oil prices are projected to reach USD60 /bbl by 2020 and USD80 by 2025.

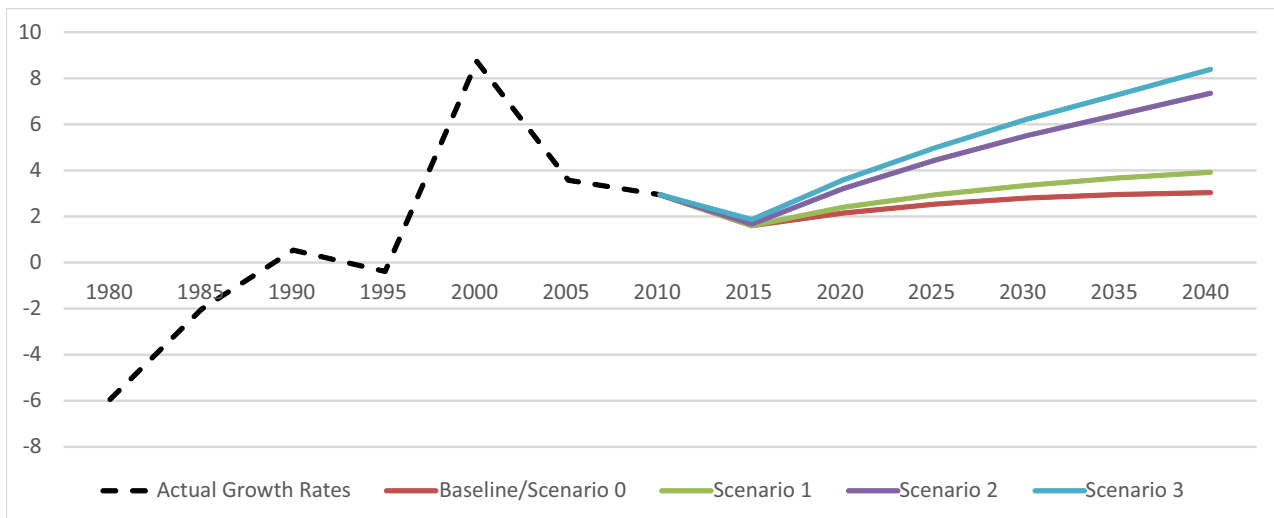
³⁸ The percentage of working age population who have completed secondary and tertiary education would increase from 40 percent to about 50 percent by 2025.

³⁹ Decrease by 0.5 percent of GDP in each five-year period.

⁴⁰ Increase by 2 percent of GDP in each five-year period.

⁴¹ The rule-of-law indicator would increase by 5 percent in each five-year period, while the control-of-corruption indicator would decrease by 10 percent in each five-year period.

Figure 3.3: Actual and predicted per capita GDP growth rates (percent) under the baseline and alternative scenarios, 2005-2040 (in 5-year periods)



Source: Herrera et al., forthcoming.

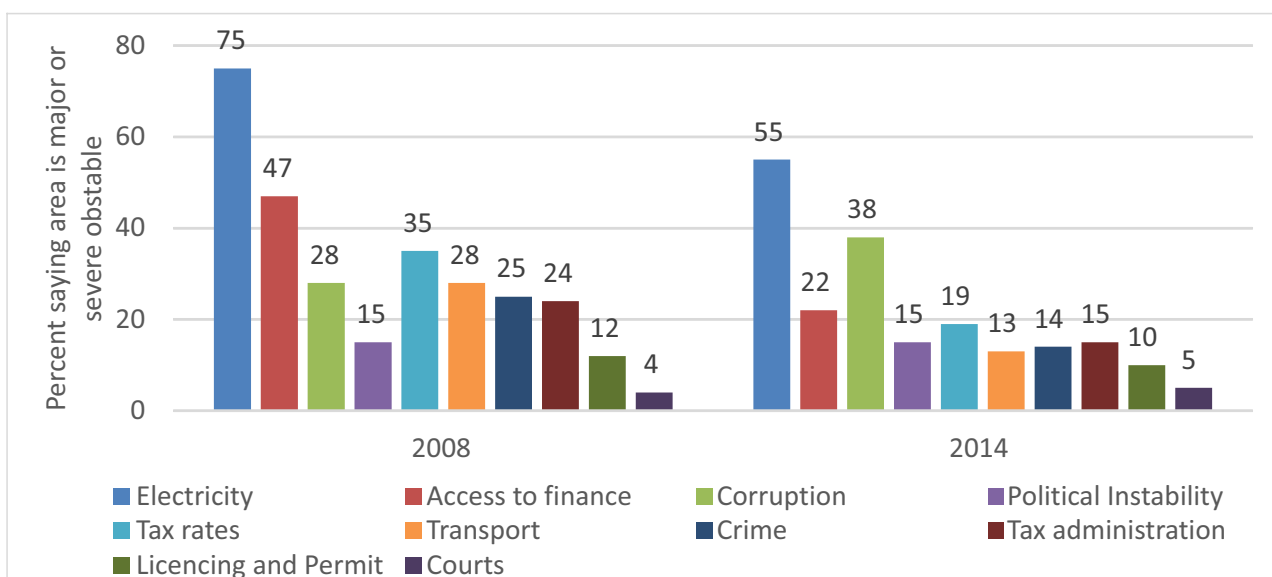
Note: The growth model by Raggl works with 5 year averages. The last actual period is 2010-2014; while 2015 to 2040 are model predictions.

3.4 Constraints to Firm Productivity and Doing Business in Nigeria

65. In an economy where the public sector is very small (total government spending was an average of 14.1 percent of GDP in 2010-2015), growth has to be private-sector led, through rising

employment and increasing firm productivity (labor productivity and value-added per worker). Analysis of firm-level data from the World Bank's Nigeria Enterprise Survey can shed light on the key constraints to raising firm productivity.

Figure 3.4: Most important obstacles to doing business in Nigeria, 2008 and 2014



Source: Herrera et al. using panel data from the World Bank Enterprise Surveys

66. The most important constraints to doing business reported by Nigerian firms are an inadequate electricity supply, the prevalence of corruption and political instability, and limited access to finance. The relative importance of both electricity and finance has decreased over time, but corruption and political instability have not (Figure 3.4).⁴² The most frequently cited obstacles to doing business differ across regions. Electricity is the most important obstacle in all regions except the northwest, where corruption is cited as the top constraint, followed by political instability. Younger firms, exporters, and manufacturers are most likely to identify crime, insecurity, corruption and electricity access as the key obstacles. Easing these constraints are consistently associated with higher levels of firm productivity. Nigerian firms estimate the average cost of power outages at about 17 percent of sales. Lower corruption affects firm productivity indirectly by encouraging investment.

67. Transportation infrastructure, in particular roads, is also likely to remain a major constraint, especially for the non-oil sectors, despite improvements in the Doing Business survey. The lack of transportation infrastructure hinders the natural expansion of the huge non-oil growth agglomeration of Lagos and explains why so many manufacturing firms operate within Lagos, where congestion and very high rents limit their competitiveness, while the economies of neighboring areas stagnate.

68. The importance of trade for Nigeria's growth prospects is supported by firm-level data, which show that higher levels of productivity are associated with a greater propensity to import raw materials and to export,⁴³ and with a greater likelihood of foreign participation in the ownership structure.

69. However, Nigeria's trade policies have had a negative impact on the allocation of productive resources. Combining the Enterprise Survey data with the World Bank's Tariff Reform Impact Simulation Tool⁴⁴ shows that the existing tariff structure systematically increases the profitability of the country's least productive sectors such as apparel, textiles, and wood products, while leaving the profitability of more productive sectors unchanged. In other words, the tariff system incentivizes the reallocation of factors toward less-efficient economic activities. A hypothetical 10 percent increase in tariff rates would boost the profitability of the median firm, but profitability would increase most in the country's least productive sectors. These findings indicate that Nigeria's trade policies inhibit productivity-enhancing structural transformation. The analysis also finds no evidence that Nigeria's tariffs are contributing to employment growth. In fact, Nigeria's current trade policy disadvantages several major sources of employment growth, including the retail and hotels and restaurants sectors, by increasing prices for their inputs and capital goods. The most heavily protected sectors are unprocessed tobacco, apparel, textiles, and leather goods. Retail and hotels and restaurants each contribute more to total employment than all of these sectors combined.

⁴²Figure 3.4 reports the percentage of firms that rated each constraint as a major or severe obstacle to growth.

⁴³While causality could run in either direction—high productivity levels may encourage exporting, or exporting may tend to increase productivity—the evidence suggests that more productive firms are more likely to become exporters.

⁴⁴Shui and Voneuxkull, 2014, describe this methodology, which estimates the prices of final, intermediate, and capital goods under the current tariff structure and a zero-tariff counterfactual. These price variations imply changes in firm profitability based on the technology involved and the type of good or service being produced. The changes in profitability are short-run static gains derived using a partial equilibrium model. The same methodology was previously used to quantify the impact of Nigeria's adoption of the Common External Tariff.

3.5 Policy Implications for Sustaining Growth

70. Both the cross-country growth and firm-level productivity analyses underscore the critical importance of (a) public capital investment, (b) education, (c) openness to trade and effective trade policy, (d) macroeconomic stability, (e) strong public institutions and governance, (f) access to finance, and (g) reliable power supply in laying the groundwork for robust and sustained growth in Nigeria. Policymakers can accelerate growth through a range of reform options, many of which complement and reinforce one another.

Short-Term Policy Objectives: Macroeconomic Stabilization and Greater Policy Predictability

71. Diversifying the sources of fiscal revenue and deploying an appropriate policy framework to reduce expenditure volatility and pro-cyclicality is key. Increasing non-oil revenue through tax policy (for example, increasing VAT rates and excise rates) and administration reforms could facilitate a sustained increase in public investment without undermining macro-fiscal stability. Nigeria's fiscal institutions are capable of delinking public expenditure from the volatile revenue base, but adjustments to the Excess Crude Account, the Sovereign Wealth Fund and the Fiscal Responsibility Law are needed to increase their effectiveness. In particular, rules for deposits and withdrawals from the SWF and ECA accounts should be more clearly detailed in a robust legal framework, coupled with greater transparency in reporting and management accountability. The monitoring and enforcement of borrowing regulations and guidelines for sub-national governments could be strengthened to ensure that fiscal policy targets are achieved. Although many states have their own FRLs, state and

local governments must respect rules for commercial bank borrowing, including the necessary authorization from the DMO.

Greater public investment, accompanied by a stronger public investment management system, will be important to support long-term growth.

Nigeria's capital budget is roughly half the size of those of comparable countries, and the country suffers from a severe infrastructure deficit. The World Economic Forum ranks Nigeria 132nd out of 138 countries for infrastructure quality. Nigeria's past periods in which rapidly rising capital spending was accompanied by stagnant TFP growth underscore the pitfalls of focusing on the quantity rather than the quality of capital spending. A recent comparative study of public investment management systems ranked Nigeria in the bottom fourth of countries worldwide due to serious deficiencies in project selection and evaluation.⁴⁵ An assessment of Nigeria's public investment management system identified persistent discrepancies between budgeted and actual capital spending, driven by weak cash management and procurement practices.

72. Given the close correlation among slow growth, high inflation rates and exchange rate misalignment, further policy adjustments are needed—including slowing the growth in money supply to reduce inflationary pressures. The multiple exchange rates and large parallel market premium suggest that the currency remains misaligned and further liberalization is needed.

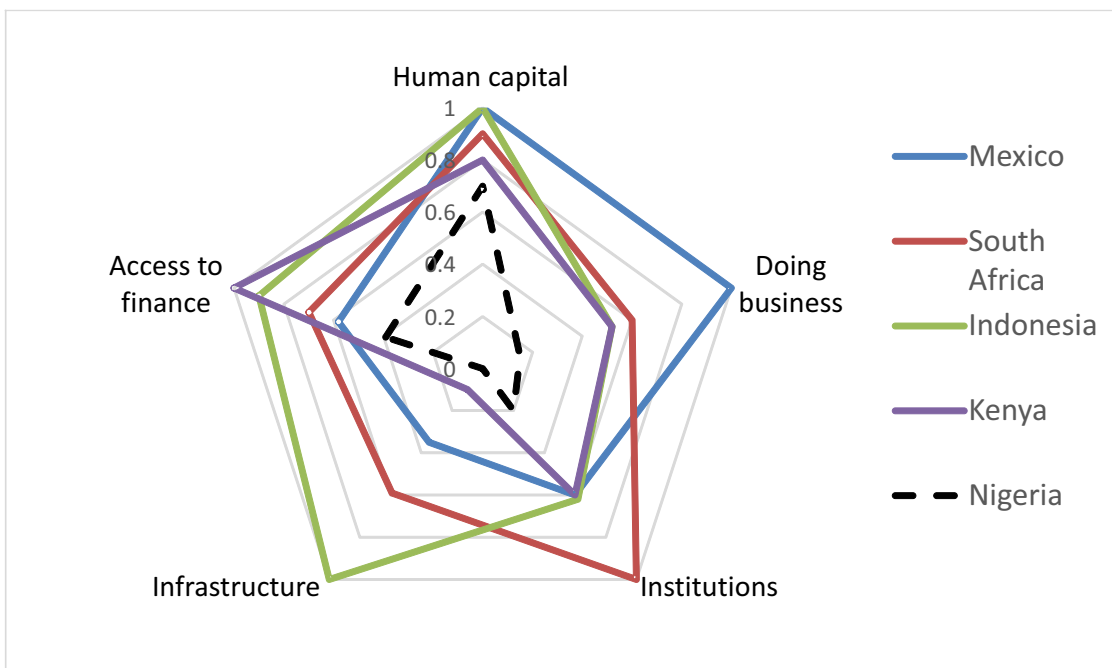
⁴⁵ Dabla-Norris et al., 2011.

This can be achieved by removing foreign exchange restrictions⁴⁶ and allowing the interbank foreign exchange market to function more freely and transparently. In addition, the list of 41 items with limited access to foreign currency in the interbank market belong mostly to low-productivity sectors such as the food, wood, rubber and plastic products and apparel. Hence, the NTB reinforce the tariff structure which protects the least productive sectors.

Medium-to-Long-Term Policy Objectives: Improving the Business Climate and Enabling Factor Mobility to Support Structural Transformation

73. Macroeconomic policy adjustments need to be accompanied by structural reforms that will promote economic diversification and productivity improvements. Nigeria's business and investment climate is far less hospitable than that of other oil exporters or its regional peers. Indonesia, Mexico, Kenya and South Africa all outperform Nigeria on measures of infrastructure quality, ease of doing business, access to finance,⁴⁷ quality of public institutions, and human capital (Figure 3.5). These structural constraints tend to slow the movement of labor and capital among sectors, and low factor mobility has been a major obstacle to Nigeria's economic diversification and productivity growth.

Figure 3.5: Structural determinants of long-term growth, Nigeria and country comparisons



Source: Herrera et al., forthcoming.

Note: For each of the five indicators, the country in the sample with the highest value was normalized, and the values for other countries were adjusted to reflect that benchmark. The human capital score is based on the World Economic Forum's Human

Capital Index; the Doing Business score is based on the World Bank's Doing Business report; the Infrastructure score is based on the number of electrical outages per month as reported in the IFC's

⁴⁶In June 2015, the CBN restricted the foreign currency access of importers of 41 items, including rice, cement, wood products, iron, steel and textiles. The output contraction observed during the first quarter of 2016 was highest in sectors that use items on the CBN list as inputs.

⁴⁷Only 12 percent of Nigerian firms reported having a loan in 2014, an extremely low share by regional standards (Nigeria Enterprise Survey)

Enterprise Survey; the Access to Finance score reflects the share of Enterprise Survey respondents who reported borrowing from a financial institution; and Quality of Public Institutions score is based on the Rule of Law indicator in the World Bank's Worldwide Governance Indicators.

74. The recently approved Economic Recovery and Growth Plan (ERGP) 2017-2020 and the Power Sector Recovery Plan contain critical structural reforms. If implemented successfully, the strategies and actions would

improve educational attainment, access to finance (though the focus on expanding existing development finance schemes should be accompanied by an evaluation of their effectiveness first), the ease of doing business, strengthen public institutions and improve transparency and anti-corruption, expand transportation infrastructure and increase reliable supply of power by restoring financial viability to the power sector. Effective implementation requires securing the financing (public and private, including PPPs) and ensuring strong coordination between Federal Government and State and Local Governments.

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