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October 2017

NIGERIA BIANNUAL ECONOMIC UPDATE

The Case for Sustaining State Fiscal Reform

THE WORLD BANK
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PREFACE

The Nigeria Biannual Economic Update has three broad aims. First, it reports on the key developments in the Nigerian Economy in recent months (Chapter 1). The cut-off date for most of the economic variables reported on in this edition was June 2017. Secondly, it summarizes the likely economic outcomes in the short-to-medium term, given the policy developments, and highlights key short term risks and development challenges (Chapter 2). Finally, the Update provides a more in-depth examination of selected highly topical economic issues (Chapter 3). The Nigeria Biannual Economic Update is intended for a wide audience, including policymakers, business leaders, financial market participants, and the community of analysts and professionals engaged in Nigeria's economy.

This report is a product of the staff of the International Bank for Reconstruction and Development / The World Bank. This edition was prepared by the World Bank Macroeconomic and Fiscal Management Global Practice Nigeria Team, led by Gloria Joseph-Raji (Senior Economist, GMF01) and Emilija Timmis (Young Professional, GMF01). Yue Man Lee (Senior Economist, GMF01) prepared the Special Topic (Chapter 3) based on World Bank analysis of state fiscal and debt data. Abul Azad (GPV07) provided an update on Socio-Economic and Welfare Indicators (Section 1.5) based on the 2015/2016 General Household Survey.

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ACRONYMS

ASI	All-Share Index
BDC	Bureau De Change
BOP	Balance of Payments
CBN	Central Bank of Nigeria
CPI	Consumer Price Index
CRR	Cash Reserve Requirement
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
FX, forex	Foreign Exchange
GDP	Gross Domestic Product
GHS	General Household Survey
GENCOs	Power Generation Companies
H1	First half of the year
IEFX	The Investors & Exporters FX window
IGR	Internally Generated Revenues
IOC	International Oil Companies
JV	Joint Venture
LCU	Local Currency Unit
M1	Narrow Money
M2	Broad Money
mb/d	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
NSE	Nigeria Stock Exchange
NTB	Non-Tariff Barriers

OAGF	Office of the Accountant General of the Federation
OECD	Organization for Economic Co-operation and Development
OGP	Open Government Partnership
OMO	Open Market Operations
OPEC	Organization of the Petroleum Exporting Countries
PMI	Purchasing Managers' Index
PPP	Purchasing Power Parity
PPPs	Public-Private Partnerships
PRSP	Power Sector Recovery Plan
Q	Quarter
SLGs	State and Local Governments
SWF	Sovereign Wealth Fund
TFP	Total Factor Productivity
USD	US Dollars
VAT	Value Added Tax
WEF	World Economic Forum
yoy	Year-on-Year
ytd	Year-to-Date

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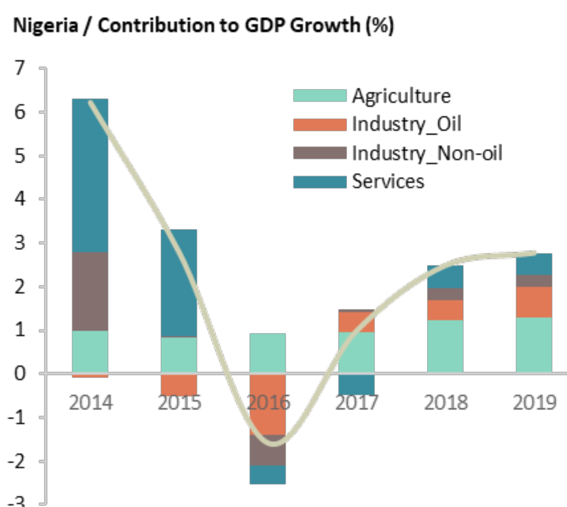
Executive Summary

Recent Economic Developments

Nigeria's economy recorded positive growth (0.6 percent year-on-year) in the second quarter of 2017, after contracting for 5 consecutive quarters, and growth is expected to reach 1 percent in 2017, contingent on sustained recovery of oil production. Although the negative spillovers from lower oil revenue have diminished with the increased availability of foreign exchange, macroeconomic imbalances remain and severe revenue shortfalls continue to hamper budget implementation.

Figure 1.1: GDP Growth (Sector Contribution)



Source: NBS; World Bank Staff projections.

Nigeria experienced its first recession in over two decades in 2016, when the economy contracted by 1.6 percent due to negative oil price and oil production shocks, which spilled over to the non-oil sectors. Oil GDP shrank by 14.4 percent, and non-oil GDP contracted by 0.2 percent. Oil exports plummeted by 25 percent in 2016 (in US$ terms); however, imports contracted even faster (33 percent) due to constraints on foreign exchange, resulting in a positive current account balance (0.7 percent GDP) in 2016.

In the first half of 2017, oil production recovered somewhat, but was below projections, partly due to maintenance work. The non-oil GDP recorded positive growth in 2017 (0.7 percent yoy in Q1 and 0.4 percent yoy in Q2), driven by continued decent performance in agriculture, and non-oil industry due to easing of foreign exchange constraints. However, agricultural production was lower than anticipated due to regional floods and instability in Northern Nigeria. The current account is estimated to remain in surplus. Imports show a rising trend in the first half of 2017 in line with higher foreign exchange availability.

Severe revenue shortfalls continue at all tiers of government. While the oil price assumption for the budget is below the actual price, oil production underperformed in the first half of 2017. Administrative measures to boost non-oil revenues have not yet delivered the expected impact. This challenges budget implementation, especially for capital expenditures.

With the revenue shortfall, fiscal pressures also persist at the subnational government level, with States requesting an extension of the Budget Support Facility, which was due to expire at end-May 2017. While all States have made progress on the reform measures included in the 22 point Fiscal Sustainability Plan, implementation is incomplete. Chapter 3 contains more detailed analysis of the historical fiscal performance of States and the implications of continuing pressures on the states' fiscal and debt sustainability.

Broad money growth slowed significantly and reached -1.8 percent in June 2017, from double digits in 2016. While the monetary policy rate was maintained at 14 percent throughout the year, Naira liquidity was nevertheless tightened considerably through more intensive Open Market Operations and foreign exchange sales by the Central Bank despite ongoing Central Bank financing of fiscal deficits and its development financing activities. Partly because of favorable base effects, headline inflation has been declining since February 2017, reaching 16.1 percent in June 2017. However, food inflation remains high (19.9 percent) and continues

to accelerate.

The Central Bank started providing relief to severely constrained foreign exchange markets in February 2017, after external reserves had recovered to about US$29 billion, from a low of US$24 billion in October 2016. Despite higher foreign exchange sales, reserves reached US$31 billion in August 2017. However, import restrictions and multiple exchange rates remain. The parallel market premium fell from the peak of over 60 percent in February to 20 percent in June, where it stabilized. The official exchange rate has been maintained at around N305/ US$.

Economic Outlook

Economic growth is expected to average about 1 percent in 2017, driven by recovering oil production and the positive impact on private sector activities from the increased supply of foreign exchange. The downward revision from the previous forecast arises largely from lower than expected oil production, highlighting downside risks of the economy's dependence on the oil sector. As the government begins to implement the structural reforms outlined in the Economic Recovery and Growth Plan 2017-2020 and the associated sector strategies, which are still being developed, growth can be expected to strengthen in the medium term, reaching about 2.8 percent by 2019. Private consumption will likely continue to contract in 2017, due to recession repercussions and high inflation, before recovering in the medium term as growth picks up and inflation continues to decline.

Expansionary fiscal policy and arrears clearance[1] combined with revenue shortfalls will continue to increase the fiscal deficit, and public debt (around 17 percent of GDP at the end of June 2017). The Federal Government is expected to continue its efforts to shift deficit financing away from the domestic market through subsequent rounds of Eurobond issuance and other sources of external financing, toward the target of a 60/40 split between domestic and foreign financing. Critical non-oil revenue growth will remain constrained in the face of less robust reforms in tax policy.

The prospects of more impactful tax reforms however remain low, as the government treads conservatively and the window of opportunity before the 2019 elections is rapidly closing. The limited non-oil revenue mobilization effort sustains the chronic fiscal policy vulnerability to oil-revenue fluctuations. Continued financing of government deficit risks crowding-out private sector credit and puts pressure on the CBN's balance sheet. The continuing segmentation of the foreign exchange market will maintain distortions, inefficiencies, and opportunities for rent seeking.

The Case for Sustaining State Fiscal Reform

As earlier highlighted, Chapter 3 contains an analysis of the historical (2011-2014) fiscal performance on Nigeria's State Governments and illustrates how this made them vulnerable to the macro-fiscal shocks of 2015-16. The dramatic fall in oil revenue and lack of fiscal consolidation led to a rapid increase in States' indebtedness, necessitating two sets of financial assistance interventions from the Federal Government.

At present, States remain under considerable fiscal stress, with States requesting continuation of the Budget Support Facility beyond the original end date of May 2017. With no fur-

1 Arrears include delayed payments to contractors and public sector salaries.

ther fiscal consolidation, States' fiscal and debt sustainability will continue to deteriorate. Under assumptions of a fragile economic recovery (with slightly higher oil price and production), no significant increase in non-oil revenues collected federally or by the States (IGR), no further rationalization of State expenditures, as well as no financing constraints, total State fiscal deficits could remain around 1 percent of GDP annually through the medium-term. This level of fiscal deficits would lead to an increase in total State debt stock to 5.4 percent of GDP and 200 percent of revenue by 2020. In this scenario with limited or no fiscal consolidation, States remain vulnerable and continue to represent a significant source of fiscal risks and macroeconomic instability for the country. The need to strengthen fiscal performance through sustaining state fiscal reforms that have been accelerated in the past 2 years is therefore of paramount importance.

Chapter 1: Economic Update

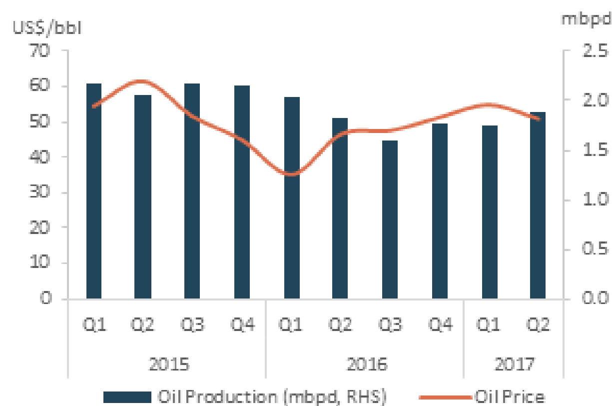
1.1 Economic Output and Employment

Economic Output

1. **Nigeria's economy returned to positive growth in the second quarter of 2017 after contracting for five consecutive quarters.** Nigeria's real Gross Domestic Product (GDP) grew by 0.6 percent[2] (year-on-year) in the second quarter (Q2) of 2017. The recovery was driven by recovering oil production and non-oil industry, and modest growth in agriculture.

2. **Oil and gas GDP improved by 1.6 percent in Q2.** This was helped by the improved security situation in the oil-producing Niger Delta, and the completion of repair and maintenance works on some of the oil installations. The country's oil output improved to an estimated average of 1.9 million barrels per day (mb/d) in Q2 from an average of 1.8 mb/d in the corresponding period of 2016 (Figure 1.2). The average oil price during the quarter (US$ 50.9) was also higher than the price in Q2 2016 (US$ 46.6).

Figure 1.2: Oil Production and Price



Source: NBS; S&P Global Platts.

Figure 1.3: Sector Contributions to GDP Growth

Source: NBS

3. **On the back of the recovery of oil GDP and increased supply of foreign exchange, non-oil industry started recovering in 2017, growing by 1.1 and 1.3 percent (yoy) in the first and second quarters, respectively.** Growth of the manufacturing sub-sector, which had returned to positive territory in Q1 (1.4 percent) slowed in Q2 to 0.6 percent, while construction remained at 0.1 percent.

4. **Agricultural sector growth slowed in the second quarter of 2017.** While the agricultural sector has maintained positive growth even through the recession, its growth has continuously slowed in the past three quarters, growing by 3.0 percent in Q2 2017, as compared with 3.4 percent in Q1 2017 (Figure 1.3). This has been likely due to the on-going crisis in the north-east region, recurrent farmer-herdsmen clashes in the north-central region and regional floods that have displaced farming communities and affected agricultural production.

5. **The services sector continued to contract in the second quarter of 2017.** The sector contracted by 0.8 percent (year-on-year) in Q2, slightly worse than the contraction of 0.4

2 This refers to the real GDP at market prices. The Nigerian Government references GDP growth at basic prices (i.e. before adding net indirect taxes), but standard international practice is to reference GDP growth at market prices. Real GDP growth at basic prices was 0.55 percent in Q2 2017.

percent in Q1 (Figure 1.3). Sub-sectors like Wholesale & Retail Trade and Finance & Insurance performed better in Q2, relative to their performance in Q1. Finance & Insurance grew particularly strongly in Q2, at 10.5 percent (Table 1.1).

6. **Non-oil industry growth was buoyed by improved availability of foreign exchange and fuel.** Foreign exchange from both the Central Bank of Nigeria (CBN) and autonomous sources was tight throughout 2016. From February 20, 2017, the CBN began to generously supply foreign exchange to the markets and in April, the flexible-rate Investors and Exporters Foreign Exchange (IEFX) window was established and contributed to an increase in autonomous foreign exchange inflows. This unlocked a major bottleneck to investment and output growth.

7. **Relief in the fuel supplies may be short lived.** With prices fixed since May 2016, the petrol price is now no longer aligned with market fundamentals. The price modulation mechanism envisaged by the Federal Government in May 2016 has not been implemented. The state-owned Nigerian National Petroleum Corporation (NNPC) has almost fully taken over importation of the petroleum products, incurring losses and paving the way for a return of the implicit fuel subsidy.

Table 1.1: Real GDP Growth by Sector and Selected Sub-Sectors (percent, year-on-year)

Activity Sector	Annual			Quarterly 2016				Quarterly 2017	
	2014	2015	2016	Q1	Q2	Q3	Q4	Q1	Q2
Total GDP (2010 market prices)	**6.3**	**2.7**	**-1.6**	**-0.7**	**-1.6**	**-2.4**	**-1.6**	**-1.0**	**0.6**
Total GDP (2010 basic prices)	**6.2**	**2.8**	**-1.6**	**-0.7**	**-1.5**	**-2.3**	**-1.7**	**-0.9**	**0.5**
Agriculture	4.3	3.7	4.1	3.1	4.5	4.5	4.0	3.4	3.0
Industry	6.8	-2.2	-8.9	-6.7	-7.2	-12.7	-8.7	-5.8	1.5
Oil and Gas	-1.3	-5.4	-14.4	-4.8	-11.6	-23.0	-17.7	-15.6	1.6
Manufacturing	14.7	-1.5	-4.3	-7.0	-3.4	-4.4	-2.5	1.4	0.6
Construction	13.0	4.4	-5.9	-5.4	-6.3	-6.1	-6.0	0.1	0.1
Services	6.8	4.8	-0.8	0.8	-1.3	-1.2	-1.5	-0.4	-0.8
Trade (wholesale and retail)	5.9	5.1	-0.2	2.0	0.0	-1.4	-1.4	-3.1	-1.6
ICT	7.0	6.2	2.0	4.1	1.4	1.1	1.4	2.7	-1.2
Finance and Insurance	8.1	7.1	-4.5	-11.3	-10.8	2.6	2.7	0.7	10.5
Real Estate	5.1	2.1	-6.9	-4.7	-5.3	-7.4	-9.3	-3.1	-3.5
Public Administration	2.5	-12.3	-4.6	-4.4	-6.1	-3.6	-4.1	-2.1	1.6
Oil GDP	**-1.3**	**-5.4**	**-14.4**	**-4.8**	**-11.6**	**-23.0**	**-17.7**	**-15.6**	**1.6**
Non-Oil GDP	**7.2**	**3.7**	**-0.2**	**-0.2**	**-0.4**	**0.0**	**-0.3**	**0.7**	**0.4**

Source: NBS

Table 1.2: Sector and Selected Sub-Sector Shares in Nigeria's GDP (percent)

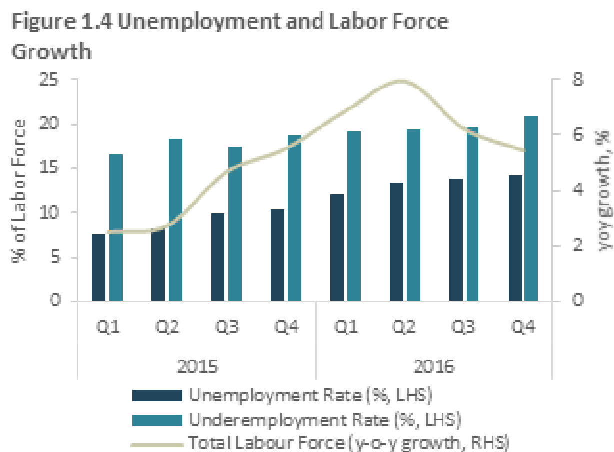
Activity Sector	Annual			Quarterly 2016				Quarterly 2017	
	2014	2015	2016	Q1	Q2	Q3	Q4	Q1	Q2
Total GDP (2010 basic prices)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Agriculture	22.9	23.1	24.4	20.5	22.4	28.7	25.6	21.4	23.0
Industry	24.9	23.7	22.0	24.1	23.1	21.0	20.0	22.9	23.3
Oil and Gas	10.4	9.6	8.3	10.0	8.8	8.1	6.7	8.5	8.9
Manufacturing	10.0	9.5	9.3	9.5	9.4	9.2	9.0	9.8	9.4
Construction	3.8	3.9	3.7	4.1	4.3	3.1	3.4	4.2	4.3
Services	52.2	53.2	53.6	55.4	54.5	50.3	54.4	55.7	53.7
Trade (wholesale and retail)	16.6	16.9	17.2	18.2	17.5	16.4	16.7	17.8	17.1
ICT	10.8	11.2	11.6	12.0	12.6	10.2	11.6	12.5	12.4
Finance and Insurance	3.0	3.1	3.0	3.1	3.0	2.9	2.9	3.2	3.3
Real Estate	7.7	7.6	7.2	6.5	7.5	7.2	7.6	6.3	7.2
Public Administration	2.8	2.4	2.3	2.3	2.4	2.1	2.4	2.3	2.5
Oil GDP	**10.4**	**9.6**	**8.3**	**10.0**	**8.8**	**8.1**	**6.7**	**8.5**	**8.9**
Non-Oil GDP	**89.6**	**90.4**	**91.7**	**90.0**	**91.2**	**91.9**	**93.3**	**91.5**	**91.1**

Source: NBS

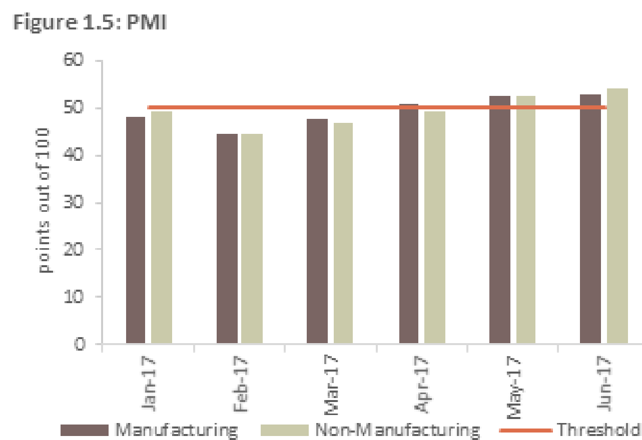
Employment

8. Latest official employment and job creation data for Nigeria show increasing unemployment and underemployment throughout 2016. Unemployment and underemployment reached 14.2 and 21 percent, respectively in Q4 of 2016 (Figure 1.4). However, the Purchasing Managers' Index (PMI)[3] (Figure 1.5), which is computed monthly by the CBN and measures employment levels as one of its constituent variables, has shown an improving trend after crossing the 50-point mark in April. The positive movement indicates some level of expansion in the economy, corroborated in part by the Q2 GDP outturns.

3 The PMI is based on data compiled from surveys of purchasing and supply executives of manufacturing and non-manufacturing businesses. Survey responses indicate whether there is *change* or *no change* in the level of business activities in the *current month* compared with the *previous month*. The specific indicators measured include: production level, supplier delivery time (for manufacturing firms), business activity (for non-manufacturing firms), new orders, employment level and raw materials inventory. A composite PMI above 50 points indicates that the manufacturing/non-manufacturing economy is generally expanding, 50 points indicates no change and below 50 points indicates that it is generally declining.



Source: NBS

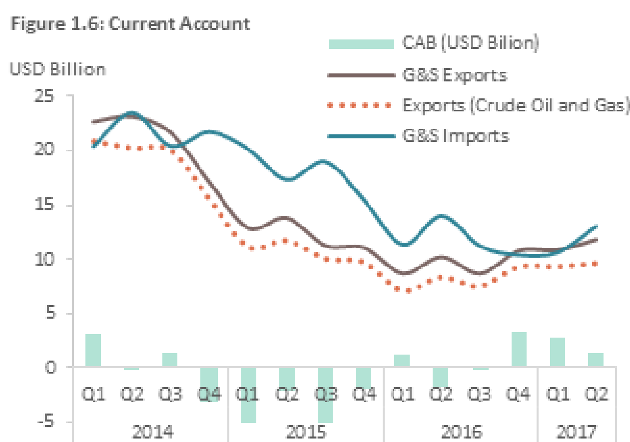


Source: CBN

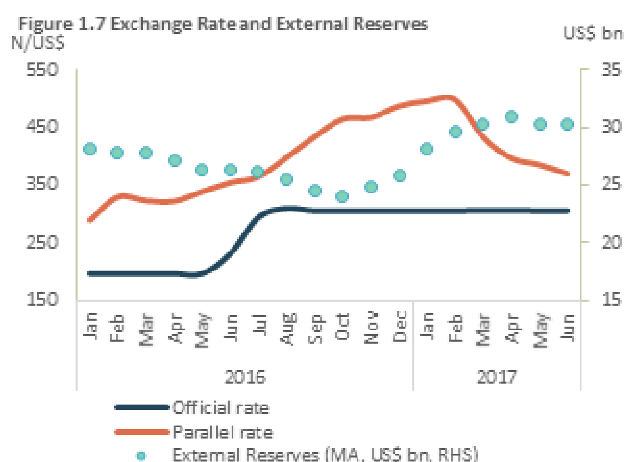
1.2 The External Sector: Balance of Payments and Exchange Rate Developments

Balance of Payments

9. **The current account balance was positive in the first half of 2017.** It however declined from US$2.7 bn in Q1 to US$1.4 bn in Q2 as imports grew faster than exports (Figure 1.6). The value of goods and services exports increased in this period in line with oil sector developments. Goods and services exports increased by 20 percent relative to the first half of 2016, and by 16 percent, relative to the second half of 2016. These movements were largely driven by crude oil prices and a recovery in production. Oil prices reached an average of US$52.8 per barrel in H1 2017, relative to the average of US$40.9 per barrel in H1 2016 and US$49.5 per barrel in H2 2016. Non-oil goods exports growth recovered to 28 percent compared to 2016 H1 and 69 percent compared to the second half of 2016. In 2017 H1, goods and services imports were lower than in the same period of 2016. However, compared to the preceding quarter, imports stagnated in Q1 2017, reflecting continuous shortages of foreign exchange, before starting to grow again in Q2 2017 as the CBN enhanced the supply of forex.



Source: CBN. 2017 Q2 data preliminary



Source: CBN, AbokiFX

10. **The Financial Account was also positive in the first half of 2017, buoyed by increasing portfolio and other investment inflows.** It returned to positive territory (USD 4.3 and 4.6 billion, respectively, in Q1 and Q2 2017), from a negative position in the fourth quarter of 2016 due to the substantial improvements in Net Portfolio and Other Investment. Net Direct Investment also remained positive (Table 1.3). The improvements in portfolio and other investment inflows were largely driven by renewed investor confidence in the economy, following the establishment of the Investors and Exporters FX window in April.

Table 1.3: The Balance of Payments of Nigeria (USD billion)[4]

	Annual			Quarterly 2016				Quarterly 2017	
	2014	2015	2016	Q1	Q2	Q3	Q4	Q1	Q2
CURRENT ACCOUNT BALANCE	**1.3**	**-15.4**	**2.7**	**1.1**	**-1.7**	**0.0**	**3.3**	**2.7**	**1.4**
Trade Balance	21.0	-6.4	-0.5	-0.8	-1.8	-0.1	2.3	2.3	2.1
Exports (fob)	82.6	45.9	34.7	7.6	9.3	7.9	9.9	10.0	10.8
o/w Crude Oil and Gas	76.5	42.4	32.0	7.0	8.3	7.4	9.2	9.3	9.6
Imports (fob)	-61.6	-52.3	-35.2	-8.4	-11.1	-8.0	-7.7	-7.7	-8.7
o/w Oil and Gas	-13.8	-8.5	-9.0	-1.9	-2.6	-2.3	-2.1	-2.4	-2.1
Services(net)	-22.5	-16.5	-8.0	-1.8	-2.0	-2.4	-1.9	-2.0	-3.3
Credit	2.0	3.2	3.7	1.1	0.9	0.8	0.9	0.9	1.0
Debit	-24.5	-19.6	-11.8	-2.9	-2.9	-3.2	-2.8	-2.9	-4.3
Income(net)	-19.2	-12.7	-8.6	-1.8	-2.3	-2.1	-2.4	-2.3	-2.8
Current transfers(net)	21.9	20.2	19.9	5.6	4.3	4.6	5.3	4.8	5.4
FINANCIAL ACCOUNT BALANCE	**4.7**	**-6.7**	**0.7**	**-8.4**	**6.7**	**5.0**	**-2.6**	**4.3**	**4.6**
Net Direct Investment	3.1	1.6	3.1	0.6	0.6	1.0	0.9	0.5	0.6
Outflows	-1.6	-1.4	-1.3	-0.3	-0.3	-0.4	-0.3	-0.3	-0.3
Inflows	4.7	3.1	4.4	0.9	0.9	1.4	1.3	0.9	0.9
Net Portfolio Investment	1.8	0.9	1.7	0.2	0.5	0.7	0.3	1.4	1.5
Outflows	-3.4	-1.7	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0
Inflows	5.3	2.5	1.9	0.2	0.6	0.8	0.3	1.4	1.5
Net Other Investment	-0.2	-9.2	-4.2	-9.2	5.6	3.2	-3.8	2.4	2.6
Outflows	-10.9	-10.3	-3.1	-9.7	6.4	1.0	-0.7	-0.7	-0.1
Inflows	10.7	1.0	-1.1	0.6	-0.8	2.2	-3.1	3.1	2.7
CHANGE IN RESERVES (positive sign indicates reserve spending, i.e. reduction in reserves)	**8.5**	**5.9**	**1.0**	**0.7**	**0.8**	**2.7**	**-3.3**	**-3.0**	**-0.3**
NET ERRORS AND OMISSIONS	**-14.4**	**16.3**	**-4.4**	**6.5**	**-5.8**	**-7.6**	**2.5**	**-4.1**	**-5.8**

Source: CBN. Note that 2017 Q2 figures are provisional.

4 Net errors and omissions in Nigeria's Balance of Payments are not only large, but swing substantially, reflecting high levels of unrecorded capital and informal trade movements in Nigeria.

Foreign Exchange Policy and Exchange Rate Developments

11. The building of foreign reserves continued in the first half of 2017. External reserves grew particularly strongly (by US$ 3 billion) in Q1 2017, driven by strengthening oil exports and issuance of Eurobonds. Foreign reserves continued to accrue after the CBN resumed generous forex supply in Q2. In light of rising reserves, the CBN moved to sell more foreign exchange to the economy in early 2017 to reduce the parallel market premium. The CBN supplied a total of US$ 610 million to the interbank market and BDCs in Q1 2017, up from US$140 million in Q4 2016; and it is estimated that it has supplied a total of over US$ 9 billion to the interbank market between February and August 2017.

12. Higher availability of foreign exchange led to an appreciation of the parallel market rate. The parallel market rate recovered from a low of N520/US$ in February to around N365/US$ currently. The premium between the official CBN rate and the average monthly parallel market rate fell from 60 percent to 20 percent. The official rate has remained in the range of N305-N307 to the US$. The CBN also abolished the requirement that banks allocate at least 60 percent of their foreign exchange sales to the manufacturing sector. However, the list of 41 items not eligible for official foreign exchange allocation, which was instituted in June 2015, was retained.

13. Furthermore, the foreign exchange markets remain segmented, creating market inefficiencies. The CBN instituted several special windows for the sale of foreign exchange to improve foreign exchange availability. Consequently, the following foreign exchange windows exist in the Nigeria foreign exchange market:

- The CBN official window for goods ("visibles") transactions where the CBN intervenes at a rate ranging from N305 – N307 per US$. This is in practice, however applicable mainly for the importation of petroleum products (which effectively keeps domestic petrol prices subsidized at current levels) and other Government transactions;
- The interbank Secondary Market Intervention Sales (SMIS) FX window where the CBN intervenes through the sale of FX to authorized dealers (wholesale) or end-users (retail) in spot and 7-60 day forward sales, with the NiFEX[5] rate being the reference rate (currently about N329/US$). At this window, the CBN has sometimes directed sales to specific sectors like agriculture, manufacturing, aviation and petroleum downstream;
- A special interbank FX window established on February 20, 2017 for retail "invisibles" transactions (school fees, medical fees, Business and Personal Travel Allowance). The CBN indicated that it expects US$ to be sold at a rate of no more than 20 percent above the interbank market rate (currently, US$ is sold at N360 at this window);
- A special SME window established on April 10, 2017, to improve access of SMEs to FX (a maximum of US$20,000 per customer per quarter with highly simplified documentation requirements). US$ is currently sold at N360 at this window;
- An Investors & Exporters FX window (IEFX), established on April 21 mainly for portfolio investors and exporters, based on market-determined rates (with the NAFEX[6] being the reference rate for transactions in this window). CBN's main objective for establishing this window was to address the needs for capital repatriation, dividend remittances, loan repayments, loan interest repayments, and software subscription payments, amongst others. The total turn-over at this window as at end-June was about $3.7 billion and this rose to over US$13 billion by end-September. The rate at this window is currently about US$360/US$, very close to the BDC/parallel market rate of N365/US$.
- The Bureau de Change (BDC) window, which currently trades at N365/US$.

5 Nigeria Foreign Exchange Fixing
6 Nigeria Autonomous Foreign Exchange Fixing.

1.3 The Monetary Sector: Monetary and Credit Aggregates, Financial Market Indicators and Inflation

Monetary and Credit Aggregates, Financial Market Indicators

14. **Monetary policy tightened in the first half of 2017.** While the Monetary Policy Rate (MPR) has remained flat at 14 percent since July 2016 and the Cash Reserve Requirement (CRR) at 22.5 percent since March 2016, monetary tightening has occurred through issuance of significant amounts of CBN securities (including the use of special Open Market Operations (OMO) to mop up large amounts of liquidity from the banking system), and the use of the CRR in a way that makes it effectively higher than the stipulated rate. Consequently, broad money (M2) contracted by 1.8 percent year-on-year (yoy) in June 2017. Year-to-date (ytd), the contraction was 7.3 percent. Credit to the private sector grew by only 2.6 percent yoy and stagnated, ytd. The Federal Government continued to borrow from both the Central Bank and the commercial banks.

15. **Monetary tightening led to high and volatile money market rates during the period.** The average interbank call rate was 65 percent in April while the average overnight rate was 50 percent (reaching as high as 200 percent on April 12). It also contributed to the slowing of inflation during the period. Headline inflation decelerated continuously for five months since February; from a peak of 18.7 percent in January to 16 percent in June 2017 (see below for broader discussion on inflation).

16. **The Nigeria Stock Exchange (NSE) All-Share Index (ASI) has appreciated continuously since February 2017**. The ASI climbed to over 30,000 in June, for the first time since September 2015, after oscillating between 23, 916 and 29, 598 in 2016. Activity benefited from the Investors' and Exporters' FX window (IEFX), introduced by the CBN in April 2017, which boosted confidence. Listed companies showed improved results in Q1 2017.

17. **Rating agencies maintained their ratings on Nigeria's long-term foreign and local currency sovereign debt**. Fitch retained the B+ rating for both foreign and local currency debt. Standard & Poor's also maintained its rating of Nigeria's long-term global scale ratings at "B" with a 'stable' outlook. Similarly, Moody's has not revised its B1 long-term issuer rating of the Government of Nigeria since Q2 2016.

Table 1.4: Monetary and Financial Indicators

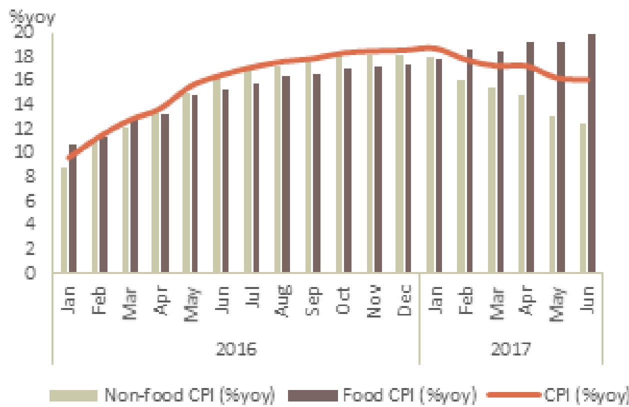
	H1 2016		H1 2017	
	YoY	YtD	YoY	YtD
Monetary & Financial Sector Indicators (% change, end of period)				
Broad Money	17.4	10.2	-1.8	-7.3
Narrow Money	45.5	11.1	3.8	-10.7
Net Foreign Assets	19.4	25.7	19.2	-7.5
Net Domestic Credit	15.0	13.9	9.3	1.0
o/w to the Federal Government (Net)	27.4	10.6	54.5	5.9
o/w to the Private Sector (Net)	13.4	14.4	2.6	0.0
	H1 2016		**H2 2017**	
Monetary Policy Rate (absolute rate, end of period)	12		14	
Exchange Rates (end of period)				
Exchange rate (LCU/$US)	283		306	
Real effective exchange rate index (Nov 2009=100)	87		83	
Financial Market Indicators (end of period)				
Stock Market (NSE) Index	29,598		33,117	
Fitch Sovereign Long Term Foreign Debt Rating	B+		B+	
Moody's Sovereign Long Term Foreign Debt Rating	B1		B1	
S&P Sovereign Long Term Foreign Debt Rating	B+		B	

Sources: Central Bank of Nigeria, Securities & Exchange Commission, Fitch, Moody's, S&P.

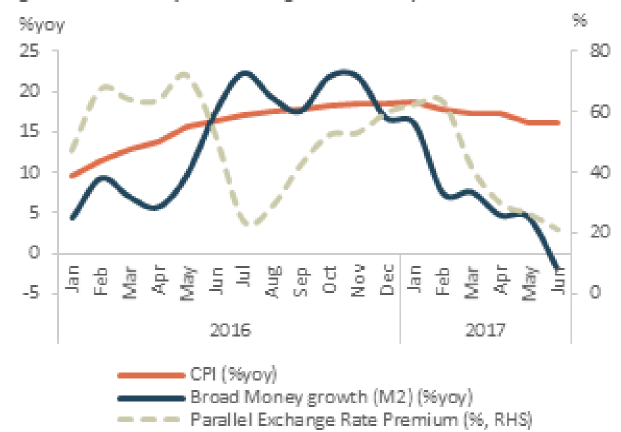
Inflation

18. **Nigeria's headline inflation slowed since February 2017**. Inflation peaked at 18.7 percent in January 2017, but slowed to 16.1 percent in June 2017. Core[7] inflation declined from a high of 18.2 percent in November 2016 to 12.5 percent in June 2017 but food inflation increased from 17.8 percent in January to 19.9 percent in June. The decline in core inflation has been largely due to favorable base effects over H1 2016, when electricity tariffs and petrol prices increased substantially, while the Naira depreciated in the parallel market. Food inflation increased partly because of the displacement of farming communities in the North-East.

7 Defined here as All items less farm produce.



Source: NBS



Source: NBS, CBN, AbokiFX

1.4 The Fiscal Accounts

Federally-Collected Revenue

19. Severe revenue shortfalls continue to hamper fiscal policy implementation. Preliminary data as at June 2017 indicate that net federally-collected revenues[8] reached only 50 percent of budget targets in the first six months of 2017[9] (compared with an average of 85 percent in the first six months of 2012-2014 and 68 percent in the first six months of 2015). Oil revenues were only 39 percent of the pro-rated budget for the six-month period, while non-oil revenues were 52 percent of budgeted amounts. While the oil price assumption used in the 2017 budget is below the actual price, oil production was lower than expected in the first half of 2017, although higher than in 2016. Oil production averaged 1.9 mb/d, compared with the budgeted 2.2 mb/d. Corporate taxes and Value-Added Tax (VAT) were also grossly under-collected relative to budget: by 61 percent and 48 percent, respectively. Administrative measures to increase non-oil revenues did not show much impact in 2017 H1. It is expected that corporate taxes pick up in the second half of the year, as most companies finalize their annual reporting at end-June of each year and remit related taxes from July.

8 This refers to revenues that were realized and distributed in the months of January to June, which represent revenues collected for the months of December to May.

9 Gross revenues net of items such as revenue collection agency fees, Joint Venture (JV) cash calls, revenues in excess of specific benchmarks (notably the excess crude oil revenue) but including the exchange rate difference, and any subsidies are deducted to arrive at the net measure, which is then distributed according to the existing revenue -sharing formulae. The reported revenues include the 13% derivation revenues shared only to the oil-producing states.

Table 1.5: Net Federation Account Revenues (in percent of GDP)

	2016			2017 Jan-June			
% GDP	**Budget**	**Actual**	**Budget Perf.**	**Budget (full year)**	**Budget (pro-rated)**	**Actual (Jan-June)**	**Budget Perf.**
Total Revenues	**5.8**	**4.2**	***72%***	**7.8**	**3.9**	**1.9**	***50%***
Oil and Gas (Net) /1	**1.7**	**1.6**	***97%***	**4.2**	**2.1**	**0.8**	***39%***
Other Extractives-related revenues and inflows /2	0.2	0.4	*n/a*	0.2	0.1	0.3	*n/a*
Non-oil Revenues (Net)	**3.9**	**2.2**	***56%***	**3.4**	**1.7**	**0.9**	***52%***
Corporate	1.7	0.9	*53%*	1.4	0.7	0.3	*39%*
Customs	0.8	0.5	*64%*	0.6	0.3	0.2	*82%*
VAT	1.4	0.8	*55%*	1.4	0.7	0.4	*52%*

Notes: /1 After first line deductions, but before derivation. /2 Includes Solid Minerals, NLNG Dividend, and Signature Bonus; unbudgeted oil revenues (exchange rate difference, excess PPT); excludes NNPC Refund and Special ECA distribution (not revenue). Not all of these items are budgeted thus budget performance is not assessed. 2017 GDP estimate is as projected by the World Bank staff.

Source: Office of the Accountant-General of the Federation (OAGF)

Federal Government Budget

20. The Federal Government's 2017 budget was approved only in June 2017. The approved budget authorizes a total expenditure of N7.4 trillion (USD24.4 billion, or 6.9 percent of GDP).[10] The allocation to capital expenditure is N2.2 trillion, which represents 29 percent of the total budgeted expenditure,[11] while the sum of N4.8 trillion, representing 65 percent of the budget, was allocated to recurrent expenditure. Statutory Transfers, with N434 billion allocated, represent 6 percent of the budget. Of the recurrent expenditure, the sum of N1.7 trillion, representing 22 percent of expenditure was allocated to external and domestic debt service.[12] The Federal Government expects to raise a total of N5.1 trillion in revenues and thus have a budget deficit of N2.4 trillion (an estimated 2.2 percent of GDP), which it expects to finance through domestic and foreign borrowing.

21. The budget passed by the National Assembly (NASS) was N143 billion (2 percent higher than the revised budget proposed by the Executive). The NASS increased the oil price benchmark from N42.50 to N44.50, which led to additional budgeted revenues for all tiers of Government. The additional revenues accruing to the federal government were mainly allocated to various capital projects. The acting President signed the budget with an understanding that there would be a budget amendment later on to address concerns raised by the Executive about some of the budget amendments made by NASS. Much like the 2016 budget, the 2017 capital budget is to be implemented from June 2017 through June 2018, unless the 2018 budget comes into effect before then.

10 If principal repayments are excluded from debt service expenditure, but rather considered as amortization of existing debt (in budget financing "below the line"), total budgetary expenditure will be N7.3 billion.

11 This is exclusive of the estimated capital component of the Statutory Transfers, which, if considered, would increase the capital expenditure component of the budget to 32 percent.

12 The Federal Government's Debt Service aggregate comprises of both principal and interest payments.

22. **The Federal Government collected only about half of its budgeted revenues in the first half of the year.** The federal government's share of oil and non-oil revenues were respectively, only 39 percent and 51 percent of budget target. Corporate taxes were only 39 percent realized and VAT only 52 percent realized. Independent revenues were only 30 percent realized. Other revenues (comprising solid mineral revenues, NLNG dividends, exchange rate difference, and excess PPT revenue) however, came in far above the budget estimates. Of the total N1.25 trillion domestic borrowing anticipated in the budget for 2017, the sum of N845 billion was raised through FGN bonds, Nigerian treasury bills and the new FGN savings bonds[13] in the first half of the year. The budget also anticipated US$3.5 billion in external borrowing. While a total of US$1.5 billion in Eurobonds was raised by the FGN in February and March, this was applied towards implementation of the extended 2016 budget. The inaugural US$300 million diaspora bonds issued in June for the financing of the 2017 budget were oversubscribed by 30 percent.

Table 1.6: FGN Fiscal Accounts (In percent of GDP)

	2016			2017 Jan-June			
% GDP	**Budget** (%GDP)	**Actual** (%GDP)	**Budget Perf.** (%Actual /Budget)	**Budget (full year)** (%GDP)	**Budget** (pro-rated, Jan-June) (%GDP)	**Actual (pro-rated)** (%GDP)	**Budget Perf. (Jan-June)** (%Actual /Budget)
Total FGN Revenue /1	**3.7**	**2.0**	**54%**	**3.7**	**1.8**	**0.9**	**51%**
Oil and Gas	0.7	0.7	97%	1.8	0.9	0.3	39%
Non-oil Revenues	1.3	0.7	50%	1.1	0.6	0.3	51%
Corporate	0.8	0.4	53%	0.7	0.3	0.1	39%
Customs	0.4	0.2	64%	0.3	0.1	0.1	82%
VAT	0.2	0.1	55%	0.2	0.1	0.1	52%
FGN Independent Revenues	1.5	0.2	16%	0.7	0.3	0.1	30%
Other Inflows /2	0.1	0.3	279%	0.1	0.1	0.2	345%
Total FGN Expenditures /6	**5.9**	**4.7**	**80%**	**6.1**	**3.0**	**2.2**	**71%**
Recurrent Expenditures (excl. Statutory Transfers)	5.9	5.3	90%	3.9	2.0	1.9	95%
o/w interest payments /3	1.3	1.2	96%	1.3	0.6	0.7	113%
Capital Expenditures /4	1.5	0.6	38%	1.8	0.9	0.2	24%
Statutory Transfers	0.3	0.3	98%	0.4	0.2	0.1	29%
Other Outflows /5	0.0	0.1		0.0	0.0	0.0	
Fiscal Balance	**-2.2**	**-2.7**	**124%**	**-2.4**	**-1.2**	**-1.2**	**101%**

Notes: /1 Total Revenue differs from FGN's computations due to World Bank excluding irregular items considered revenue by FGN but financing by the World Bank. /2 Other inflows include Mineral revenues, NLNG Dividend, Exchange rate difference, and Excess oil PPT; but excludes Balances in Special Accounts, Mopped up capital, TSA Pool Account and Paris Club over-deduction. /3 Interest rate component estimated using the OAGF Debt Service data and 2016 interest payment- to- debt service ratio. /4 The total capital expenditures for the 2016 budget carried out by May 2017 amount to N 1.1 trn (about 1 percent of GDP), however, this table reports capital expenditure in the 2016 calendar year. /5 Other Outflows include Refund to MDAs and Banks, ECA Loan Deduction, but exclude Settlement of State Coupon Payment, Mopped up Capital Refunded, Reimbursement of Paris Club over-deduction. /6 Total Expenditure also differs from FGN's computations as the World Bank excludes principal repayments from debt service expenditure and considers it as amortization of existing debt.

Source: OAGF, World Bank Staff Calculations

13 New retail investment instrument introduced in March 2017, issued monthly for tenors of 2 and 3 years.

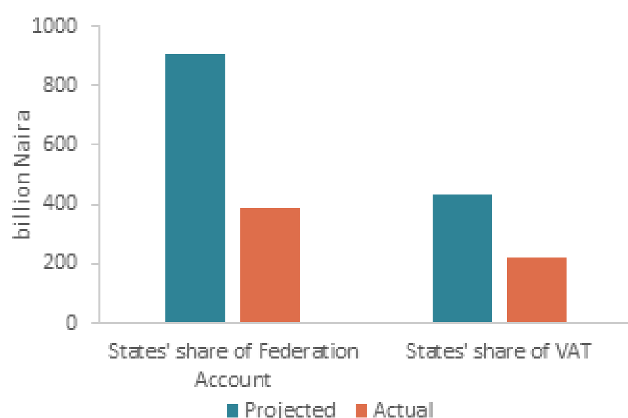
23. **Capital budget implementation was delayed by the late budget approval**. While the recurrent budget (pro-rated for six months) was 95 percent implemented, there had been no quarterly capital release under the 2017 budget as at the end of June.[14] All the capital projects executed up to this time were executed as part of the 2016 budget which was implemented up till May 5, 2017. As in 2016, the capital budget will likely be implemented well after the end of the calendar year.

State Government Fiscal Developments

24. **Statutory transfers to state governments were severely affected by revenue shortfalls.** Transfers from the federation account were 57 percent short of projected, while transfers from the VAT pool account were 48 percent short. These transfers still constituted 66 percent of total state government revenues in 2016.

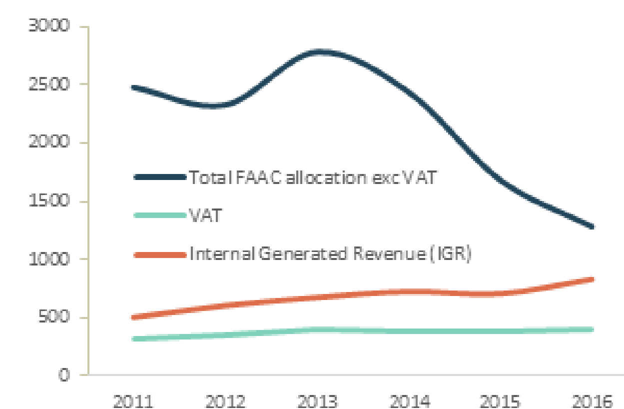
25. **In a bid to further support states to weather the fiscal headwinds, the Vice President, on June 29, 2017, approved an extension of the second financial assistance package: the 'Budget Support Facility (BSF)'**. The BSF, anchored on the 22-point Fiscal Sustainability Plan (FSP), was extended to the states from June 2016, for 12 months, and was thus meant to have fully disbursed at end-May 2017. The original facility was to be around a total of N500 billion financed by "special purpose" bonds sold to the private sector and guaranteed by the federal government in the bond market, to be disbursed in 12-monthly tranches to provide added relief from the fiscal crunch. The implementation of the FSP is in progress but remains incomplete and has not been fully enforced as conditions for receiving the monthly BSF disbursements. The BSF was authorized for extension until all state government claims on the federal government have been fully settled. Such claims would include the balance of the Paris Club over-deduction refunds due to states[15], amongst any others. A first tranche of the

Figure 1.10: Federation Transfers to States, H1, 2017



Source: OAGF.

Figure 1.11: States' Major Revenues (Naira billion)



Source: OAGF, CBN, World Bank Staff Calculations.

Note: includes all States and *FCT*.

Paris Club over-deduction refunds (to the tune of N388.3 billion) was paid to the states in late 2016 and a second tranche (to the tune of N243.8 billion) was paid in July 2017.

14 However, a sum of N133 billion (11 percent of the pro-rated capital budget) shows up in the fiscal accounts as 2017 capital spending between January and June.

15 These are long-standing claims relating to over-deductions by the Federal Government from states' Federation Account Allocation Committee (FAAC) allocations for external debt service arising between 1995 and 2002.

1.5 Socio-Economic and Welfare Indicators

26. This section provides an update on some of Nigeria's socio-economic and welfare indicators based on the 2015/2016 General Household survey (GHS). The GHS is a panel survey of 5,000 households representative at the national and geopolitical zone/regional level. The survey is a collaborative effort of the Living Standards Measurement Study and Poverty teams of the World Bank and the National Bureau of Statistics of the Federal Government of Nigeria. The teams, both Government and the World Bank, have been working together since 2010 on the GHS and have implemented a total of three waves of GHS panel; 2010/2011, 2012/2013 and 2015/2016. Data from the panel surveys allows a comprehensive analysis of welfare indicators and socio-economic characteristics, and also helps measure poverty and growth at the regional and national level. The following are key highlights of the 2015/2016 GHS Panel:

27. Demographic Characteristics: The average household size in Nigeria is 5.5 persons. Rural and urban averages are 5.9 and 4.9 persons respectively, which hasn't changed significantly since the 2012/2013 GHS. The data also reveal that households in the South tend to be smaller than those in the North: household size in the South ranges from 4.0 to 4.9 persons, while in the North the range is 5.7 to 7.9. The average number of household members have increased in the northeast by 0.6 and in the northwest by 0.5 persons.

Table 1.7: Household Size, Percentage Distribution of Individuals by Sex and Age Group

			0-5		6-9		10-14		15-64		65+		Total (by Sex)	
Region	Average HH size	Dependency Ratio	M	F	M	F	M	F	M	F	M	F	M	F
North Central	5.7	0.9	6.1	5.8	7.1	5.4	8.4	7.4	26.4	28.9	2.5	2	50.5	49.5
North East	7.9	1.1	8.4	7.1	7.5	6.7	8.5	7.6	25.9	25.6	1.8	1	52.0	48.0
North West	7.4	1.4	9.9	9.4	7.6	7.6	9.4	6.9	22.5	23.5	2.3	0.9	51.7	48.3
South East	4.3	0.8	5.5	5.1	4.7	4.4	6.2	5.3	25.6	32.7	4.7	5.8	46.7	53.3
South South	4.9	0.8	5.6	5.1	4.8	5.6	6.9	7.1	29.1	30.5	2.6	2.9	49.0	51.0
South West	4	0.9	5.8	6.3	4.8	5.3	6.6	6.5	26.6	29.5	4.1	4.4	47.9	52.1
Urban	4.9	0.9	6.6	6.4	5.4	5.9	7.2	6.7	27.2	29.1	2.9	2.8	49.2	50.8
Rural	5.9	1.1	7.7	7.2	6.8	6.2	8.3	6.9	24.7	26.9	2.9	2.4	50.3	49.7
Nigeria	**5.5**	**1**	**7.3**	**6.9**	**6.3**	**6.1**	**7.9**	**6.9**	**25.6**	**27.7**	**2.9**	**2.5**	**49.9**	**50.1**

28. The dependency ratio both in rural (1.1%) and urban (0.9%) areas remained unchanged since the last GHS. Regionally, the highest dependency ratios occur in the North West (1.4) followed by Northeast (1.1).

29. The 15 to 64 years age group (working age population) accounts for the largest share of the national population: 53.3 percent. This group is relatively evenly distributed across men (25.6%) and women (27.7%). The second largest group is the 10 to 14 years age group (41.3 percent), while the 65 and above age group constitutes 5.4 percent. . Nationally, 21 percent of the households are female headed, with the highest regional occurrence found in the Southeast (38%).

30. **Education:** Between the ages of 5 and 9, 42.7 percent and 46.4 percent of males and females, respectively, reported to be able to read and write. 91 percent of the males within the age group 20-30 reported to be able to read and write compared to 74.5 percent of females. Literacy rate among the age bracket 30+ is found to be 77.2 percent for males and 56.6 percent for females. There is an urban and rural divide, with significantly more literate individuals across all age brackets in urban areas than in rural.

Table 1.8: Percentage Reporting Literacy in Any Language by Age Group and Sex

	5-9		10-14		15-19		20-30		30+		65+	
Region	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**
North Central	32.4	32.3	70	64.5	84.5	80.6	91.6	61.1	69.7	37	35.1	6
North East	20.6	20.8	57.9	54.1	74.5	75.1	83.7	55.8	60.3	33.4	50.5	14.2
North West	32.8	35.3	67	65.9	76.3	70.6	83.2	55.5	65.2	43.8	42.2	22.4
South East	67.3	68.7	97.8	98.3	98.4	98.5	98.2	96.5	89.4	71.2	60.8	19.5
South South	61.9	67.6	84.2	90.3	96.4	98.2	95.8	96.3	86.8	71.6	67.2	23.7
South West	75.3	77.6	95.1	95.4	98.6	98.4	97.8	96.7	92.2	75.4	66.6	31.5
Urban	65.3	67.1	89	90.4	95.1	97.1	96.4	91.1	91.6	76.8	71	29.8
Rural	31.9	35.1	68.4	66.9	82	79.1	87.4	64.6	67.5	44.1	45.8	17.3
Nigeria	**42.7**	**46.4**	**75.2**	**75.3**	**86.5**	**86.2**	**91**	**74.5**	**77.2**	**56.6**	**54.9**	**22.3**

Table 1.9: Enrollment of Children 5-14 Years Old by Government/Private/Other

	Government		Private		Other		Enrolled		
Region	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**All**
North Central	69.1	63.1	26.7	30.9	4.2	6.1	84.4	84.4	82.9
North East	75.6	79.5	11	10.6	13.4	9.9	70	70	67.5
North West	87.3	85.6	6	6.1	6.8	8.3	69.2	69.2	68.1
South East	61.3	57.2	34.3	37	4.5	5.8	98.5	98.5	98.8
South South	59.3	57.4	38.5	39.9	2.2	2.7	98.5	98.5	98.2
South West	44.9	42.9	51.5	55.8	3.6	1.3	97.5	97.5	97.4
Urban	56.9	51.9	40.8	46.4	2.2	1.7	96.3	96.3	95.2
Rural	76.1	74.9	15.8	16.8	8.1	8.3	74.7	74.7	74
Nigeria	**68.7**	**65.4**	**25.5**	**29.1**	**5.8**	**5.6**	**81.8**	**81.8**	**81.2**

31. Between the ages of 5 and 14, 68.7% of the male children and 65.4% of the female children are enrolled in a type of government primary and secondary schools. Regionally, the largest gender disparity for enrollment in government schools occurs in the Northcentral with 69.1 percent for males and 63.1 percent for females. While enrollment in private schools is not as common as in government, it is most common in the South and within urban areas of the country with an overall urban enrollment of 40.8 and 46.4 percent for males and females

respectively, and 51.5 and 55.8 percent enrollment among the same in the Southwest. Data show an overall increase in government school enrollment of 1.6 percentage point for males and 0.9 percentage point for females between 2012/2013 and 2015/2016 GHS. Enrollments in private schools on the other hand have decreased by 0.9 percentage point for males and 0.1 percentage point for females from last GHS.

32. No interest in school, too young to be in school and school is too far from the household dwelling are the most cited reasons for children not enrolled in schools.

33. **Health:** 13.7% men and 15.2% women reported to be ill 4 weeks preceding the survey. 27.9% men and 28.3% women that reported illness sought care at a hospital, and 33.2% men and 35.5% women sought care from a chemist. In rural areas, there was a considerable difference between those visiting hospitals (24.6% for both males and females) and those visiting chemist (33.8% males and 35.3% females).

Table 1.10: Type of Health Facility Visited, among Those Reporting Any Illness in the Last 4 Weeks

	Hospital		Dispen-sary		Phar-macy		Chemist		Clinic		Mater-nity		Tradi-tional		No Facility	
Region	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**
North Central	33.8	31.5	3.5	4.2	3.5	1.5	18.6	22.7	29	28.1	2.6	1.2	1.7	0.8	2.2	4.2
North East	25.9	28.2	19.1	19.8	1	1	28	28.9	7.5	5.8	4.8	6.5	3.8	2.3	5.8	4.5
North West	33.6	33.6	18.5	22.1	2	2.6	28.9	28.6	3.5	3.5	1.8	0.4	2	2.4	3.5	3.3
South East	22.4	24.6	0.6	2.4	5.4	4	45.9	46.8	2.4	3.3	1.8	1.6	1.2	1.6	10.6	7.1
South South	20.3	23.9	0.7	0.3	16.1	15.3	40.6	40.7	3.8	2.8	0.3	0	2.4	0.9	3.1	0.3
South West	32.5	27.6	0.6	0	5	3.6	36.3	43.9	2.5	3.1	1.3	1	1.9	2.6	11.3	9.2
Urban	35.8	36.5	3.2	1.8	8.7	7.1	31.8	35.7	6.1	5.2	1.1	0.8	0.9	1.1	5.3	4.5
Rural	24.6	24.6	11.1	12.6	3.8	3.6	33.8	35.3	7.8	7.6	2.5	2.1	2.7	2	5.9	4.6
Nigeria	**27.9**	**28.3**	**8.7**	**9.3**	**5.2**	**4.7**	**33.2**	**35.5**	**7.3**	**6.9**	**2.1**	**1.7**	**2.2**	**1.8**	**5.7**	**4.6**

Table 1.11: Any Health Problems in the Past 4 Weeks (%)

	Ages 0-4		Ages 5-9		Ages 10-14		Ages 15-64		65+		All	
Region	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**	**M**	**F**
North Central	24.2	18.7	10.8	9.5	9.2	4.7	7.3	11.5	21.2	20.6	10.5	11.2
North East	24.7	27.5	15.2	14.5	8.7	9	7.2	11.1	33.5	27.8	12	13.6
North West	27.9	21	14.1	17.4	9.8	7.9	10.2	13.7	25.9	25.8	14.2	15
South East	35.6	31.8	23.7	22	16.3	15.6	15.7	22.6	42.3	59.8	21.4	26.6
South South	28.2	24.8	14.7	13.6	14.2	10.4	12.1	15.8	32.2	44.7	15.3	17
South West	17.1	14.1	10	6.9	10.4	5.6	8.1	10	27.9	31.7	11.2	11.3
Urban	25.3	20.1	16.5	14.2	14.6	7.7	10.3	13.8	30.7	38.9	14.6	15
Rural	26.3	22.6	12.9	14	8.9	8.5	9.6	13.8	30.1	38.9	13.2	15.4
Nigeria	**26**	**21.8**	**14.1**	**14.1**	**10.8**	**8.2**	**9.9**	**13.8**	**30.3**	**38.9**	**13.7**	**15.2**

34. Two thirds of the healthcare expenditure (74.7% for male and 71.3% for female) is spent on drugs and the rest on consultation. There were no sizeable changes in the distribution of expenditures in the country as a whole, although there were some shifts at the zonal level; share of expenditure on drugs increased for males in Southeast and South-south but decreased for females in the northern zones.

35. 39.4% of the boys and 35.4% of the girls are stunted nationally. 33.4 percent of the boys and 29.5 percent of the girls are stunted in the urban areas compared to 42.2 percent of the boys and 38.5 percent girls in the rural areas. Nationally, 22 percent of the boys and 16.8 percent of the girls are underweight.

36. Housing Characteristics: 68.5% of the households own their dwelling and 16.6% rent. 86% households in urban and 41% in rural areas have access to electricity.

37. ICT: 89% of household members over 10 years old have access to a mobile phone. 29% of the household members of the same age group in urban areas and 9.8% in rural areas have access to internet. Respondents most commonly use internet for email exchanges (45.8%).

38. Food Security and Shocks: Food shortages are reported to be seasonal. January and February are the months that pose the biggest risk of food insecurity. 26% of the households reported to reduce the number of meals taken in the 7 days preceding the survey. Major shocks that negatively affected the households include increase in food price (12.4%), increase in price of inputs (3.6%), death or disability of working household income (5.7%), and nonfarm enterprise failure (3.1%). The most common coping mechanisms are reported to be receipt of assistance from family and friends (24%) and reduction in food consumption (23.6%).

Chapter 2: Economic Outlook

2.1 Economic Outlook

Growth

39. **Economic growth is expected to remain positive in the second half of 2017, averaging about 1 percent for 2017**. Growth is expected to be driven by a recovery of oil production, sustained growth in agriculture, and the positive impact on investment and other private sector activities from improved availability of foreign exchange to support imports. A small downward revision from our earlier forecast arises from lower than expected oil production, highlighting the downside risks of the economy's dependence on oil. As the government begins to implement the structural reforms outlined in the Economic Recovery and Growth Plan 2017-2020, growth can be expected to strengthen further in the medium term, reaching about 2.8 percent by 2019.

40. **The Federal Government's Economic Recovery and Growth Plan envisages higher oil and non-oil growth.** World Bank staff expect economic growth reaching 2.8 percent in 2019, compared to 4.5 percent expected by the Government (Tables 2.1-2.2). The World Bank baseline projections take into consideration several risks, including to the level of oil production and the availability of foreign exchange, and sluggishness in agriculture because of the ongoing crises in the North East and the regional floods affecting agricultural production. Finally, the World Bank projects a much slower recovery of the services sector.

41. **Inflation is projected to remain high, declining slowly in the short-to-medium term.** Inflationary inertia is expected to continue to put pressure on prices, because of as-yet incomplete pass through of higher fuel and electricity prices, and monetization of fiscal deficits. Imported goods' prices remain sticky even after the appreciation of the Naira in the parallel foreign exchange market. Food inflation is expected to remain high, due to both slower growth in agricultural production, the restrictions on several key imported food items, and disruptions in several regions.

42. **Private consumption is expected to continue to contract slightly in 2017.**[16] Consumption is negatively affected by high unemployment following the recession and high (especially food) inflation. Consumption should recover slowly in the medium term as growth picks up and inflation continues to decline. Projections indicate that the poverty rate will continue to rise during 2018 and 2019 but at a slower pace than in the past.

16 Note that 2016 demand-side GDP numbers are World Bank staff estimates, as the data are not yet available from the NBS.

Table 2.1 World Bank Growth Projections

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant factor prices	6.2	2.8	-1.6	1.0	2.5	2.8
Agriculture	4.3	3.7	4.1	4.0	4.9	5.1
Industry	6.8	-2.2	-8.9	2.2	3.3	4.2
Services	6.8	4.8	-0.8	-0.9	1.0	1.0
Inflation (Consumer Price Index)	8.0	9.0	15.7	16.3	14.8	13.9

Source: World Bank, IMF

Table 2.2: ERGP Growth Projections

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant factor prices	6.2	2.8	-1.6	2.2	4.8	4.5
Agriculture	4.3	3.7	4.1	5.0	7.0	7.2
Industry	6.8	-2.2	-8.9	7.7	6.1	6.1
Services	6.8	4.8	-0.8	3.2	2.5	5.8
Inflation (Consumer Price Index)	8.0	9.0	15.7	15.7	12.4	13.4

Source: Government of Nigeria (Economic Recovery and Growth Plan (ERGP) 2017-2020 Document)

Balance of Payments

43. The current account is expected to remain in surplus in the short-to-medium term. Exports are expected to grow in line with the recovering oil and gas production and the projected increase in oil prices in 2017 and 2018. In 2017, non-oil exports are expected to maintain the strong growth rates exhibited in the first half of 2017, and then grow in line with agricultural production in the medium term. Imports are expected to continue to grow, in line with the recovering industrial production and gross capital formation, as well as higher prices for imported petroleum products. The positive trend in oil exports and imports is expected to be reversed once the new private sector oil refinery becomes operational (expected in 2019-2020). However, the net overall effect on the trade balance will depend on the configuration of the refinery[17].

Government Fiscal Operations

44. The implementation of the 2017 Federal Government budget and the Medium-Term Expenditure Framework will be challenging given the expected severe revenue shortfalls. In particular, based on the data of the first 6 months of revenue collections, non-oil revenues are expected to fall short of their ambitious revenue targets: the VAT and Corporate revenues by about half, Special levies by about a third, with only Custom revenues coming in at just slightly under the budget targets. Combined with the expected arrears clearances, this will increase the fiscal deficit, and public debt, which stood at around 17 percent of GDP at the end of June 2017. The fiscal deficit is expected to widen further in 2018, with settlement of arrears and power sector reform.

17 Refinery economics are complex and subject to large swings (booms and busts). There are years when refineries make large losses globally. During such periods, it may be more economic to import refined products than to refine domestic crude. What is important for economic efficiency is that all refineries pay market prices for crude oil, and sell their products at trade parity (export or import parity, depending on the trade status of each product). Assuming the domestic refineries are efficient and competitive, domestic refining can save the costs of ocean shipping of refined products.

45. **The Federal Government is expected to continue its efforts to shift the deficit financing away from the domestic markets.** In addition to US$ 1.5 billion of Eurobonds issued in the first quarter of 2017 and the $300 million diaspora bond issued in the second quarter, the government is expected to move toward the target of a 60/40 split between domestic and foreign financing. **State governments' spending is also likely to continue to be subdued in 2017 if FAAC transfers remain relatively low.** While States' total inflows are expected to increase relative to 2016, including through receipts from FAAC for Paris Club over-deductions, the overall increase is likely to be limited with the projected federally collected revenue shortfalls. As States will continue to be constrained in borrowing from commercial banks and domestic capital markets, we can expect total expenditures to also be constrained – unless the accumulate further domestic arrears..

46. **In the medium term, the critical non-oil revenue growth will remain constrained by lack of reforms in tax policy and administration.** Tax administration reforms and a tax amnesty launched in July 2017 are expected to have only a moderately positive impact in the short and medium term (please see Section 2.2 for more detail).

2.2 Risks to the Recovery

47. **The prospect of sustained positive economic growth remains contingent on a sustained recovery of oil production, and the absence of shocks to agriculture.** Although the Niger Delta security situation has improved, oil production remains vulnerable to disruptions. In the first half of 2017, oil production was on average 0.4 mb/d below the Government's projection.

48. **Given the unorthodox exchange rate policies, the exchange rate stability and the parallel market premium depend on recovering oil exports and external financial inflows.** External shocks to foreign exchange earnings may lead to a recurrence of disruptive foreign exchange shortages. The segmentation of the foreign exchange market will continue to create distortions, inefficiencies, and opportunities for rent seeking. Further policy adjustments towards a more transparent and liberal exchange rate regime, including the removal of the foreign exchange restrictions and reduction of foreign exchange market segmentation, would reduce the forex dependence on favorable external conditions, and limit the negative spillovers to the economy.

49. **The prospects of impactful tax policy reforms remain low in light of the 2019 elections.** The limited non-oil revenue mobilization efforts sustain the chronic fiscal policy vulnerability to oil revenue fluctuations. The continued financing of government deficit by the CBN and commercial banks crowd out private sector credit and puts pressure on the CBN's balance sheet. The lack of conditionality in bail-out disbursements to state-governments may reduce the incentives for meaningful fiscal reforms at the state level of government, potentially further increasing fiscal risks.

2.3 ERGP Implementation update: Developments in Priority Areas

50. **The Federal Government's Economic Growth and Recovery Plan (ERGP) 2017-2020 identifies structural weaknesses in the economy**. It lays out a comprehensive strategy for achieving short-term economic recovery. It also shows the Government's vision of structural reforms aimed at diversifying the economy and setting it on a path toward sustained and inclusive economic growth in the medium-to-long-term.

51. **There was some progress in key structural reform areas identified in the ERGP over the past year.** Some highlights include:

- **Fiscal policy and Governance**: Treasury Single Account (TSA) provides increased transparency on Federal Government's revenues and cash flows; public monthly financial and operational reports increased NNPC transparency of the NNPC; Federal and States' governments' agreements on Fiscal Sustainability Plan and Open Government Partnership principles stand to improve sub-national coordination (see Chapter 3 for details).
- **Access to finance:** in addition to CBN's several directed financing schemes (such as the Anchor Borrowers Program for farmers and MSME fund), the Secured Transactions in Moveable Assets Bill (gazetted in May) provides the legal framework for the movable collateral registry at the CBN and should facilitate access to finance for SMEs. The Federal Competition and Consumer Protection Bill (also passed in May) is expected to contribute to enabling business environment.
- **Oil and Gas** Sector benefitted from improvements in the Niger Delta security situation, progress in settlement of Joint-Venture Cash Call arrears and in passage of the Petroleum Industry Governance Bill by the Senate.
- **Job Creation, with special focus on Youth,** can be expected to benefit from private sector credits and grants (such as GEEP), targeted skill building programs (such as YESSO, N-Power, and Life Skills training).

52. **However, the window for further concrete policy action is gradually closing as the country approaches a new election season.** A number of the associated sector strategies remain to be developed, and meaningful buy-in from subnational governments is not very evident. Below is the review of two parts of the plan that can be seen as the backbone of ERGP: power sector reform, where the progress is visible; and domestic revenue mobilisation, where more decisive actions are needed.

Power Sector Recovery

53. **The power sector is in crisis, both in terms of service delivery and as well as its financial situation**. The accumulated financial deficit of the sector reached US$2.6 billion at end-2016. The poor financial situation of the eleven distribution companies (DISCOs) coupled with their highly-leveraged balance sheets, severely constrain their ability to access commercial financing. This in turn hampers their ability to invest to reduce losses and improve reliability. Since generation companies (GENCOs) are not being paid in full, they are not able to meet their operational costs and payment to gas suppliers. Poor governance and associated poor transparency and accountability, together with lack of financial viability, lead to lack of enforcement of laws, regulations and contracts.

54. **The Power Sector Recovery Program (PSRP) approved in March 2017 aims to restore financial viability while improving transparency and service delivery.** It seeks to de-risk the power sector to mobilize private sector investment along the entire value chain. It is a comprehensive package of policy, legal, regulatory, operational, and financial interventions. The PSRP envisages measures to contain costs and manage contingent liabilities so as to ensure affordability of tariffs. Tariffs are expected to be raised in a phased manner to reach full cost recovery by 2021. During the transition period, the gap between tariff revenues and actual costs (i.e. the "tariff shortfall") is to be fully funded by the Government to ensure no further deficit is accumulated and existing arrears are settled.

55. The key challenge of the PSRP will be in implementation. Building on the lessons of past reform efforts, the PSRP has several distinguishing features:

- improving governance and institutional effectiveness to ensure that mechanisms to improve performance and efficiency in the power sector are fully enforced;
- strong commitment of reformists in the Government to chart a comprehensive action plan for recovery of the sector;
- it embraces Government's role in a privatized power market including the role of public funding in meeting the required revenues of privatized companies until tariffs reach cost recovery levels;
- strong emphasis on stakeholder engagement and communication to generate consensus building and acceptance of reforms;
- a concerted effort to promote rural electrification through a complimentary program of off-grid solutions.

56. There is some progress in the implementation of the PSRP. This includes appointment of competent commissioners for the regulatory agency NERC, and funding allocation in the 2017 budget for the electricity purchased by Ministries, Departments and Agencies. A Delivery Unit has been set up to monitor the PSRP.

Domestic Revenue Mobilization

57. Increasing the insufficient level of public investment and social spending in Nigeria requires substantially higher revenue collection. Weak global oil prices and stagnating domestic oil production mean Nigeria can no longer rely on oil revenues. However, Nigeria's non-oil revenue collection is extremely low. In 2016, corporate taxes reached only 1 percent of GDP, excises a negligible 0.04 percent, and VAT only 0.8 percent of GDP, compared to 5 percent on average in Africa and 6-8 percent globally.

58. Weak non-oil revenue collection is a result of sub-optimal tax policy and weak tax administration. The VAT system illustrates this clearly:

- Nigeria's VAT rate of 5 percent is the lowest in the Africa region (average 16 percent);
- Nigeria's VAT collection efficiency (i.e. actual vs. potential) is at 18 percent, compared to 33 percent on average in Africa, due to exemptions (only 40 percent of consumption is subject to VAT) and weak VAT administration with compliance below 50 percent.

59. So far, the Government is relying on strengthening tax administration to increase non-oil revenues. Most notably, FIRS tax and Customs administration reforms aimed at taxpayer registration bringing in 800,000+ new taxpayers, Intensified CIT audits, Stamp duty machines rolled out in every state, VAT automation, and Enforcement of VAT remittances from States. This is necessary but not sufficient, as can be seen in the first half of 2017, when non-oil revenue collection only reached 50 percent of budget target.[18] The Voluntary Asset and Income Declaration Scheme that has recently been launched may boost revenues, but only temporarily.

18 The discussion refers to revenues in nominal terms. While the economic recession could have negatively affected the revenue collection in real terms, with high inflation and positive nominal GDP growth the nominal revenues would still be expected to increase.

60. **Strong tax policy reforms are urgently needed in addition to administration efforts**. Increasing the VAT rate – this would have the biggest revenue impact - may not be feasible in the short term as it requires legislative action[19]. However, impactful measures can still be implemented through executive actions in the near-term:

- Reduce VAT exemptions so that only goods that are consumed mostly by the poor such as publicly provided health and education and unprocessed staple foods are exempt. Limit zero rating to exports only. These measures could raise additional 1 percent of GDP without increasing the rate;
- Increase excise rates on alcohol and tobacco – could raise additional 0.2 to 1 percent of GDP (depending on how the size of the increase);
- Rationalize tax incentives that erode the corporate tax base without clear economic benefits and eliminate discretionary power to grant tax incentives;
- At the subnational level, additional revenue gains could be made from state/local government reforms such as a review of property taxes.

61. **The Federal Government should also support States to strengthen their IGR efforts to boost their ability to do development spending at the state level**. Subnational governments historically were responsible for about half of the total public spending, and crucially, the majority of service delivery. States and Local governments' active role and contributions to structural reforms spelled out in the ERGP are essential in diversifying the Nigerian economy away from its chronic dependency on oil sector and placing the country on a more sustainable growth path.

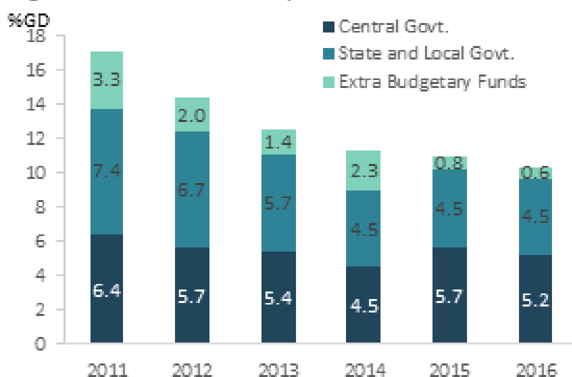
19 Private sector actors argue that the Government needs to improve the workings of the VAT by improving the refund process of input VAT before considering an increase in the VAT rate.

Chapter 3: States' Fiscal Performance

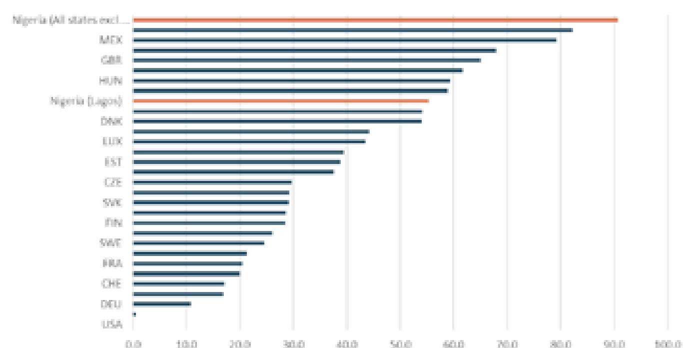
3.1 The Role of States[20] in Fiscal Management

62. **Nigeria's Federal System comprises of three tiers of government: Federal, 36 State governments and FCT, and 774 local governments**. The sub-national fiscal framework in Nigeria consists of expenditure responsibilities and tax assignments, inter-governmental fiscal transfers (federation and VAT accounts revenue sharing according to specific formulae and mechanisms), and a fiscal policy framework that seeks to ensure overall macroeconomic stability. The expenditure responsibilities and tax assignments are established by the 1999 Constitution and other relevant legislation and policies. Inter-governmental fiscal transfers are based on revenue allocation formulae proposed by the Revenue Mobilization Allocation and Fiscal Commission and approved by the National Assembly. The FGN established a framework to control fiscal deficits and public sector borrowing through the Debt Management Office (DMO) Act of 2003, Federal Fiscal Responsibility Act (2007), Investment and Securities Act (2007), and External and Domestic Borrowing Guidelines (2012, revised).

63. **Subnational governments are responsible for over 40 percent of public expenditure but majority of their revenues are statutory transfers from the Federation Account**. State and local governments together are responsible for an average of 43 percent of total public expenditure (2011-2016) (Figure 3.1) and the lion's share of spending in health and education. However, the majority of revenues, including oil and gas and main non-oil taxes (corporate income tax, excises), are collected by the FGN into the federation account to be subsequently shared to different tiers of government as statutory transfers; VAT is collected by both FGN and States, but pooled and distributed by FAAC to the different tiers of government. Revenues collected *and* maintained by States - known as internally generated revenues (IGR)[21] – represented only 4 percent of total public revenues in 2011 and only 9 percent of total revenues accruing to the States (excluding Lagos[22] and FCT). The States' vertical fiscal gap (defined



Source: *IMF Staff Calculations*



Source: OECD, IMF, Central Bank of Nigeria, and World Bank Staff Calculations; Note: For Nigeria, only State Governments are included (Local Governments are excluded from the calculations)

Vertical Fiscal Gap = [%SG Spending - %SG Revenues]/[%SG Spending]

20 For the analysis in this Chapter, FCT is included so All States refer to 36 States and FCT.
21 In 2016, 57 percent of IGR came from pay-as-you-earn (PAYE), 24 percent from state agency fees, 4 percent direct assessment, 3 percent road taxes and 13 percent other taxes.
22 Lagos revenue structure is markedly different from the other 35 states as it raises significantly higher IGR. IGR represented 63 percent of total revenues to Lagos in 2011.

as [State Government (SG) share of Spending (%)- SG share of Revenues (%)] / [SG share of Spending (%)]) is larger than in all OECD countries in 2011 (Figure 3.2). In Peru, which has the largest vertical fiscal gap in the OECD, subnational governments are responsible for 40 percent of spending while collecting 10 percent of tax revenue[23].

64. The subnational fiscal framework provides limited safeguards for prudent fiscal management and incentives for good fiscal performance at the state level. First, there are weak fiscal transparency and accountability mechanisms. Approved budgets are in many cases not publicly available, or when they are, the contents are not very clearly presented. States are not required to account for actual expenditures to the FGN, and budget implementation reports and annual audited financial statements are mostly not published at all or published with a significant time lag. The absence of regular reliable and accurate financial reporting not only hinders evaluation of public expenditures but also monitoring of fiscal performance and risks. On the revenue side, the incentive to improve IGR collection has been low, given the relative size of statutory transfers, and when States have been able to borrow relatively freely to finance spending. Apart from Lagos, the tax administration systems at the state level are generally weak with limited investment made into them[24]. In terms of expenditures, there are no fiscal rules to limit the annual growth in recurrent spending or to ensure that capital spending and other development spending is prioritized.

65. There are several formal rules on public sector borrowing at the State level, but many guidelines and rules were not fully adhered to before May 2015. Key rules include the following: (1) no commercial bank borrowing without approval from the Federal Ministry of Finance[25]; and (2) liquidity and solvency debt thresholds where States should only be able to borrow externally and from the domestic capital markets if their debt stock to revenue ratio is less than 50 percent[26] *and* their debt service to revenue ratio is less than 40 percent[27]. However, adherence and enforcement of these guidelines was weak, with some States borrowing from commercial banks without prior approval before May 2015. In addition, there is an absence of controls on domestic arrears accumulation – salaries/pensions and contractor payments.

3.2 Historical performance 2011 to 2014[28]

66. The fiscal performance of States (Figures 3.3-3.8) during 2011-2014 made them vulnerable to the macro-fiscal shocks of 2015-16. In nominal terms, total state revenues stagnated between 2011 and 2014 and fell as a share of national GDP. Total revenues of all States increased from 2011 levels in 2012 and 2013 before falling back again to 3.57 trillion Naira in 2014. It declined from 5.5 percent of national GDP to 4.0 percent as FAAC allocation (mostly oil revenue sharing) fell from 3.9 percent to 2.7 percent of GDP, while VAT and IGR stagnated at 0.4 and 0.8 percent of GDP. IGR in all States except Lagos and FCT increased only slightly from an average of 9 percent of total revenues in 2011 to 14 percent in 2014; statutory transfers remain more than three-quarters of revenues. In only two States (Rivers with 31 percent

23 'Peru: Building a More Efficient and Equitable Fiscal Decentralization System', World Bank, 2017
24 With the downturn in statutory transfers since the oil price decline starting in 2014, many more states are investing more in their tax administration systems.
25 DMO Act, 2003, Section 24; Domestic Borrowing Guidelines, 2008-2012, paragraph 2.2.4; Revised External and Domestic Borrowing Guidelines for Federal and state Governments and their Agencies, 2012, Section G, paragraph a.
26 ISA, 2007, Sections 222-223; Revised External and Domestic Borrowing Guidelines for Federal and State Governments and their Agencies, 2012, Section F, paragraph c.
27 Revised External and Domestic Borrowing Guidelines for Federal and State Governments and their Agencies, 2012, Section F, paragraph f; External Borrowing Guidelines, 2008-2012, paragraph 2.2 (iii); Domestic Borrowing Guidelines, 2008-2012, paragraph 2.2.4.
28 See Appendix 1 for detailed States fiscal table. Figures in this section are WB Staff calculations using State fiscal data from NBS and CBN and State debt data from DMO.

Figure 3.3 Revenue and Grants - All States (Billion Naira)

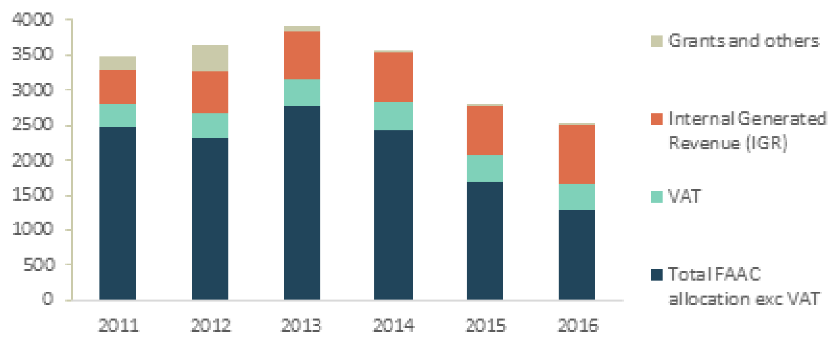
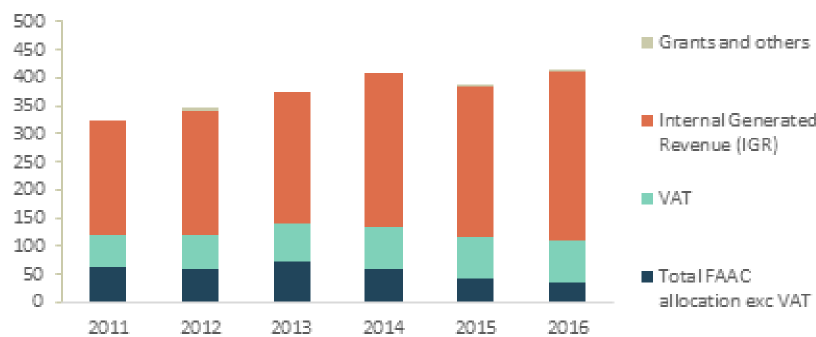


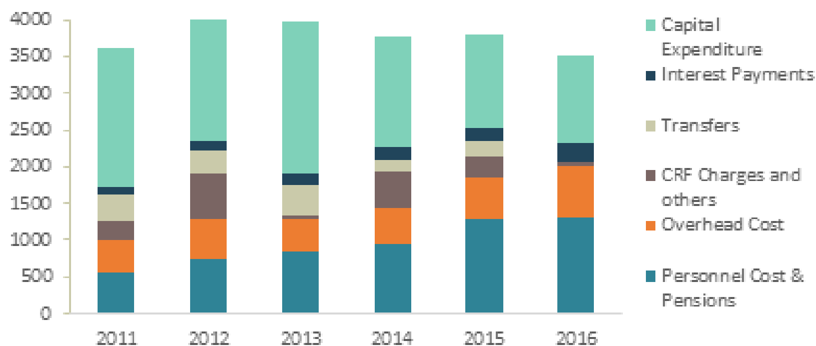
Figure 3.4 Revenue and Grants - Lagos (Billion Naira)



and Lagos with 68 percent), IGR represented more than 30 percent of revenues in 2014.

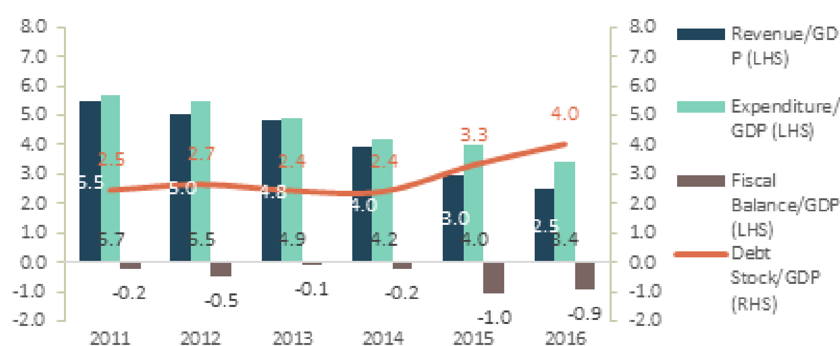
67. **With limited growth of the resource envelope, state expenditures stagnated and declined as a share of national GDP.** Total expenditures of all States increased from 2011 levels in 2012 and 2013 before falling back to 3.76 trillion Naira in 2014. It declined from 5.7 percent of national GDP to 4.2 percent in 2015. During this period, recurrent spending increased from 48 percent to 60 percent of total spending, driven by increase in personnel spending, while capital spending fell from 52 percent to 40 percent of total spending. In nominal terms, capital spending declined from 1.9 trillion Naira in 2011 to 1.5 trillion Naira in 2014, while person-

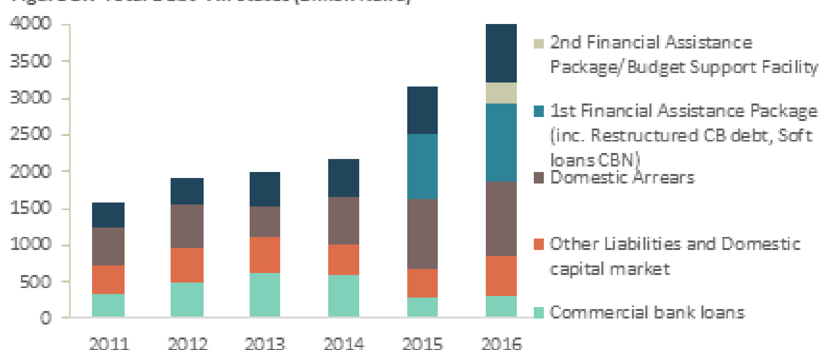
Figure 3.5 Total Expenditure - All States (Billion Naira)



nel spending increased from 0.55 trillion to 0.94 trillion.

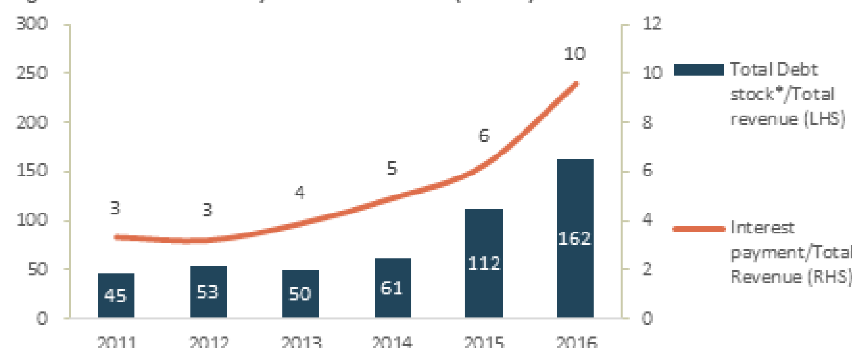
68. **The fiscal deficit for all States (aggregated) remained below 0.5 percent of GDP during 2011-2014 and the total debt stock for all States (aggregated) remained constant around 2.4-**





2.5 percent of national GDP. The composition of debt shifted towards commercial bank loans, which increased from 22 percent of total debt to 27 percent by 2014 as States borrowed relatively freely from commercial banks during 2011-2013. Domestic arrears stayed significant throughout the period at an average 29 percent of debt. Both commercial bank loans and domestic arrears were typically short-term, with the principal repaid or rolled over within one year.

69. **While the total State Debt to GDP ratio remained constant as a share of GDP, the relative decline in revenue has meant that Debt to Revenue and Interest Payment to Revenue ratios for all States (aggregated) increased significantly.** The Debt to Revenue ratio for all States (aggregated) increased from 45 percent in 2011 to 61 percent in 2014, higher than the debt threshold rule of 50 percent. Individually, 17 States (including FCT) had a Debt to Revenue ratio higher than 50 percent in 2014. The annual interest payment to revenue ratio for all States (aggregated) increased from 3 percent to 5 percent. Annual debt service payments excluding arrears to revenue ratio is estimated to have increased from 18 percent in 2012 to



29 percent in 2014. Including arrears, debt service to revenue ratio is estimated to have increased from 32 to 41 percent in the same period.

3.3 Recent historical performance 2015-16[29] and Financial Assistance to States

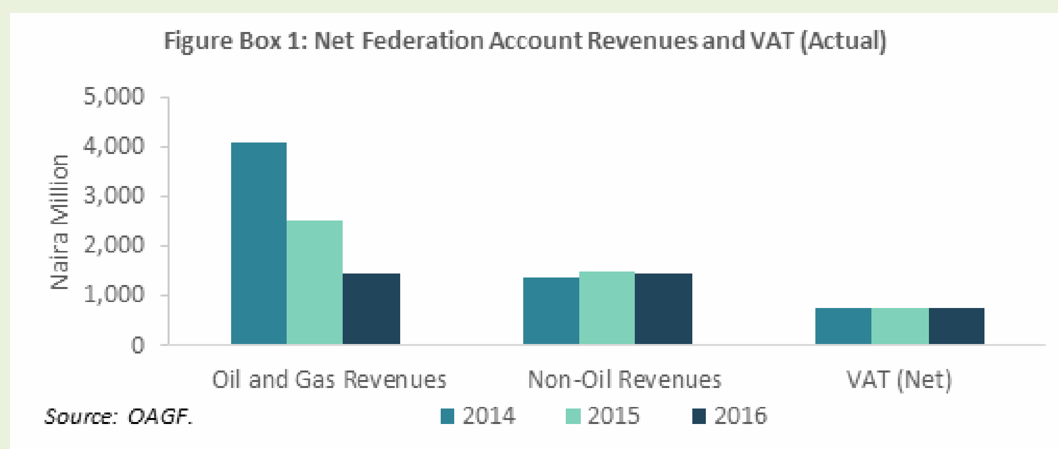
70. Government revenues are dominated by oil - representing around three quarters of total revenue prior to 2015. This dependency was not adequately addressed during the boom years so that total government revenues, which were already low at 10.5 percent of GDP in 2014, declined to 5.2 percent of GDP in 2016. Unlike the previous crisis in 2008, there were insufficient buffers accumulated in the Excess Crude Account (ECA) to play a counter cyclical role. The collapse of oil revenues translated into significant revenue shortfalls at all tiers of government in 2016 (See Box 1).

Box 1: Decline in Federation Account Revenues, Stagnation of Non-Oil Revenues and VAT

Net* 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 FGN (of which FGN retains 48.5 percent after transfers to special funds and the Federal Capital Territory (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, value-added tax (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.

Net Federation Account revenue nearly halved, falling from N5,462 billion in 2014 to N2,902 billion in 2016. This sharp drop was entirely driven by the decline in oil and gas revenues because of (a) the decline in global oil prices (from US$100.8/bbl in 2014 to US$45.2/bbl in 2016); and (b) the lower oil production in 2016 (from 2.2 mb/d in 2014 to 1.8 mb/d in 2016).

Collection of non-oil revenues and VAT stagnated throughout this period. The targets for non-oil revenues in 2016 had been increased ambitiously; but without any significant tax policy reforms, actual revenues did not increase, despite many efforts to strengthen tax administration. Only 56 percent of the budgeted amount of non-oil revenues was collected and only 55 percent of the budgeted VAT amount was collected.



* From gross revenue items, such as revenue collection agency fees, 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 per the formulae described.

29 See Appendix 1 for detailed States fiscal table. Figures in this section are WB Staff calculations using State fiscal data from NBS and CBN, and State debt data from DMO.

71. The reduction in statutory transfers led to a fiscal crisis among the States in 2015-16. Total revenue to GDP ratio for all States (aggregated) fell from 4.0 in 2014 to 3.0 percent in 2015, driven by a decline in FAAC allocation (excluding VAT) from 2.7 to 1.8 percent of GDP. VAT and IGR collection did not increase sufficiently to offset this decline. As total state expenditures fell only slightly from 4.2 in 2014 to 4.0 percent of GDP in 2015, the fiscal deficit increased significantly from 0.2 percent of GDP in 2014 to 1 percent in 2015. While total expenditure in nominal terms stagnated in 2015, States reported 38 percent higher personnel spending in 2015 than compared to 2014, while there was a 16 percent drop in capital spending – for the first-time personnel spending outstripped capital spending. As total revenue further declined to 2.5 percent of GDP in 2016, States had to reduce their expenditures – from 3.8 trillion Naira (4 percent of GDP) to 3.5 trillion Naira (3.4 percent of GDP) to maintain their fiscal deficit below 1 percent. The spending cuts recorded mostly came from transfers and capital spending, which fell to 1.2 trillion Naira, nearly a third lower than it was in 2011.

72. Increased borrowing needs saw total State debt increase from 2.4 percent in 2014 to 4.0 percent of GDP by the end of 2016. Total State debt increased from 2.17 trillion Naira in 2014 to 4.1 trillion in 2016[30]. Domestic arrears on contractor payments pensions and salaries increased significantly from 660 billion Naira in 2014 to over 1 trillion Naira in 2016, which would have impacted negatively on public service delivery. Commercial bank loans were restructured during the first set of financial assistance to States so declined from 583 billion Naira to 300 billion Naira. At the end of 2016, debt is estimated at just over 1 trillion Naira from the first FG financial assistance package and at just under 300 billion Naira from the second package (Budget Support Facility). External loans also increased from 519 billion Naira to 904 billion Naira.

73. The Debt to Revenue ratio for all States (aggregate) nearly doubled in one year to 112 percent in 2015 and increased further to 162 percent in 2016, when all States (including FCT) are estimated to have breached the formal debt threshold of 50 percent. The annual interest payment to revenue ratio for all States (aggregated) increased from 5 percent to 10 percent. However, annual debt service payments excluding arrears to revenue ratio fell from 29 percent in 2014 to 20 percent in 2016 due to the restructuring of short-term commercial bank debt into longer-term instruments. Including arrears, debt service to revenue ratio is estimated to have increased from 41 percent to 50 percent in the same period.

74. The States' fiscal crisis led to two financial assistance packages by the FGN. The first financial assistance package was approved in July 2015 with no conditions attached for accessing the funds to the States. It included restructuring of existing short-term commercial bank loans into longer-term state bonds guaranteed by the FG with 23 States participating for a total of N573 bn (individual state amounts varied) in 2015, soft loans from CBN, and Excess Crude Account-backed loans (state amount varied). As the States' fiscal situation continued to worsen in 2016, affected by the overall macroeconomic situation, a second assistance package was needed. The second package, called the Budget Support Facility, was accompanied by the Fiscal Sustainability Plan (FSP) – a plan of 22 fiscal management reform actions - see Appendix 2 for details. Financed by special purpose government bonds sold to the private sector and guaranteed by the FGN, an estimated total of N489 bn was released to 35 states (excluding Lagos and FCT) in monthly disbursements over 12 months (June 2016 to May 2017). The monthly disbursements to each state were supposed to be conditional on progress

30 2016 debt stock was derived from DMO data augmented with estimates of the second financial assistance program: the Budget Support Facility assuming participation from 35 States.

against each of the States FSP action plans[31]. While the second assistance package disbursements were to last only for 12 months - to the end of May 2017 - the reforms in the FSP are supposed to be sustained over the long-term.

75. The FSP is comprehensive in scope and tries to address many of the key fiscal management weaknesses at the state-level: weak fiscal transparency and accountability; poor IGR mobilization; inefficiencies in public spending; and weak compliance with debt management rules. If implemented successfully, the actions should strengthen States' fiscal transparency, accountability and, ultimately, sustainability. The FSP reforms also reinforce each other with increased fiscal transparency and accountability contributing to sustainability by enabling monitoring of adherence to fiscal and debt rules, identification of fiscal pressures and risks, as well as underpinning improvements in the effectiveness of spending. Improving IGR performance will serve to increase the States' total actual expenditures against budgets (thereby improving budget credibility), and make fiscal outcomes less vulnerable to shocks in oil revenue volatility. The actions to rationalize recurrent expenditure will help states to reduce borrowing requirements when faced with revenue shortfalls and protect capital expenditure. The debt management actions seek to strengthen compliance with existing debt/borrowing rules and complement with actions that support access to the domestic capital market for longer-term financing. The actions build on various PFM reforms which have been and are being undertaken by States, solidifying them into a set of common standards for fiscal management for all States.

76. In parallel to the FSP, the Government has committed to the Open Government Partnership (OGP) which should strengthen further fiscal transparency and accountability mechanisms. In May 2016, President Buhari announced Nigeria's joining of the OGP initiative. A Secretariat under the Ministry of Justice and a Steering Committee have been established, comprising MDAs, civil society representatives and organized private sector and professional associations. 14 national commitments at federal level, to be implemented from January 2017 to December 2019, have been identified, with 5 of them promoting fiscal transparency, open procurement, open contracting, access to information, asset disclosure, citizen engagement and empowerment. As some of the underlying principles of OGP (at least seven out of the 14 commitments) can be applied to States in Nigeria, there are initiatives to pilot the principles. States agreed to commit to the OGP at the National OGP Retreat in Kaduna on October 24, 2016. Application of key OGP principles in States should enhance service delivery efficiency and effectiveness, reduce corruption through better accountability and transparency, and empower citizens better.

3.4 The Case for Sustaining State Fiscal Reforms[32]

77. The need to strengthen fiscal performance and sustainability remain, as fiscal conditions are likely to remain challenging in the medium-term. With no further fiscal consolidation, States' fiscal and debt sustainability will likely continue to deteriorate. At present, States remain under considerable fiscal stress, with States requesting continuation of the Budget Support Facility beyond the original end date of May 2017. Under assumptions of a fragile economic recovery (with slightly higher oil price and production) and assuming no significant increase in non-oil revenues collected federally or by the States (IGR), total State

31 And a monthly FAAC allocation threshold falling below N500 billion. Total gross allocation is defined as follows: statutory allocation, distribution by NNPC, distribution from foreign excess crude saving account to SURE-P, exchange gain difference, and VAT to be distributed to beneficiaries including federal, state, local government, derivation funds, Nigeria Customs Service (NCS), Excess Crude Account, FIRS, and Excess revenue and subsidy account.

32 See Appendix 1 for detailed States fiscal table. Figures in this section are WB Staff calculations using State fiscal data from NBS and CBN, and State debt data from DMO.

revenue is projected to increase slightly to 2.8 percent of GDP by 2018, but will remain much lower than 2011-2014 levels. Furthermore, if we assume in this scenario the following: 1) No further rationalization of State expenditures with spending at least remaining constant in real terms; and 2) No financing constraints, total State fiscal deficits would remain around 1 percent of GDP annually through the medium-term. This level of fiscal deficits would lead to an increase in total State debt stock to 5.4 percent of GDP by 2020, and an increase in the total State debt to revenue ratio to over 200 percent by 2020. This would lead to a higher share of state revenues being used for interest payments and debt servicing (especially if States borrow on mostly commercial terms again), rather than development spending. In this scenario with no or very limited fiscal consolidation, States remain vulnerable and continue to repre-

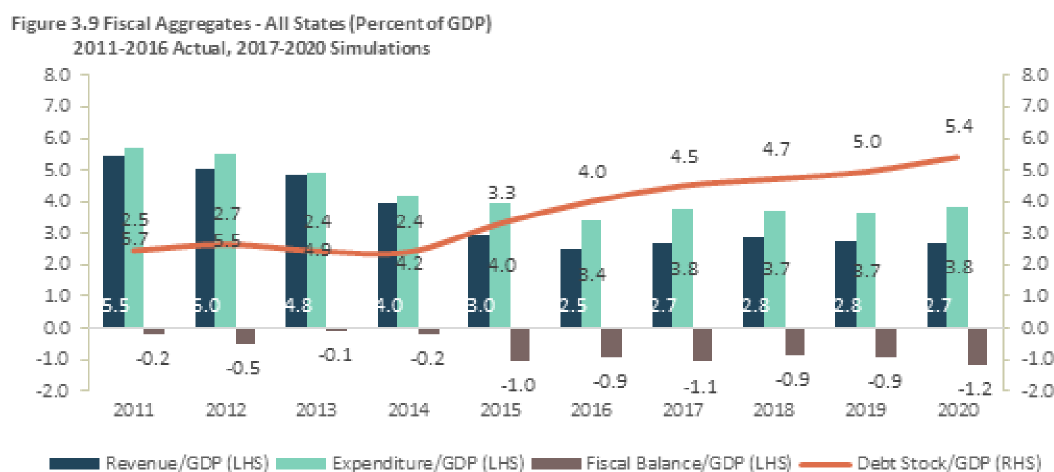


Figure 3.9 Fiscal Aggregates - All States (Percent of GDP)
2011-2016 Actual, 2017-2020 Simulations

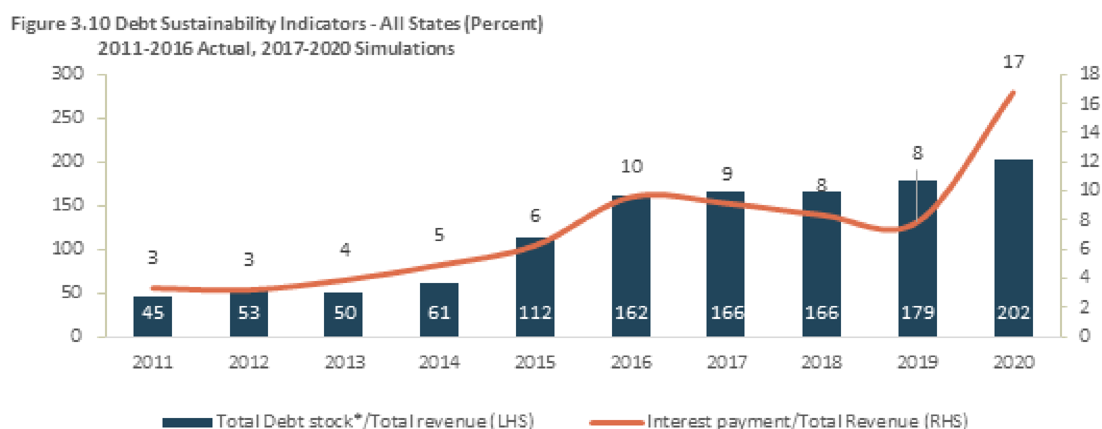


Figure 3.10 Debt Sustainability Indicators - All States (Percent)
2011-2016 Actual, 2017-2020 Simulations

sent a significant source of fiscal risks and macroeconomic instability for the country.

78. To prevent this scenario and further fiscal crises from materializing, States need to increase their internally generated revenues (IGR), manage recurrent spending pressures, prevent arrears accumulation and strengthen debt management. This means implementing key PFM and fiscal management reforms at the State level, including the full and sustained implementation of the FSP actions and fiscal transparency commitments of the OGP. The implementation of the FSP is ongoing with all States making some progress but is far from complete. The success of the FSP also requires Federal Government to strengthen its role, in particular in the monitoring and enforcement of guidelines and rules on state borrowing, and to support the States in implementing some of the actions. Since 2014, there has been a systematic process of quarterly monitoring by DMO of the States debt stock and control by the Central Bank of Nigeria (CBN) on borrowing activities from commercial banks.

Appendix 1: State Fiscal Performance (All States)

Data Sources for Appendix 1 and Figures in Chapter 3

- Historical Data 2011-2016: WB Staff calculations using State fiscal data from NBS and CBN, and State debt data from DMO
- National Bureau of Statistics /Joint Tax Board, Internally Generated Revenue at State Level 2011-2016. Weblink: http://www.nigerianstat.gov.ng/download/497
- Central Bank of Nigeria, Biannual Surveys of States' Revenue and Expenditure, 2011- 2016. Weblink: https://www.cbn.gov.ng/documents/annualreports.asp?beginrec=1&endrec=20
- Debt Management Office, States Domestic and External Debt Stock, 2011-2016. Weblink: https://www.dmo.gov.ng/debt-profile/sub-national-debts
- Projection years 2017-2020: WB Staff calculations

2011-2016 Estimated Actual, Naira billion

ALL STATES including FCT (Aggregated)	Historical Years					
	2011	2012	2013	2014	2015	2016
Billion Naira						
Total Revenue & Grants	**3,481**	**3,639**	**3,924**	**3,568**	**2,808**	**2,547**
o/w Total FAAC allocation exc VAT (Statutor	2,479	2,327	2,782	2,438	1,681	1,281
o/w VAT	318	348	390	389	381	397
o/w Internally Generated Revenue (IGR)	502	603	673	724	705	829
Total Expenditure	**3,616**	**4,000**	**3,977**	**3,762**	**3,789**	**3,514**
Recurrent Expenditure	**1,730**	**2,336**	**1,897**	**2,267**	**2,527**	**2,311**
o/w Personnel Cost & Pensions	554	740	847	937	1,295	1,310
o/w Transfers	360	311	396	157	206	0
o/w Interest Payments	116	116	152	175	176	244
Capital Expenditure	**1,886**	**1,663**	**2,080**	**1,494**	**1,262**	**1,204**
Total Fiscal Balance	**(134)**	**(361)**	**(53)**	**(194)**	**(980)**	**(968)**
Financing/Gross Borrowing = (2)-(1)	n/a	**1,410**	**1,379**	**1,498**	**2,529**	**2,001**
Primary Balance (1)	(19)	(244)	99	(19)	(804)	(723)
Debt service inc. arrears clearance (2)	n/a	1,166	1,477	1,480	1,724	1,278
Debt service - amortizations inc. arrears	n/a	1,049	1,325	1,304	1,548	1,033
Debt service - interests	116	116	152	175	176	244
Debt Stock	**1,566**	**1,927**	**1,980**	**2,174**	**3,155**	**4,122**
Domestic	1,233	1,552	1,537	1,655	2,503	3,218
External	333	376	443	519	651	904

Fiscal Indicators

2011-2016 Estimated Actual and 2017-2020 'No Fiscal Consolidation' Simulations

ALL STATES including FCT (Aggregated)	Historical Years						Projected Years			
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Fiscal Indicators as a share of State revenue/expenditure										
Revenue - share of revenue										
FAAC Allocation exc VAT/Total Revenue	71%	64%	71%	68%	60%	50%	55%	57%	55%	54%
VAT/Total Revenue	9%	10%	10%	11%	14%	16%	14%	13%	14%	15%
IGR/Total revenue	14%	17%	17%	20%	25%	33%	30%	28%	29%	30%
Expenditure - share of expenditure										
Recurrent (inc interest)/total expenditure	48%	58%	48%	60%	67%	66%	64%	64%	63%	65%
Personnel/total expenditure	15%	19%	21%	25%	34%	37%	32%	32%	32%	30%
Interest/total expenditure	3%	3%	4%	5%	5%	7%	7%	6%	6%	12%
Capital/total expenditure	52%	42%	52%	40%	33%	34%	36%	36%	37%	35%
Fiscal and Debt Sustainability Indicators										
Interest payment/Total Revenue	3%	3%	4%	5%	6%	10%	9%	8%	8%	17%
Annual Debt service inc. arrears clearance/Total Revenue		32%	38%	41%	61%	50%	33%	48%	60%	64%
Total Debt stock inc. arrears /Total revenue	45%	53%	50%	61%	112%	162%	166%	166%	179%	202%
Fiscal Indicators as a share of national GDP										
Revenue										
Total revenue/GDP	5.5%	5.0%	4.8%	4.0%	3.0%	2.5%	2.7%	2.8%	2.8%	2.7%
FAAC Allocation exc VAT/GDP	3.9%	3.2%	3.4%	2.7%	1.8%	1.2%	1.5%	1.6%	1.5%	1.4%
VAT/GDP	0.5%	0.5%	0.5%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
IGR/GDP	0.8%	0.8%	0.8%	0.8%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%
Expenditure										
Total expenditure/GDP	5.7%	5.5%	4.9%	4.2%	4.0%	3.4%	3.8%	3.7%	3.7%	3.8%
Personnel/GDP	0.9%	1.0%	1.0%	1.0%	1.4%	1.3%	1.2%	1.2%	1.2%	1.1%
Interest/GDP	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.5%
Capital/GDP	3.0%	2.3%	2.6%	1.7%	1.3%	1.2%	1.4%	1.4%	1.4%	1.4%
Fiscal and Debt Sustainability Indicators										
Fiscal balance/GDP	-0.2%	-0.5%	-0.1%	-0.2%	-1.0%	-0.9%	-1.1%	-0.9%	-0.9%	-1.2%
Gross borrowing/GDP	n/a	1.9%	1.7%	1.7%	2.7%	2.0%	1.7%	2.0%	2.3%	2.4%
Annual Debt service inc. arrears clearance/GDP	n/a	1.6%	1.8%	1.6%	1.8%	1.2%	0.9%	1.4%	1.7%	1.7%
Total Debt stock inc. arrears/GDP	2.5%	2.7%	2.4%	2.4%	3.3%	4.0%	4.5%	4.7%	5.0%	5.4%

Appendix 2: 22-Point Fiscal Sustainability Plan

	Objective 1: To Improve Accountability & Transparency
1	Publish audited annual financial statements within 6 months of financial year end.
2	Introduction and compliance with the International Public Sector Accounting Standards (IPSAS)
3	Publish State budget online annually.
4	Publish budget implementation performance report online quarterly.
5	Develop standard IPSAS compliant software to be offered to States for use by State and Local Governments.
	Objective 2: To Increase Public Revenue
6	Set realistic and achievable targets to improve independently generated revenue (from all revenue generating activities of the State in addition to tax collections) and ratio of capital to recurrent expenditure. Implementation of targets
7	Implement a centralised Treasury Single Account (TSA) in each State
8a	Quarterly financial reconciliation meetings between Federal and State Governments to cover VAT, PAYE remittances, refunds on Government projects, Paris Club and other accounts
8b	Share the database of companies within each State with the Federal Inland Revenue Service (FIRS). The objective is to improve VAT and PAYE collection
9	Introduce a system to allow for the immediate issue of VAT / WHT certificates on payment of invoices
10	Review all revenue related laws and update of obsolete rates / tariffs
	Objective 3: To Rationalise Public Expenditure
11a	Set limits on personnel expenditure as a share of total budgeted expenditure
11b	Biometric capture of all States' Civil Servants will be carried out to eliminate payroll fraud
12a	Establishment of Efficiency Unit
12b	Federal Government online price guide to be made available for use by States
13	Introduce a system of Continuous Audit (internal audit)
	Objective 4: To Improve Public Financial Management
14	Create a fixed asset and liability register
15	Consider privatization or concession of suitable State owned enterprises to improve efficiency and management
16	Establish a Capital Development Fund to ring-fence capital receipts and adopt accounting policies to ensure that capital receipts are strictly applied to capital projects
17	Domestication of the Fiscal Responsibility Act (FRA)
	Objective 5: Sustainable Debt Management
18	Attainment and maintenance of a credit rating by each State of the Federation
19a	Federal Government to encourage States to access funds from the capital markets for bankable projects through issuance of fast-track Municipal bond guidelines to support smaller issuances and shorter tenures
19b	Full compliance with the FRA and reporting obligations, including: No commercial bank loans to be undertaken by States; Routine submission of updated debt profile report to the DMO
20	Publish a benchmark rate for Municipal loans to achieve greater transparency
21	Ensure total liabilities do not exceed 250% of total revenue for the preceding year. Monthly debt service deduction is not to exceed 40% of the average FAAC allocation for the preceding 12 months
22	In addition to the sinking fund, States are encouraged to establish a Consolidated Debt Service Account to be funded from the State's Consolidated Reserve Fund Account to a minimum of 5% of IGR

s