WORLD BANK GROUP

NIGERIA DEVELOPMENT UPDATE | NOVEMBER 2021

Time for Business Unusual

Nigeria Development Update

November 2021

Time for Business Unusual

WORLD BANK GROUP

1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

Acknowledgements

The Nigeria Development Update (NDU) is a World Bank report series produced twice a year that assesses recent economic and social developments and prospects in Nigeria, and places these in a longer-term and global context. The NDU also provides an in-depth examination of selected policy issues and medium-term development challenges in Nigeria. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged in Nigeria's evolving economy.

The report was prepared by a World Bank team led by Gloria Joseph-Raji (Senior Economist), Miguel Angel Saldarriaga (Economist), and Marco Antonio Hernandez Ore (Lead Economist). The team included: Nyda Mukthar, Joseph Ogebe, Masami Kojima, Jonathan Lain, Ahmed Rostom, Mariano Cortes (Recent Economic Developments and Outlook); Masami Kojima (Petrol Subsidy); Jonathan Lain, Tara Vishwanath (Youth Employment); Ida Mboob, Danielle Robinson, Dilip Parajuli, Siegfried Zottel, Parminder Brar, Hyea Won Lee, Aliaksandra Tyhrytskaya (Digital Nigeria); Ahmed Rostom, Mariano Cortes, Sophie Dong, Leila Aghabarari (Financial Deepening). The team also included Samer Matta, Jakob Engel, Bertine Kamphuis, Tekabe Belay, Sean Lothrop, and Chuka Agu.

The team is grateful for valuable discussions with the Ministry of Finance, Budget and National Planning, the Central Bank of Nigeria, and the National Bureau of Statistics. The team would like to thank the International Monetary Fund's Mission Chief, Jesmin Rahman, and her team for invitations to participate in macro-monitoring missions and for their continual dialogue and collaboration.

Mary Akerele assisted the team. Arsianti Arsianti and Miguel Castiblanco aided in designing. External and media relations are managed by Mansir Nasir.

The report was prepared under the overall supervision of Shubham Chaudhuri (Country Director for Nigeria), Abebe Adugna (Regional Director for Equitable Growth, Finance, and Institutions), and Francisco Carneiro (Practice Manager for Macroeconomics, Trade, and Investment).

For questions about this report please email marcohernandez@worldbank.org

For information about the World Bank and its activities in Nigeria, please visit: www.worldbank.org/ng

Abbreviations and Acronyms

bbl	Barrels
CBN	Central Bank of Nigeria
CNG	Compressed Natural Gas
CRR	Cash Reserve Ratio
DBN	Development Bank of Nigeria
DFS	Digital Financial Services
FAAC	Federation Account Allocation Committee
FDI	Foreign Direct Investment
FX	Foreign Exchange
GDP	Gross Domestic Product
GHS	General Household Survey
ICT	Information and Communication Technology
IMF	International Monetary Fund
LDR	Loan to Deposit Ratio/Rate
MSMEs	Micro, Small, and Medium Enterprises
NAFEX	Nigeria Autonomous Foreign Exchange Rate
NBP	National Broadband Plan
NBS	National Bureau of Statistics
NDU	Nigeria Development Update
NLPS	National Longitudinal Phone Survey
NNPC	Nigeria National Petroleum Corporation
OPEC	Organization of the Petroleum Exporting Countries
PCGs	Partial Credit Guarantees
PIA	Petroleum Industry Act
PMS	Premium motor spirit
PSF	Petroleum Support Fund
UNCTAD	United Nations Conference on Trade and Development
VAT	Value-Added Tax

Nigeria Development Update

November 2021

Time for Business Unusual

Structure

The Nigeria Development Update (NDU) has three sections:

1. **Recent economic developments and outlook**: A review of the most salient economic developments over the previous 6 months and the outlook for the following two years, including a set of short-term and medium-term policy recommendations.

2. **Taking a closer look**: A topical review of a selection of issues that have "risen to the surface" in the previous 6 months.

3. **Spotlight on Nigeria's development agenda**: A long-term view on key challenges and opportunities for Nigeria's development agenda, including a set of actionable policy recommendations.

Contents

List of Figures

List of Tables

List of Boxes

Overview

Nigeria's growth prospects have improved…

The Nigerian economy has recovered at a faster-than-expected pace in 2021, though the statistical base effect is largely responsible for its recent performance.[1] In Q1-Q3 2021, the GDP growth rate reached 3.3 percent. However, the observed spike in the growth rate in early 2021 follows a 1.8 percent contraction in 2020. In Q2 2021, the GDP growth rate reached 5.4 percent, its highest level since 2014. However, when the base effect is factored out, the Q2 growth rate falls to 1 to 2 percent. The situation improved in Q3, when the recovery was sufficient to recoup the economic losses inflicted by the pandemic. In Q3, growth was driven by the non-oil sector. Meanwhile, the oil sector continued to underperform despite the recovery of global oil prices, as production inefficiencies and heightened insecurity adversely affect the production and distribution of crude oil.

The World Bank has revised its growth projections for 2021-2022 upward. The June 2021 edition of the Nigeria Development Update (NDU) forecast a 1.8 percent growth rate for 2021, reflecting the expectations of declining incomes, heightened insecurity, and subdued oil production that prevailed at the time. However, the recent growth of services and manufacturing has exceeded expectations, leading to revised projections (Table O.1). The improved performance of manufacturing was largely due to the base effect, as the sector contracted sharply during 2020. By contrast, the growth of services was largely organic, albeit uneven: telecoms expanded robustly during the pandemic, while trade, transportation, and financial services also recovered, but professional services, accommodation and food services, and other services contracted. Nonetheless, despite the improved outlook, Nigeria's GDP is forecast to grow more slowly compared to emerging economies and oil-producing countries.

Table 0-1: Key Macroeconomic Indicators, 2019-2022

	2019	2020	NDU JUNE 2021 Projections		NDU NOVEMBER 2021 Projections	
			2021	2022	2021	2022
GDP (%)	2.2	-1.8	1.8	2.1	2.7	2.8
Inflation (%)	11.4	13.2	16.5	13.0	17.0	13.5
Fiscal Deficit (% of GDP)	4.6	5.4	4.7	4.4	5.7	5.3
Public Debt (% of GDP)	28	33	33	34	36	38

Source: World Bank estimates.
Note: The Public Debt (% of GDP) includes CBN Ways and Means financing and AMCON debt

[1] In statistics, the "base effect" occurs when an initial decline in an indicator makes a subsequent increase appear especially large, in percentage terms, by altering the "base" on which the later change is calculated. For example, 100 minus 20 is a decrease of 20 percent, but 80 plus 20 is an increase of 25 percent. Due to the base effect, an economic recovery may appear greater than the contraction that preceded it, even if indicators are merely returning to their original levels. The steeper the initial contraction, the more the base effect magnifies the subsequent recovery.

…but pre-crisis challenges threaten the post-crisis recovery, highlighting the need to depart from business-as-usual policies

In 2020, the COVID-19 pandemic served as a wakeup call and the government took bold measures to mitigate the effects of the crisis, but the reform momentum waned in 2021, and unaddressed macroeconomic weaknesses have imperiled Nigeria's recovery. In 2020, the Nigerian government began to address longstanding macroeconomic challenges by harmonizing the two main exchange rates, adjusting electricity tariffs to more cost-reflective levels, cutting nonessential spending, redirecting budgetary resources towards the COVID-19 response at both the Federal and State levels, strengthening debt management, and increasing the transparency of oil and gas operations. However, the reform momentum weakened in 2021, and in the absence of continued progress, key macroeconomic challenges have reemerged as major threats to growth. Issues around the predictability and credibility of exchange-rate management the insufficient supply of foreign exchange (FX) (Figure O.1), the unsustainable subsidy for premium motor spirit (PMS), burdensome trade restrictions, and the sizeable fiscal deficit financing by the Central Bank of Nigeria (CBN) continue to undermine the business environment, compounding underlying constraints related to governance and the delivery of public services.

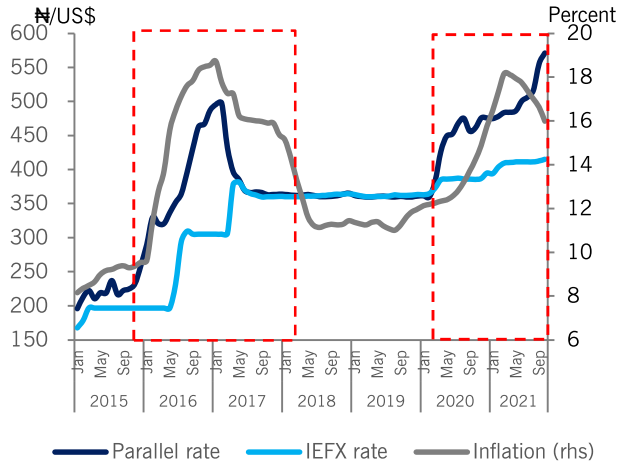
Despite a strong initial recovery and resurgent global oil prices, the stalled reform agenda has undermined Nigeria's long-term growth prospects. This edition of the NDU highlights the need for renewed reforms over the next 3 to 6 months in four key areas:

- **Reducing inflation while supporting the recovery:** Double-digit inflation rates are depressing economic activity and exacerbating poverty. Rising food prices are eroding household purchasing power, and we estimate that during 2020 and 2021, the "inflation shock" alone pushed about 8 million more Nigerians below the poverty line (Figure O.2). We have revised our inflation forecast upwards from our June projection because (i) the inflation rate is declining more slowly than initially expected, and (ii) during 2021 the government did not take concerted action to curb inflation. The June edition of the NDU also discussed the drivers of inflation and highlighted the urgency of adopting a sequenced and coordinated mix of exchange rate, trade, monetary, and fiscal policies to reduce inflation in a way that supports the recovery and protects the poor. In this edition, we underscore the mounting economic hardship imposed by inflation and present policy options designed to address this increasingly urgent challenge. Without decisive action, the average inflation rate for 2021 will exceed that for 2020 and will be unlikely to approach the CBN's target range of 6–9 percent by end-2022. The inflation rate has not fallen to 9 percent since 2014, but in a hypothetical scenario where the inflation rate would have been close to the CBN's goal of 9 percent in 2020 and 2021, the consumption level of the average Nigerian would have been at least 15 percent higher today.
- **Improving exchange rate management to catalyze private investment:** The government's exchange rate management policies continue to discourage investment and fuel inflation. Exchange rate stability is a key CBN policy objective, and to preserve its external reserves the CBN continues to manage FX demand and limit the supply of FX to the market. Pressure on the naira (₦) remains intense, and while the CBN has raised the nominal official exchange rate

three times since the start of the pandemic (by 15 percent in March 2020, 5 percent in August 2020, and 7 percent in May 2021), FX management remains too rigid to respond to external shocks. Meanwhile, exchange-rate management has emerged as one of the key drivers of inflation (Figure O.1).

Figure O.1: The rising parallel (black market) exchange rate is driving inflation…

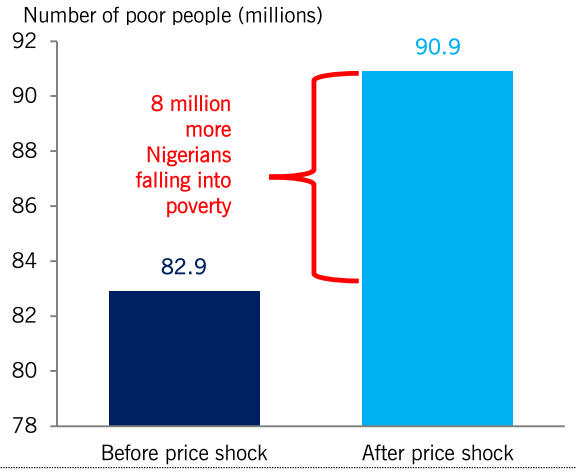
Inflation and exchange rates



Source: NBS, BDCs and World Bank estimates.

Figure O.2: …and high inflation rates are pushing millions of Nigerians into poverty.

Poverty headcount rate



Source: NBS.

- **Addressing fiscal pressures**: Due to deteriorating revenues, our forecast for the consolidated government fiscal deficit has been revised upward. Nigeria's fiscal deficit is now projected to reach 5.7 percent of GDP by end-2021, its highest level in over a decade. Despite rebounding oil prices, Nigeria's oil output has fallen, and total fiscal revenues are expected to recover only modestly from 6.5 percent of GDP in 2020 to 7.1 percent in 2021, well below their 2014 level of 11 percent. Faced with a widening budget deficit, policymakers have increasingly turned to costly CBN overdrafts (also known as Ways and Means financing), which are not properly integrated into the fiscal accounts. The high cost of servicing CBN overdrafts is compounded by large off-budget expenditures—especially the PMS subsidy—which crowd out much-needed investments in human and physical capital. While Nigeria's debt burden remains manageable for the time being, maintaining sustainable debt dynamics will require curbing the use of CBN financing for the deficit and addressing fiscal pressures to break the cycle of low growth and rising public debt.

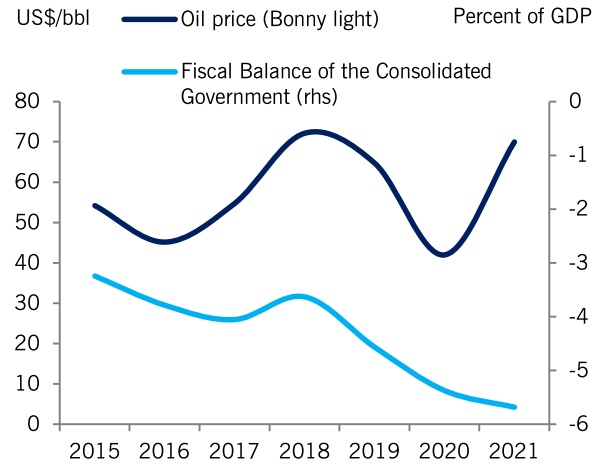
- **Protecting poor and vulnerable households to ensure a robust and inclusive recovery:** The lingering effects of the 2020 recession have significantly affected Nigerian's household welfare and livelihoods. Households suffered a permanent loss of income as a result of the COVID-19 crisis, and many Nigerians were forced to reduce their food intake and resort to adverse coping strategies, such as selling or consuming their productive assets. As a result, labor productivity is expected to decline, lowering the potential GDP growth rate from 4.0 percent over the last five years to 3.0 percent projected for 2022-2023.

Fiscal pressures are mounting due to lower-than-expected revenues and the rising cost of the premium motor spirit (PMS) subsidy

The Nigerian government's fiscal position typically improves when oil prices rise, but this will not be the case in 2021. In contrast to past periods of high oil prices, two factors are preventing the government from fully benefitting from the current boom. First, oil production has fallen below Nigeria's estimated capacity and the OPEC+ quota due to inefficiencies and emergency shutdowns in the production and distribution processes for Bonny Light, Escravos, and Qua Iboe crudes. Second, the domestic price of PMS has remained fixed while global PMS prices have risen, increasing the cost of the PMS subsidy. Nigeria is the only country in the world that subsidizes only PMS; most governments end the PMS subsidy first. The Nigeria National Petroleum Corporation (NNPC) deducts the cost of the PMS subsidy from the oil and gas revenues that it transfers to the Federation Account. Rather than being accounted as an explicit expenditure, the PMS subsidy is treated as "forgone revenue", and its cost is not reflected in the budget. Deducting the cost of the PMS subsidy at the source of income undermines the predictability of revenue inflows into the Federation Account, creating serious challenges for budget and debt management at both the Federal and State level.

Figure O.3: Declining oil output and rising PMS subsidy costs have decoupled the fiscal balance from global oil prices.

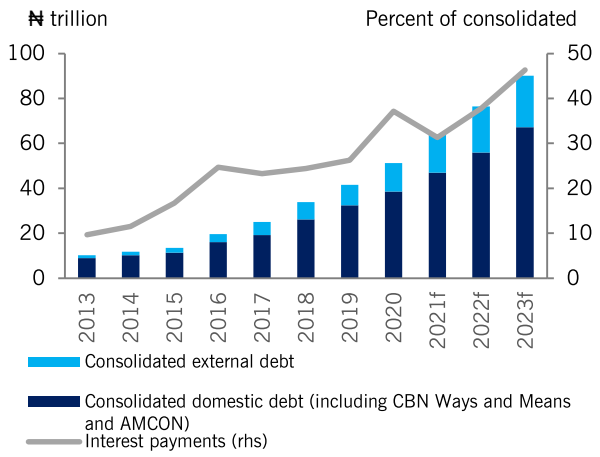
Oil price and fiscal deficit



Source: CBN, OAGF, NBS.

Figure O.4: The public debt stock is rapidly increasing, and interest payments are consuming a growing share of revenues.

Public debt and interest payment



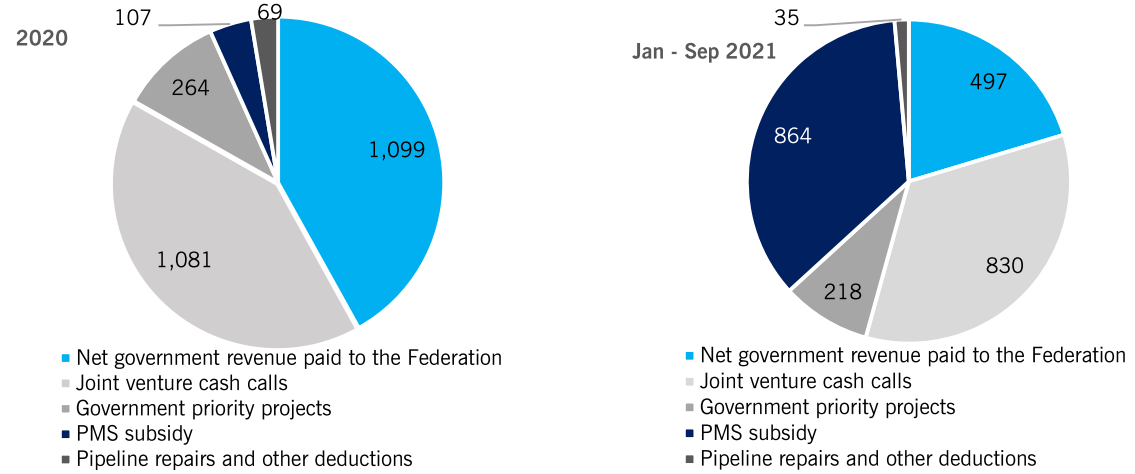
Source: OAGF.

Because most States rely heavily on intergovernmental transfers, diminished revenue inflows to the Federation Account are jeopardizing fiscal sustainability at the State level. For example, in the oil-producing State of Bayelsa Federal transfers account for 91 percent of revenues, and declining transfers caused a 22-percent drop in Bayelsa's revenues per capita during 2021. Even in the State of Lagos, which relies the least on Federal transfers, transfers accounted for 29 percent of revenues in 2020. Most State expenditures cover salaries and administrative expenses, and given their rigid (i.e., nondiscretionary) nature, State-level expenditures are difficult to cut. Consequently, lower revenues are likely to intensify pressure on States' debt stocks and undermine their fiscal sustainability.

Nigeria's PMS subsidy imposes a massive and unsustainable fiscal burden. The cost of the PMS subsidy in 2020 rose from just 4 percent of the oil and gas revenues that are first transferred to the NNPC (US$0.3 billion) to a staggering 35 percent in 2021 (US$4.5 billion or roughly 2 percent of GDP).[2] Meanwhile, Nigeria's average daily oil production fell from 2.0 million barrels per day (bpd) in 2019 to 1.8 million bpd in 2020 and less than 1.6 million bpd in the first nine months of 2021, its lowest level in two decades. Despite the decline in production, oil and gas revenues collected by the NNPC in the first nine months of 2021 alone are estimated to broadly match those collected in the entire year in 2020 because global oil prices rose by more than 50 percent between the two periods. However, rebounding oil prices also increased the cost of the PMS subsidy by raising the price of imported PMS from less than US$200 per ton in April 2020 to US$840 per ton by November 2021, causing net oil and gas revenues transferred to the Federation Account by the NNPC to plunge from ₦1.1 trillion to ₦0.5 trillion. In the absence of the PMS subsidy, Federal oil and gas revenues passing through the NNPC net of all deductions would have surpassed its 2020 level by nearly 25 percent during the first nine months of this year (Figure O.5).

Figure O.5: Rising global PMS prices have increased the cost of Nigeria's PMS subsidy, significantly reducing the NNPC's transfers to the Federation Account.

Breakdown of revenues received by the NNPC, ₦ billion



Source: World Bank calculations based on data from the FAAC reports.

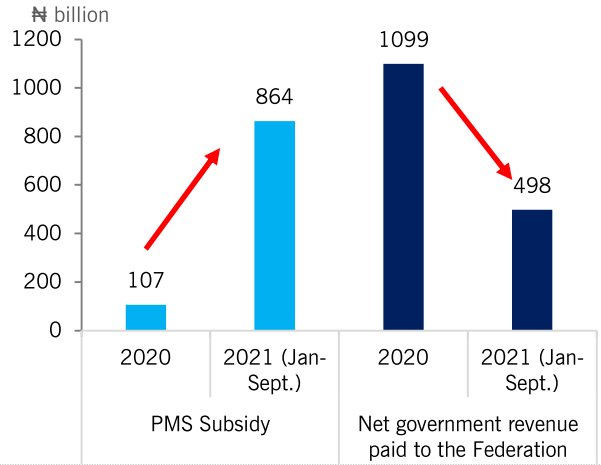
Nigeria is sacrificing critical investments in physical and human capital to fund the PMS subsidy. While the fiscal cost of the PMS subsidy is enormous, its opportunity cost is even greater. By

[2] The NNPC's reports to Federation Account from January to October 2021 include revenue transfers for the first nine months of 2021 and deductions for the PMS subsidy for the first eight months.

maintaining an inefficient price control on PMS, Nigeria is forgoing productivity-enhancing investments in essential public goods and services. Even in 2019, when oil production surpassed 2 million bpd while Nigeria's PMS consumption and global PMS prices were both lower, the government spent more on the PMS subsidy than on health or social protection. Based on the global gasoline prices and futures prices that prevailed as of early-November 2021, in the coming 12 months the government could spend more than four times as much on the PMS subsidy as it does on public health. Notably, the Federal budget for 2022 allocates about ₦3,000 (US$7) per person for public health, while the cost of the PMS subsidy in the next 12 months could be as high as ₦13,000 (US$32) per person.

Figure O.6: The cost of the PMS subsidy is at a six-year high.

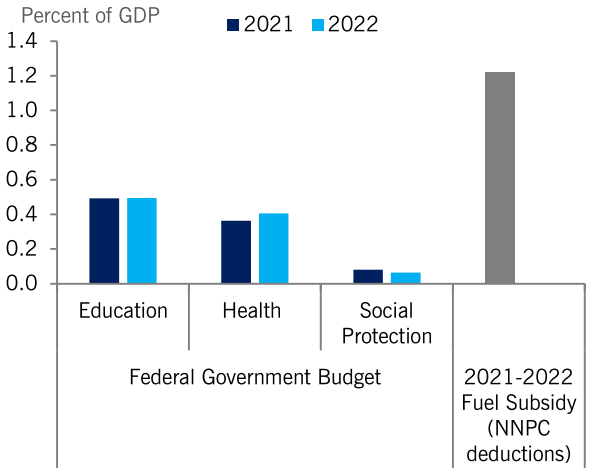
The cost of the PMS subsidy and net revenue paid by NNPC to the Federation Account



Source: FAAC reports.

Figure O.7: The cost of the PMS subsidy far exceeds public spending on essential services.

Social spending and the cost of the PMS subsidy as a share of GDP



Source: OAGF and World Bank staff calculations

The benefits of the PMS subsidy overwhelmingly accrue to wealthier households, and a large share is captured by smugglers and black marketeers. Households in the bottom 40 percent of the income distribution account for less than 3 percent of all gasoline purchases. By contrast, three-quarters of all gasoline sold in Nigeria is consumed by private firms, public transportation services, government agencies, and other business entities, and a substantial share is smuggled out of Nigeria for resale in neighboring countries. By creating a large price differential between Nigeria and its neighbors, the government is effectively subsidizing criminal activity while also preventing the formation of a legitimate market for cross-border PMS transportation and sale. The extent of PMS smuggling is difficult to estimate, but the available evidence suggests that the problem is widespread, and this implies that Nigeria is subsidizing the PMS that is smuggled and consumed in other countries. In 2011, when fuel subsidies had soared to the point of triggering several commissions of inquiry in the government, there was a sharp spike in "apparent" PMS consumption in Nigeria that did not correlate with any commensurate acceleration in economic activity. The most plausible explanation for this pattern is a sharp increase in smuggling driven by the widening price gap between Nigeria and its neighbors as well as domestic developments outside of the oil sector in Nigeria.

Attempts to eliminate the subsidy have repeatedly failed, but the 2021 Petroleum

Industry Act (PIA) effectively mandates the elimination of the subsidy by February 2022, and also ends the policy of having uniform prices throughout the country. The government removed the PMS subsidy in January 2012 after months of high global oil prices, but after two weeks of protests the policy was reinstated. The government tried to eliminate the subsidy again in May 2016, this time as the world oil price had just hit a new low, and the authorities introduced a price band designed to move with international PMS prices. However, the government failed to adjust the price band when the naira depreciated sharply later in 2016, and by 2017 the subsidy had returned. In March 2020, amid another oil-price collapse, the government replaced the subsidy with market-based pricing regulations for PMS. However, when global oil prices recovered and the government failed to make upward price adjustments the PMS subsidy returned, and since January 2021 the gap between the government-controlled retail price and the cost of supply has been steadily widening. The PIA, signed into law in mid-August 2021, allows the subsidy to persist for up to six months as a transitional measure, but in mid-February 2022 the government's authorization to reimburse the NNPC for losses suffered from selling PMS at a loss will expire. In parallel, the PIA closed out the Petroleum Equalisation Fund used to set uniform prices.

To successfully end the PMS subsidy, it would be critical to establish a "compact" with the Nigerian people that protects the welfare of lower-income households without distorting price signals or destabilizing the public finances. Its many flaws notwithstanding, the PMS subsidy delivers modest but meaningful benefits to hard-pressed Nigerian households, and previous efforts to curtail the policy were undermined by the absence of a compensatory mechanism targeting the vulnerable. Establishing a targeted and time-bound cash-transfer system to offset the negative welfare impact of eliminating the PMS subsidy would help protect poor and vulnerable households, which are already suffering from high inflation rates. This edition of the NDU outlines a prospective cash-transfer policy and details its advantages from a macroeconomic, fiscal, and household-welfare perspective.

Nigeria's fiscal position is fragile and vulnerable to global headwinds. Without immediate macroeconomic reforms, Nigeria will remain exposed to oil price and production shocks, and the PMS subsidy will further deplete the government's scarce resources. While global oil prices remain high, the expected relaxation of OPEC+ quotas and the planned release of oil reserves by China and the United States should ease upward price pressure and may even cause prices to decline. In the absence of deep reforms to nonoil revenue policy and administration, nonoil taxes will likely fall short of their targets and be unable to compensate for oil shocks. Meanwhile, off-budget spending and rising debt-service costs will continue to drive expenditure pressures. The government has historically underbudgeted for debt service by failing to account for the cost of Ways and Means financing. Without appropriate measures to reduce Ways and Means financing and restructure the existing debt stock, the heavy cost of debt service will further constrain the government's fiscal space.

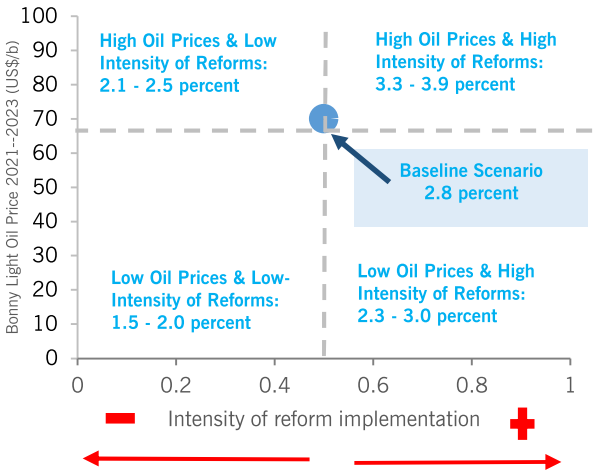
Under a business-as-usual scenario, GDP per capita growth would remain stagnant, but bold reforms could accelerate growth

Nigeria faces a critical choice: it can continue to pursue a business-as-usual policy approach while its economy and job market deteriorates, or it can undertake bold reforms that put Nigeria on a robust and sustainable long-run growth trajectory. A favorable external context marked by higher oil prices could bolster growth and job creation, but only if the government successfully addresses key weaknesses in the country's macroeconomic framework. Urgent priorities for

the next 3 to 6 months include reducing inflation, improving exchange-rate management, mobilizing additional oil and nonoil revenues, eliminating the PMS subsidy and redirecting expenditures towards targeted cash transfers and other priority investments, fostering competitive markets, and improving infrastructure. While Nigeria's macroeconomic projections have been updated since the previous edition of the NDU, the government's fundamental policy challenges remain unchanged (Table O.2).

Figure O.8: Scenario analysis indicates that an aggressive reform effort could contribute more to growth than a sustained period of high oil prices.

Average GDP Growth 2021-2023



Source: World Bank estimates.

Table O-2: Critical Near-Term Policy Objectives for Nigeria

Reducing inflation to support the economic recovery by implementing a coordinated mix of exchange-rate, trade, monetary, and fiscal policies 	**Catalyzing private investment to boost job creation** by improving the predictability of exchange-rate management and increasing access to FX, easing trade restrictions, and fostering an enabling business environment 
Addressing fiscal pressures by eliminating the PMS subsidy while protecting the poor, mobilizing oil and nonoil revenues, enhancing tax administration, curtailing the use of CBN deficit financing, and accounting CBN overdrafts as part of the debt stock 	**Protecting poor and vulnerable households** by implementing a large-scale cash-transfer program designed to compensate for the welfare impact of high inflation and the elimination of the PMS subsidy, and by accelerating COVID-19 vaccinations 

Taking a Closer Look at the PMS Subsidy and the Youth Labor Market

Nigeria's Petrol Subsidy: Unique, Opaque, Costly, Unsustainable, Harmful, and Unfair. As described above, the PMS subsidy imposes massive fiscal and opportunity costs while enriching smugglers and black marketeers at the expense of everyday Nigerians. Poor households purchase just 3 percent of all PMS sold in Nigeria, while the bulk of the subsidy accrues to wealthy households, concentrated business interests, and criminal enterprises. Leveraging existing social protection systems to provide compensatory cash transfers would enable the government to eliminate the PMS subsidy while protecting the welfare of lower-

income households. The PIA provides an opportunity to phase out the PMS subsidy and focus on increasing competition in the market, enabling efficiency gains in the supply chain to be passed on to consumers in the form of lower PMS prices over the long run.

Jobs for a New Generation: Rebuilding Nigeria's Labor Market after COVID-19. Employment is critical to poverty reduction and shared prosperity, but Nigeria's labor market is failing to produce adequate jobs for the country's large and growing cohort of young workers. Nigeria's private sector is dominated by highly uncertain informal jobs, and a large majority of workers are employed in household farms or nonfarm household enterprises. Underemployment is common, income security is rare, and given the country's threadbare social protection system most Nigerians cannot afford to be unemployed for even a short period to complete a job search. Moreover, recent macroeconomic shocks have prompted households to adopt adverse coping strategies, including young people sacrificing their education to contribute to household income. Moreover, many displaced workers appear to treat family farms as an employer of last resort, with negative implications for the long-term development of the country's vast agricultural sector. In this context, policies that promote investment in human capital, encourage job creation, and support the development of small enterprises can enable Nigeria to seize the demographic dividend offered by its young population and establish a strong foundation for inclusive growth.

Spotlights: The Potential of Nigeria's Digital Economy and the Power of Financial Inclusion

Investing in Nigeria's Digital Infrastructure. Nigeria faces significant challenges that hinder the country's ability to reap the full benefits of the digital economy. One leading barrier is Nigeria's underdeveloped fixed broadband infrastructure, which is partly attributable to burdensome Federal and State regulations. This weak infrastructure base creates a ripple effect across the economy, contributing to low levels of financial inclusion, and persistent geographic and gender gaps in access to and use of digital technologies. Conflicts, particularly in the north, exacerbate these challenges, due to heightened security risks. By investing in its digital infrastructure and strong foundational ID systems, Nigeria can promote economic development, security, governance, and efficient delivery of services, thereby accelerating progress toward an inclusive digital economy. Nigeria's digital economy can also transform economic activities by unleashing new productivity gains, offering new services, skills, and improving the government's efficiency.

Banking Small and Medium Enterprises to Build Back Better. Expanding access to financial services among small and medium enterprises is vital to achieve sustainable job creation and foster a swift and resilient recovery. However, widening spreads between bank lending rates and the monetary policy rate on newly approved loans, weaknesses in the credit-contracting environment, and the pervasive impact of macroeconomic uncertainty disincentivize financial intermediation. The government could help expand credit access by realigning responsibilities for monetary and financial sector policy, strengthening institutions for financial intermediation, building financial resilience by managing loan forbearance, and providing banks with access to long-term funding for lending to small and medium enterprises.

Part 1: Recent Economic Developments and Outlook for Nigeria

Economic Growth: Nigeria's prospects have improved, but the recovery is fragile

In 2021, the Nigerian economy exited the pandemic-induced recession, as a faster-than-expected recovery in manufacturing and services drove renewed growth. However, the recent expansion is due in part to a statistical base effect, as the combined impact of the COVID-19 crisis and falling oil prices caused economic output to contract by 6.0 percent in Q2 2020, Nigeria's worst quarterly decline in three decades, and to contract by 3.4 percent in Q3 2020. Growth resumed in Q4 2020, and the recovery continued in 2021. During Q1-Q3 2021 output rose by 3.3 percent, led by a 4.3 percent expansion in the nonoil sectors, well above the average for the last six years (Figure 1.1). The recovery accelerated in Q2 2021, with the quarterly GDP growth rate reaching 5.4 percent—the first time quarterly growth exceeded 5.0 percent since the oil-price shock of 2015.

While economic activity has rebounded, especially in the nonoil sectors, Nigeria's recent growth performance has been less robust than it initially appears. When the base effect is factored out, the growth rate for Q1-Q3 2021 falls to between 1 and 1.5 percent, but it was only in Q3 2021 that the output recovered to pre-pandemic levels (Figure 1.2 and Figure 1.3). Moreover, positive growth in the nonoil sectors was partially offset by a severe contraction in the oil industry, which continues to fall short of its historical performance.

- **Agriculture:** In Q1-Q3 2021, agricultural output rose by 1.5 percent, down from 1.7 percent during the same period in 2020. Crop production, which represents 90 percent of total agricultural production, is driving the expansion in 2021, with especially strong growth among staple foods produced primarily for domestic consumption such as rice, corn, beans, and cassava. In 2020, agriculture was the sector that proved most resilient to the impact of the pandemic, and production accelerated as displaced services and manufacturing workers shifted to smallholder farming. The Central Bank of Nigeria (CBN) provided ample support to the sector during the pandemic through the Anchor Borrowers' Programme, the Agribusiness Small and Medium Enterprises Investment Scheme, the Nigeria Incentive-Based Risk Sharing System for Agricultural Lending, and other targeted initiatives. Agricultural support programs have bolstered overall growth in 2021.

- **Oil.** Despite rising prices, crude-oil production[3] in Nigeria has continued to decline. Oil production in Q1-Q3 2021 contracted by 8.4 percent compared to a year earlier. In Q3 2021, Nigeria reportedly produced 1.27 million bpd of crude oil (excluding condensate), its lowest level in at least two decades and well below the OPEC quota for Q3 of 1.6 million bpd. In October, production decreased further to 1.23 million bpd. While OPEC has tightened its quotas in 2020 and 2021, Nigeria's 2021 production levels have remained consistently below the quota. Moreover, OPEC quotas began to increase in 2021 and are expected to continue rising gradually every month until the end of 2022. The consistent decline in production

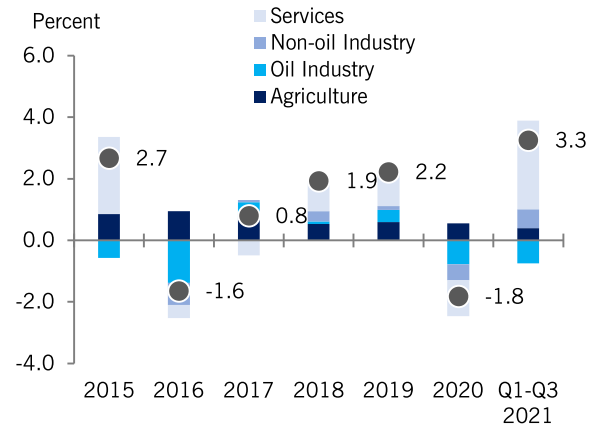
[3] There are two measures of crude oil production in Nigeria. The OPEC quota applies only to crude oil without any condensate (similar to very light crude oil), whereas crude oil production reported in Nigeria includes condensate. The production figures in this paragraph apply to crude oil only. In the rest of the report, crude oil production (or oil production) includes condensate.

is the result of inefficiencies and emergency shutdowns, which have disrupted the production and distribution of Bonny Light, Escravos, and Qua Iboe crudes, and the NNPC's inability to cover the Federation's share of the production costs on account of the growing PMS subsidy burden. In contrast to previous periods of high oil prices, Nigeria is not fully benefitting from the current boom, and revenues for both the public and the private sectors remain below their potential levels.

- **Manufacturing and construction.** During Q1-Q3 2021, manufacturing and construction drove a 4.7 percent expansion in the nonoil industrial sector. In Q2-Q3 2020, lockdown measures and slowing economic activity caused the deepest contraction in manufacturing and construction in the last two decades. With the exception of cement, processed foods, and chemical and pharmaceutical products, all manufacturing industries experienced a severe decline in production. Even after firms had resumed operations, most nonoil industries faced lower demand and excess inventory. The recovery in Q3 2021 increased output and capacity utilization above 2019 levels for the first time (Figure 1.4). However, serious supply constraints are slowing the recovery of nonoil industry, with rising costs for inputs and services and a consistent shortage of foreign exchange compounding a weak recovery in domestic demand.
- **Services.** A robust recovery in telecommunications, trade, and transportation boosted services output by 5.6 percent in Q1-Q3 2021. In contrast to the more modest rebound observed in nonoil industry, a combination of base effects in trade and transportation and the solid performance of information technology and telecommunications pushed services output above its pre-pandemic level (Figure 1.4). Information technology and communications expanded by 7.1 percent as households and firms continued to increase their data consumption. In Q1-Q3 2020, the subsector grew by 12.4 percent—one of the few areas of economic activity to experience a boost from the pandemic. Trade increased by 9.9 percent in Q1-Q3 2021 following five years of continuous decline, while transportation expanded by 10.1 percent, and both sectors benefitted from the loosening of containment measures relative to Q2-Q3 2020. However, other services subsectors continued contracting. Accommodation and food services by 1.8 percent, professional services by 0.5 percent, and other services by 0.9 percent. These subsectors are mainstays of urban employment.

Figure 1.1: Services and the nonoil industry led Nigeria's recovery during Q1-Q3 2021.

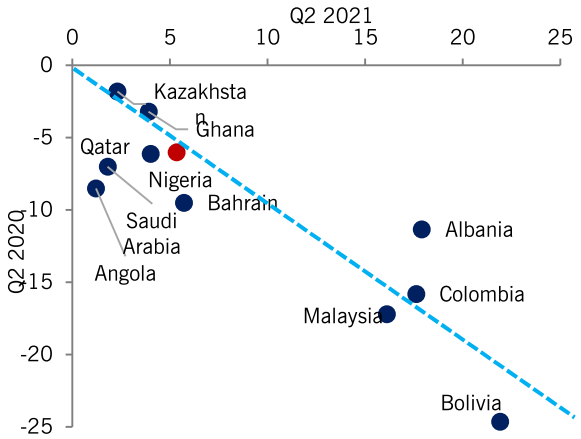
Contribution to GDP Growth, Nigeria



Source: NBS and World Bank estimates.

Figure 1.2: Nigeria's economy is recovering, but more slowly than other oil producers.

Quarterly GDP Growth, Nigeria and Comparators

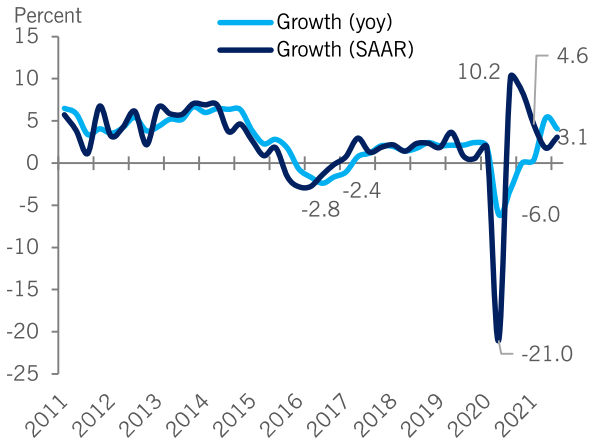


Source: WEO and Statistics Agencies of depicted countries.

Rebounding oil prices and rising income levels are supporting growth, but the recovery is losing momentum. In Q3 2021, the seasonally adjusted quarterly GDP growth rate reached 3.1 percent in annualized terms, above the average rate of 1.8 percent for 2019 and the rate observed in Q2 2021 (Figure 1.3). However, high-frequency indicators suggest that the recovery of the nonoil sectors could slow in Q4 2021 (Figure 1.5). Each week of suppressed economic activity during 2020 represented a loss of about 0.2 percentage points of GDP growth, but the expansionary effect of lifting pandemic restrictions will disappear completely in Q4 2021. Meanwhile, expectations for future growth appear to be deteriorating, as evidenced by the worsening performance of the PMI, the Nigerian Economy's Temperature (NET) Index and the Nigerian Macroeconomic News (NMN) Index (Box 1.1 and Figure 1.6).

Figure 1.3: Seasonally adjusted annual GDP growth improved in Q3 2021…

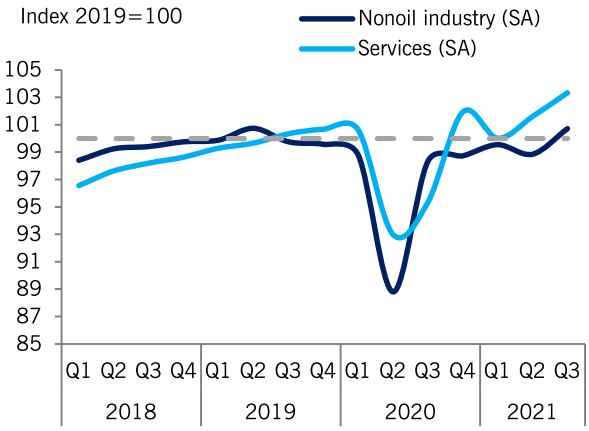
Quarterly GDP Growth Rates



Source: NBS and World Bank estimates.
Note: TRAMO-SEATS is used for seasonal adjustment.

Figure 1.4: …as the output of the nonoil industry and services exceeded pre-pandemic levels.

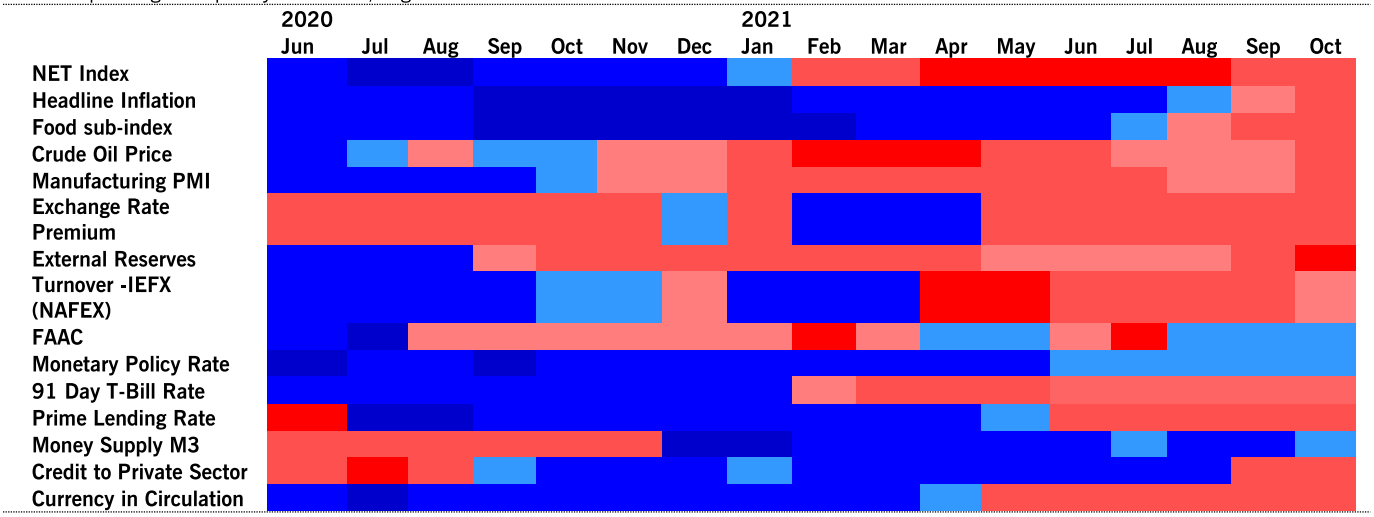
Quarterly GDP Growth Rates in Selected Sectors



Source: WEO and Statistic Agencies of depicted countries.

Figure 1.5: High-frequency indicators suggest that Nigeria's economic recovery will continue in Q4 2021.

Heatmap of High-Frequency Indicators, Nigeria



Source: CBN, NBS, Financial Markets Dealers Quotation (FMDQ), Aboki FX, and World Bank estimates.
Notes: Color coding is based on the deviations of standardized values of each indicator relative to a 1-year mean. Red represents growth above the mean (the economy is heating); darker shades of red represent stronger growth. Blue represents the opposite.

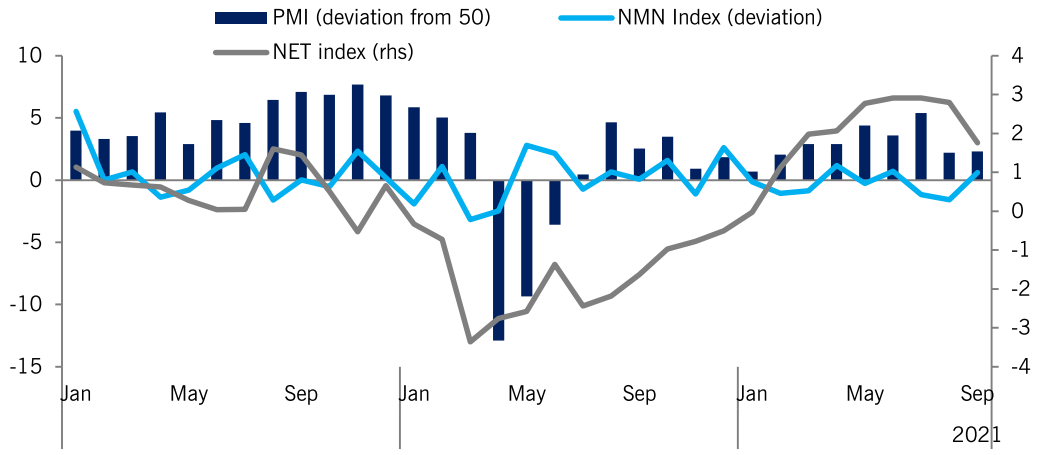
Box 1.1: The Nigerian Economy's Temperature Index (NET)

The NET Index provides a monthly assessment of the state of the economy. The NET Index is based on the 14 high-frequency indicators that have the highest correlation with GDP. These include the headline inflation rate, crude-oil prices, the manufacturing PMI, the rate of return on Treasury bills, the price of diesel, the price of gasoline, the amount of currency in circulation, the premium between the official exchange rate (NAFEX) and the parallel (black market) rate, and the broad money supply (M2). The NET Index also incorporates ad hoc indicators, such as the Nigerian Macroeconomic News (NMN) Index recently developed by the World Bank. The NMN Index measures economic sentiment by using natural language processing to read and detect the tone of economic reporting in Nigeria's leading newspapers. The index does not provide a point estimate, but rather a qualitative assessment of whether the state of overall economy is improving or worsening.

Despite the projected recovery, the lingering impact of the 2020 recession has undermined household welfare and exacerbated poverty and vulnerability. The COVID-induced recession has permanently lowered national income relative to the counterfactual. By the end of 2020, GDP per capita had fallen to its 2010 level (which were equivalent to the levels seen in the 1980s), and it is not expected to return to pre-pandemic levels before 2025 (Figure 1.7). Between 2020 and 2022, GDP per capita is projected to be 14,000 naira (₦), in 2010 prices, lower than it would have been in a non-COVID scenario. This loss is unlikely to be recovered over the near term without comprehensive measures to accelerate growth. Moreover, the recession disproportionately impacted Nigeria's poorest households, many of which have resorted to coping mechanisms that diminish their long-term productivity. The loss in average productivity and the reduction in potential GDP from 4.0 percent in the last five years to 2.5–3.0 percent in 2021 are lowering Nigeria's long-term growth trajectory.

Figure 1.6: Confidence about the state of the economy deteriorated in Q3 2021.

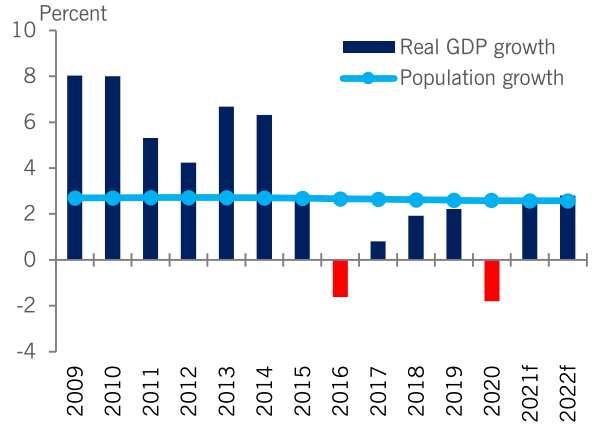
PMI Index, Average Mobility, and New COVID-19 Cases



Source: CBN, NBS, Stanbic, and World Bank estimates.

Figure 1.7: The growth of GDP per capita is expected to turn positive in 2021-2022…

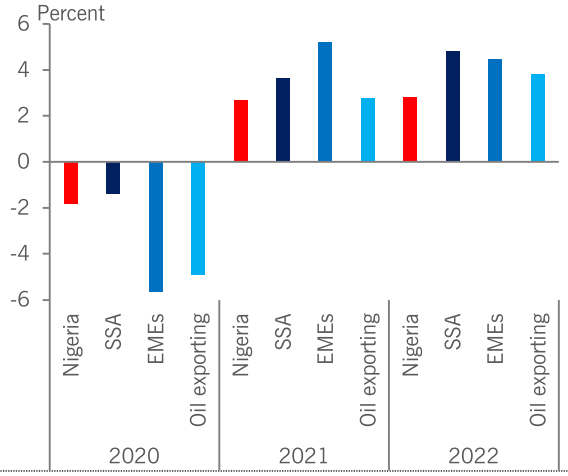
GDP growth and population growth



Source: WEO, MPO, and World Bank estimates.

Figure 1.8: …but Nigeria's would still grow more slowly compared to its peers.

GDP growth



Source: NBS and World Bank estimates.

The Nigerian economy is forecast to grow by 2.7 percent in 2021 and 2.8 percent in 2022, though the outlook remains highly uncertain. Services, trade, agriculture, and construction are expected to lead growth in 2021, while the oil sector will continue to contract. In 2022, the growth of manufacturing and services will moderate but remain positive as base effects subside, with the oil industry recovering amid high oil prices. Increased oil production will boost exports and fiscal revenues, which given a more flexible exchange-rate regime and lower inflation would boost the disposable income and purchasing power of households while promoting domestic investment. However, Nigeria's recovery during 2021–22 is expected to underperform those of other oil producers, as well as the averages for Sub-Saharan Africa and emerging economies worldwide (Figure 1.8). GDP per capita by the end of 2022 is projected to remain below 2010 levels. Meanwhile, Nigeria's economy will remain vulnerable to both external and domestic shocks. High inflation and high unemployment exacerbate these risks, and activity in the tertiary sector will not fully normalize unless

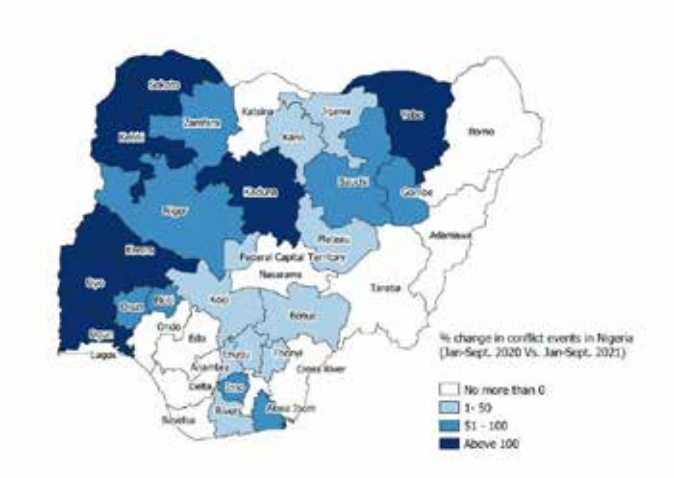
COVID-19 is contained. The vaccine rollout will likely impact the pace of the recovery, but immunization in Nigeria is not expected to be widespread in 2021 (see Outlook section).

Box 1.2: Worsening Insecurity Threatens Nigeria's Fragile Economic Recovery

Conflict events and insecurity continue to intensify in many parts of the country. The Armed Conflict and Location Event Data (ACLED) Project estimates that the number of conflict events in Nigeria increased by 150 percent between 2018 and 2020, and the number of such events between January and September 2021 has increased by 55 percent over the number between January and September 2020. In April 2021, Amnesty International estimated that the mass kidnappings of schoolchildren by Boko Haram, which have resulted in hundreds of children being killed, raped, forced into "marriages" with insurgents, or compelled to join the group, have resulted in the closure of over 600 schools, with educational losses for tens of thousands of children. Conflicts between farmers and pastoralists, which first emerged in the middle belt, have spread to other parts of the country, and escalated to armed banditry, with kidnapping for ransom becoming increasingly common. ACLED estimates that the number of kidnapping events in 2021 (up to September) have almost reached the total number in 2020.

Figure B1.2.1: Conflict and violence in Nigeria continue to intensify

Change in Conflict Events in Nigeria (Jan-Sept 2021 Vs Jan-Sept 2020)



Source: World Bank estimates based on ACLED.

The instability caused by conflict and insecurity constitutes a drag on economic activity and job creation—resulting in a vicious cycle. The latest poverty data for Nigeria (2019) indicates that the northeast and northwest of the country, which have the highest incidences of conflict events, also have the highest poverty rates. Insecurity is driving internal displacement and crippling the economic activities of vulnerable communities. Clashes between farmers and pastoralists have severely damaged agricultural output in north-central Nigeria in recent years, contributing to rising food insecurity and food-price inflation. Insecurity is a powerful disincentive to both domestic and foreign investment, compounding the negative effect of weak governance and poor infrastructure. Moreover, the growth of a lucrative criminal industry centered on kidnapping for ransom is presenting appealing opportunities for young workers, especially those facing dim prospects in a weak and unstable labor market.

Government capacity to address the security challenge is limited. Intergovernmental struggles for sovereignty and (contested) fiscal federalism have not helped the already fragile situation. The paucity of resources allocated to various tiers of government and agencies, low quality of spending and lack of transparency around budget allocations, means the different levels of government–federal, state, and local–lack sufficient resources to address the crisis. Diversifying revenue earnings at all levels of government is critical.

Prices: In 2021 inflation is expected to be higher than in 2020, and urgent action is needed to reduce a protracted loss of welfare

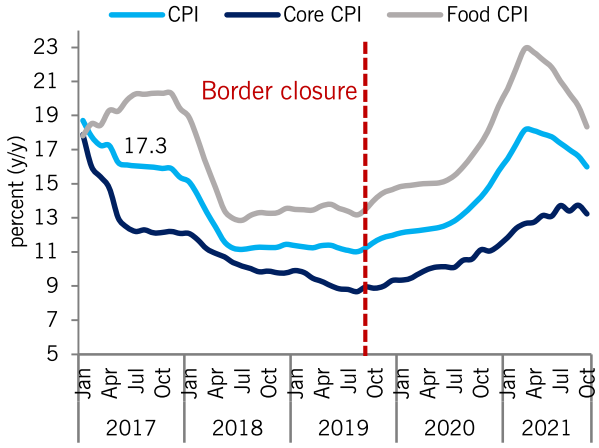
High inflation is frustrating Nigeria's economic recovery and eroding the purchasing power of the most vulnerable households. In the absence of measures to contain inflation, rising prices will continue to diminish the welfare of Nigerian households. If inflation had been closer to the CBN's goal of 9 percent in 2021, the average Nigeria's consumption would have been 15 percent higher, and 8 million Nigerians would have not fallen into poverty. If double-digit inflation persists during 2022-23, rising prices will distort the consumption, investment, and saving decisions of the government, households, and firms, with adverse ramifications for long-term borrowing and lending. Over time, the disproportionate impact of inflation on lower-income households and those working in sectors with low savings (e.g., agriculture) will exacerbate inequality. Ultimately, inflation will not only negatively affect incomes, but also economic productivity and job creation, further constraining the recovery.

Over the last two years, surging domestic food prices accounted for almost 70 percent of the total 12-month increase in inflation. The food-price inflation rate averaged 21.1 percent during the first ten months of year, with especially dramatic increases in the prices of staple foods such as bread and cereals, potatoes, yams, meat, fish, fruits, and oils and fats. In September 2020, ₦1,000 would purchase 3.2 kilograms of beans, on average. One year later, ₦1,000 bought just 2.0 kilograms of beans.

Core inflation, which reflects underlying demand pressures, has also increased, rising from an H1 2021 average of 12.8 percent to 13.5 percent in July–October. However, core inflation is not being driven by surging domestic demand, as GDP remains below its potential level, but by rising prices for consumer goods such as textiles and footwear, durable goods such as motor vehicles, and retail services such as passenger air and road transportation, healthcare, and pharmaceuticals.

Figure 1.9: In 2021, consumer price inflation has remained above the average for the last four years…

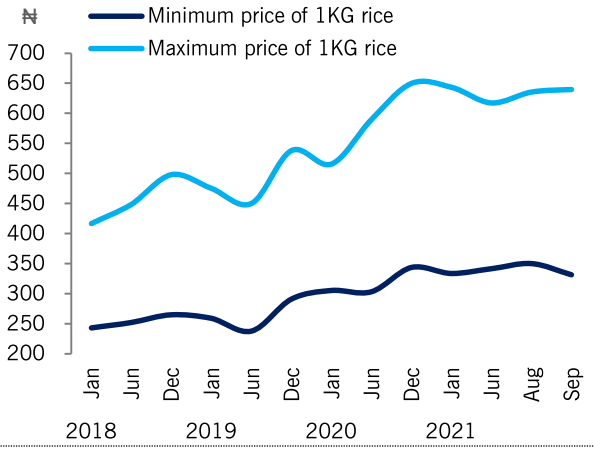
Consumer price index, % change y/y



Source: NBS data and World Bank estimates.

Figure 1.10: …and widening price dispersion is exacerbating the disproportionately negative impact of inflation on poor and vulnerable households.

Minimum and maximum prices for rice across states



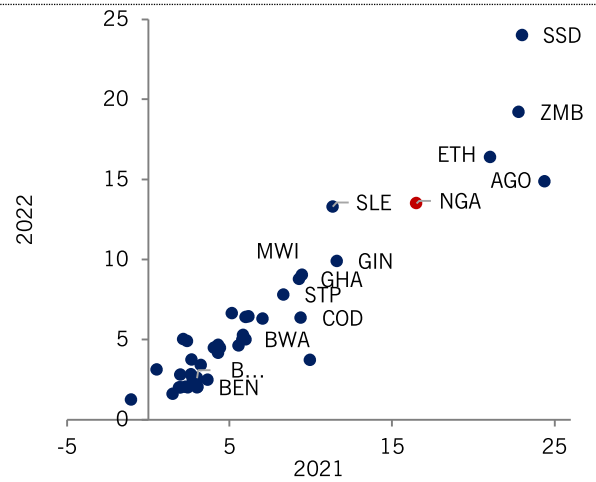
Source: NBS data and World Bank estimates.

Despite a decline in recent months, inflation remains high. Driven by rising food prices, the headline inflation rate surged during 2019 and 2020, and in March 2021 it reached a four-year high at 18.2 percent (Figure 1.9. The inflation rate eased to 16.0 percent in October 2021 as food-price inflation fell from a peak of 22.9 percent in March to 18.3 percent. However, the likelihood that inflation will approach the CBN's target of 9.0 percent by the end of 2021 is low. Even if food-price inflation reached zero in 2021, the loss of purchasing power would remain irreversible, and widening disparities across regions indicate heightened market inefficiencies (Figure 1.10). At its current pace, total inflation in 2021 will exceed its 2020 level, and the risk of a scenario in which high inflation persists through 2022 has not decreased.

Inflationary pressures are being generated by multiple demand and supply shocks. Supply shocks arising from disruption of supply chains linked to COVID-19 and associated containment measures have eased, but security issues, border closures, and limited access to markets continue to fuel inflation. The current mix of monetary, fiscal, foreign exchange (FX), and trade policies also plays a prominent role as a driver of inflation. Trade and FX restrictions, including the closure of land borders starting in August 2019, have increased prices for food and consumer goods, and imports of over 40 goods, including many staple foods, are currently ineligible for FX through formal windows. Nigeria's exchange-rate management has resulted in the rise of parallel rates, which are closely linked to food-price dynamics. Unable to access FX through the official exchange-rate (IEFX) window, businesses seek FX on the parallel market and other alternative sources. The parallel rate influences their business decisions, and fluctuations in the parallel rate pass through to market prices for goods and services. Moreover, monetary policy has not prioritized controlling inflation, and the monetary financing of fiscal deficit undermines the effectiveness of policies to contain demand-side inflationary pressures.

Figure 1.11: In 2022, Nigeria's inflation rate will remain among the highest in the region.

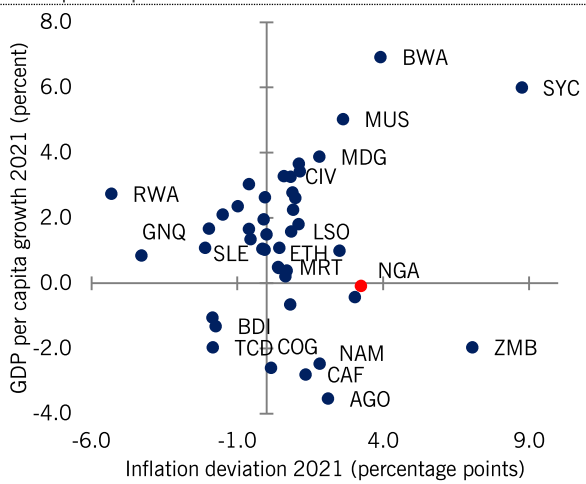
Inflation



Source: WEO data and World Bank estimates.

Figure 1.12: Nigeria is one of the few countries in Sub-Saharan Africa where inflation has risen as average income has declined.

GDP per capita and inflation



Source: WEO data and World Bank estimates.

In 2022, Nigeria is expected to have one of the highest inflation rates in the world and the 7th highest in Sub-Saharan Africa. In 2021, the inflation rate is expected to average 17.0 percent before declining to 13.5 percent in 2022 as supply-side constraints ease (Figure 1.11). Even if supply

shocks could be fully addressed, a combination of exchange-rate management problems, trade restrictions, expansionary monetary policies, and the monetary funding of the fiscal deficit will continue to generate inflationary pressures. Consequently, Nigeria is expected to remain an outlier in Sub-Saharan Africa, with inflation rates only below those of Zimbabwe, Zambia, South Sudan, Angola, Sudan, and Ethiopia (Figure 1.12). Elevated prices in a context of below-potential growth rates, compounded by the erosion of trust in the CBN's ability to curb inflation, will limit the CBN's options for alleviating inflationary pressures. Unless bold measures are taken to curb inflation, Nigeria's inflation rates will remain among the highest in Sub-Saharan Africa.

Box 1.3: Nigeria's Inflation in Comparative Perspective and Policy Responses

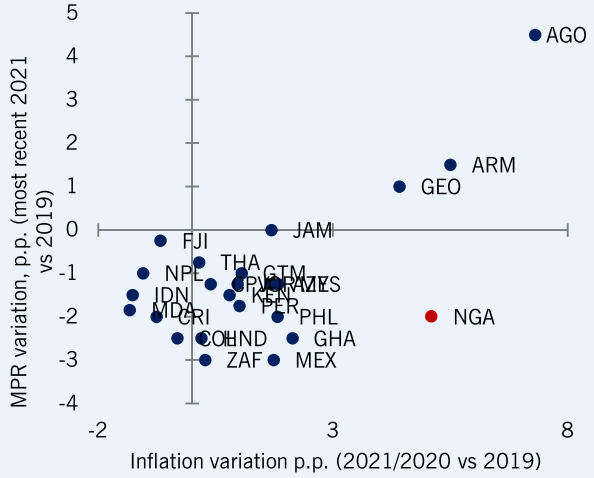
Since the beginning of 2021, inflation has increased in advanced and emerging market economies worldwide, driven by rebounding demand, input shortages, and rapidly rising commodity prices. While the experience of individual countries has varied widely, on average inflation has increased consistently in the first three quarters of 2021. As advanced and emerging market economies continue to recover from the deep contraction of 2020, continued supply-chain disruptions, ongoing policy support, and the release of excess savings accumulated during the pandemic are intensifying inflationary pressures on both the supply and demand sides.

The factors driving inflation in Nigeria differ from those observed elsewhere in the world. While Nigeria's experience is not completely isolated from global trends, the causes of the recent increase in prices are mostly idiosyncratic. Nigeria has experienced double-digit inflation for most of the last two decades. The inflationary cycle started after the border closure in 2019, the effect of which has been compounded by a complex and often contradictory array of fiscal and monetary policies, including support for industrialization, exchange-rate targets, countercyclical stimulus, and the monetization of the fiscal deficit. Demand remains subdued, with real incomes below pre-pandemic levels, while input shortages are not linked to supply-chain disruptions but to monetary and trade policies that predate COVID-19. In a context of import protectionism and continued oil exports, rapidly rising commodity prices have only partially passed through to domestic prices. Moreover, inflation in Nigeria has slowed slightly since April 2021, whereas in much of the world inflation started accelerating in Q2 2021.

Also contrary to the international experience, monetary policy has had a major impact on inflation in Nigeria. The tradeoff between growth and inflation became more acute in the wake of the pandemic. In H1 2021, central banks in emerging economies tended to avoid measures that would alleviate inflationary pressures at the cost of weakening domestic demand, but many central banks also recognized the risk that de-anchoring inflationary expectations could reduce their latitude to implement countercyclical policies to stimulate demand. By contrast, the CBN's response since the beginning of the pandemic has consistently favored growth (Figure B.1.3.1), and between 2019 and 2021 Nigeria experienced the greatest increase in inflation of any middle-income country that did not raise its policy rate during the same period. The consequent de-anchoring of inflation expectations has exacerbated the inflationary cycle (Figure B.1.3.2). In 2021, the inflation among emerging economies peaked at 6.8 percent, while Nigeria's peak was about 18 percent. In both advanced and emerging economies, inflation is expected to revert to pre-pandemic levels by mid-2022, but inflation in Nigeria is expected to remain above the average of the four years before the pandemic through mid-2022.

Figure B.1.3.1: CBN monetary policy has consistently favored growth over low inflation…

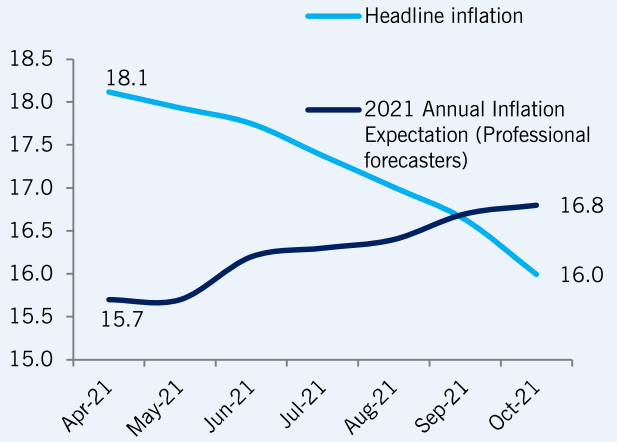
Inflation and policy rates



Source: WEO data and World Bank estimates.

Figure B.1.3.2: …and inflation expectations have become de-anchored from observed inflation.

Inflation and annual inflation expectations



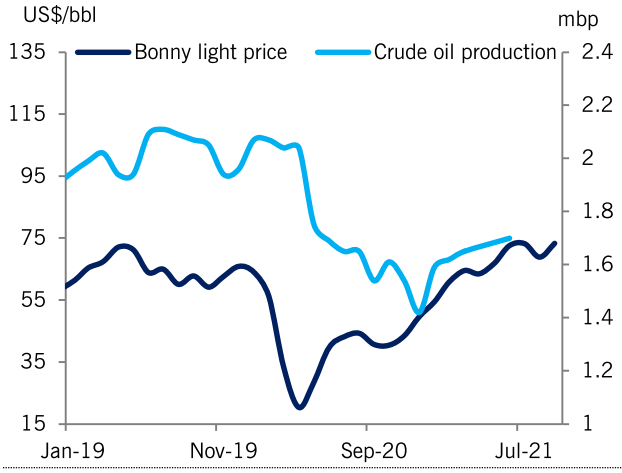
Source: NBS data, Consensus Forecast and World Bank estimates

The External Sector: An improved external position amid rebounding oil prices and remittances

Buoyed by rising oil prices and improved remittance inflows, Nigeria's current account balance has improved since 2020 and the deficit is expected to narrow to 1.6 percent of GDP in 2021. The current account deficit narrowed from -3.9 percent of GDP 2020 to -1.2 percent of GDP in H1 2021. Oil exports improved as oil prices returned to pre-pandemic levels, but export volumes remained below their potential due to lower oil production, as a result of which average output fell from 2.04 million bpd in 2019 to 1.68 million bpd in H1 2021. Due in part to FX shortages, imports fell by 3 percent relative to H1 2020 and by 14 percent relative to H2 2020, slowing growth but also improving the current account position. Remittance inflows, which along with oil exports are traditionally a major contributor to positive current account balances in Nigeria, also improved relative to H1 2020 and H2 2020 but remained about 20 percent below pre-pandemic levels.

Figure 1.13: Oil prices have recovered to pre-pandemic levels, but oil output remains below its potential.

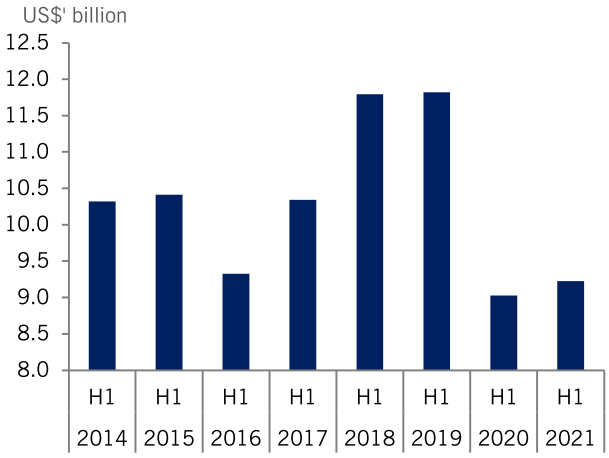
Bonny Light Oil Prices and Nigeria's Oil Output



Source: CBN

Figure 1.14: Remittances are recovering but have yet to reach pre-pandemic levels.

Diaspora Remittance Flows to Nigeria

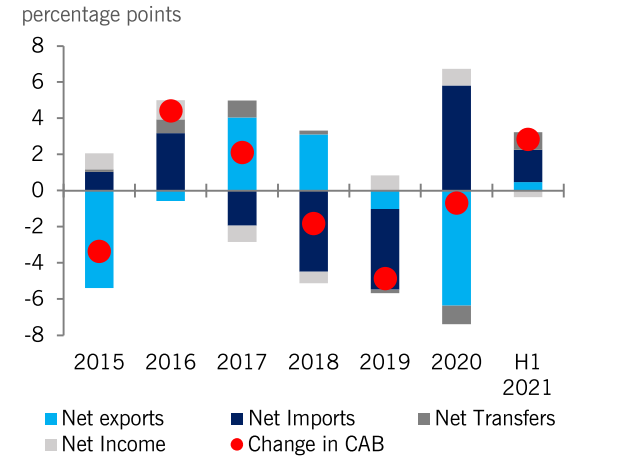


Source: CBN
Note: Only H1 remittances across the years have been compared, given that remittances have seasonal patterns. In particular, they increase during festive periods; notably during the Christmas season.

The current-account deficit was financed by net capital inflows, which rose from 0.2 percent of GDP in H2 2020 to 1.9 percent in H1 2021. The uptick in capital inflows was likely due to the gradual recovery of global financial activity and the renewed implementation of investments that had been suspended due to the pandemic. Equity investments accounted for the bulk of foreign direct investment (FDI) during the period, while money-market instruments comprised the largest share of foreign portfolio investment (FPI). In H1 2021, FDI flows to Nigeria however remained significantly lower than the flows to other emerging economies.

Figure 1.15: Higher oil exports and foreign remittances and lower imports narrowed the CAD in H1 2021

Contribution to Changes in Nigeria's Current Account Balance



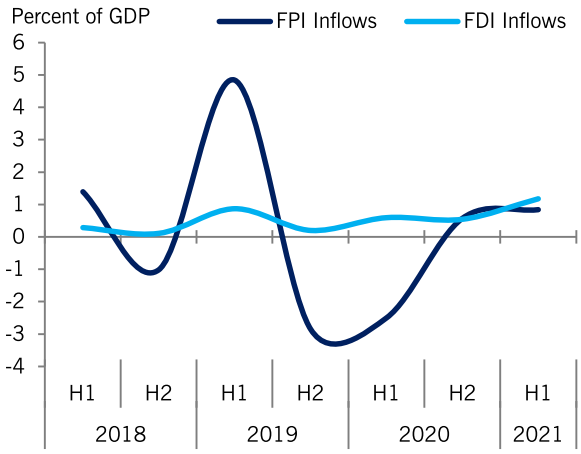
Source: CBN

Foreign reserves have remained fairly stable, supported by the CBN's continued FX demand-management strategy and its limited supply of FX to the market. Gross reserves declined by 5

percent from US$35 billion at end-2020 (5.98 months of import coverage) to US$33.3 billion at the end of June 2021 (5.95 months).[4] The US$3.35 billion IMF Special Drawing Rights (SDR) allocation to Nigeria in September 2021 and the US$4.0 billion Eurobond issuance in October 2021 provided a further boost to the reserves position, and by mid-October gross external reserves had reached US$39.2 billion. However, the private sector continues to report significant FX shortages, which is having a dampening effect on imports, and the stock of reserves is lower after adjusting for the pipeline of proposed imports.

Figure 1.16: There has been a slight uptick in foreign capital inflows to Nigeria.

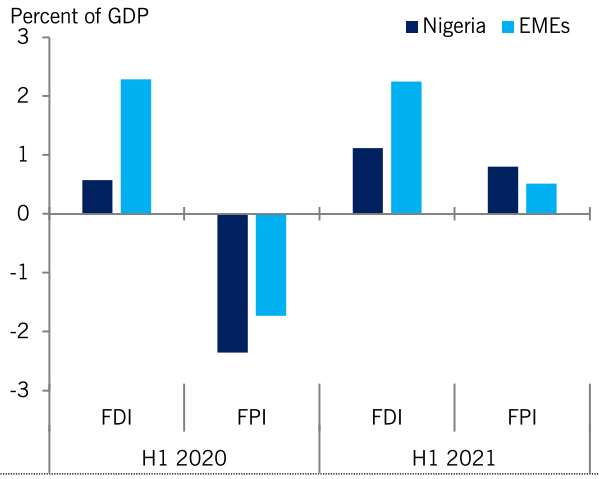
FPI and FDI flows to Nigeria



Source: CBN

Figure 1.17: Other emerging economies however continue to receive more FDI flows than Nigeria.

FPI and FDI flows to Nigeria and EMEs



Source: CBN, WDI
Note: EMEs considered are Argentina, Brazil, Colombia, Indonesia, Malaysia, Mexico, Philippines and Turkey.

Monetary Policy and Exchange Rate Management: Tighter monetary policy and enhanced exchange rate management are essential to reduce inflation and attract private investment

The economic impact of the pandemic has warranted an accommodative monetary policy but given the need to reduce inflation it is critical to establish price stability as the monetary policy objective. With the headline inflation rate continuously declining since April 2021, and growth strengthening in Q2 2021, the CBN has kept the monetary-policy rate and other benchmark rates steady. However, with core inflation increasing and headline inflation still well above the upper limit of CBN's target range of 6-9 percent, tighter monetary policy is warranted, as well as curbing monetary financing of the federal government's fiscal deficits.

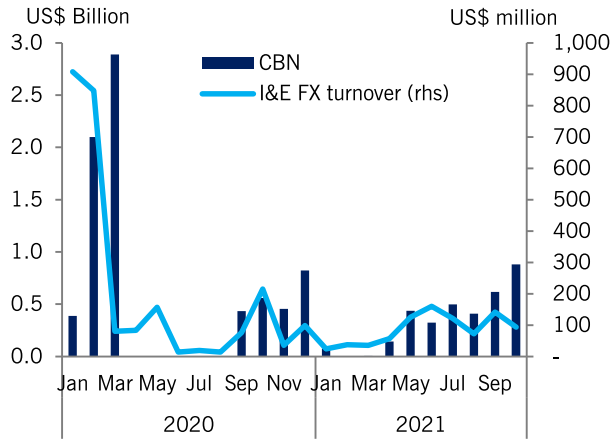
Exchange-rate stability remains a key policy objective, and with the CBN also keen to preserve its external reserves, it continues to manage FX

[4] This is a 30-day moving average. The CBN has stopped publishing exact gross reserves numbers.

demand and limit the supply of FX to the market. As higher oil prices are being offset by lower oil exports in a context of weakened FPI inflows, pressure on the naira remains strong. While the CBN effected three relatively large adjustments to the nominal official exchange rate since the pandemic began (15 percent in March 2020, 5 percent in August 2020 and 7 percent in May 2021), it has yet to introduce enough flexibility into FX management to sustainably respond to external shocks. While the CBN supplied an average of US$2.5 billion to the Investors and Exporters forex window in the months just prior to the COVID-19 crisis, it only supplied an average of US$0.5 billion in the months thereafter (Figure 1.18). The NAFEX rate, which is now the guiding exchange rate for the economy, continues to be managed and is not fully reflective of market conditions. The parallel-market premium over the NAFEX rate reached 29 percent in August 2021 after the CBN cut off its weekly supply of US$20,000 per bureau de change (BDC). The CBN has intermittently supplied forex to BDCs since 2005, providing ample opportunities for currency round-tripping.

Figure 1.18: The CBN's FX supply to the IEFX market is still well below pre-pandemic levels.

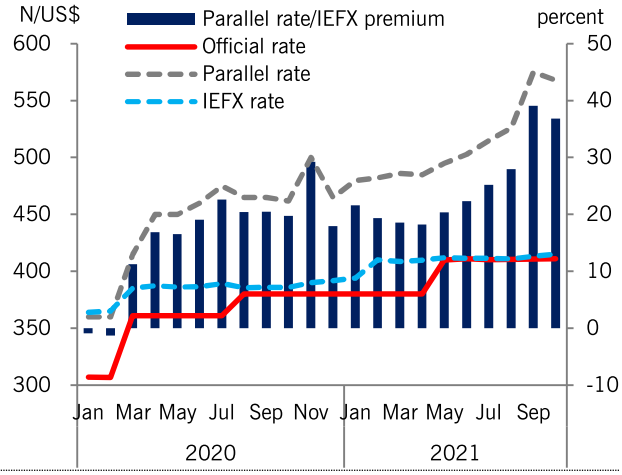
IEFX Market Turnover and CBN Supply



Source : CBN, FMDQ

Figure 1.19: The premium between the NAFEX rate and the parallel (black market) rate has widened.

Official, NAFEX and BDC (Parallel) Rates

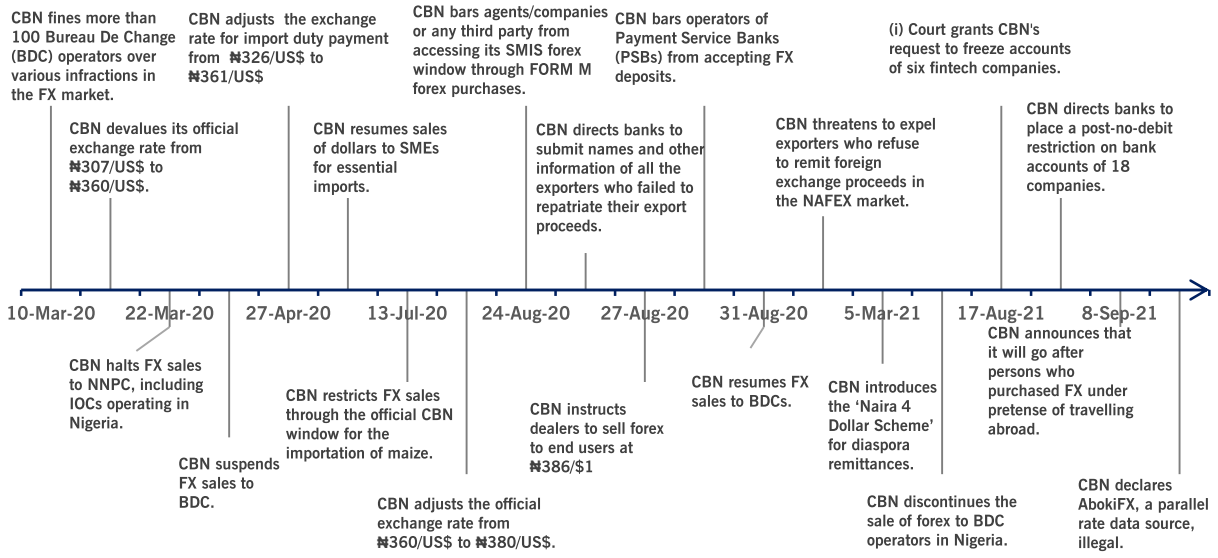


Source: CBN, FMDQ

A more predictable, transparent, and flexible FX-management system will be necessary to attract and retain private investment flows. Allowing greater flexibility (i.e., further depreciation) in the IEFX market would help satisfy pent-up demand for FX and enable the CBN to preserve its stock of international reserves. In addition, ensuring a more robust, transparent, and predictable FX supply response by the CBN, which should include regular auctions and communications with participants in the IEFX window to mitigate demand pressures and reduce investor uncertainty.

Figure 1.20: The CBN's foreign-exchange policy involves FX demand management as well as supply containment.

Timeline of CBN's Exchange Rate Management Interventions, 2020-21



Source: CBN.

The Financial Sector: Nigeria avoided a credit crunch

To mitigate the pandemic's economic impact on households and businesses, the CBN expanded its development finance interventions and sharply reduced interest rates, along with other measures, which helped prevent a severe private sector credit crunch. Prudential norms for restructured exposures were relaxed, initially for one year through March 2021 and later extended for an additional year. The CBN cut its monetary policy rate by 100 bps in May 2020 and by another 100 bps in September. The CBN softened the terms of its development-finance interventions, and the new terms have been extended also through March 2022; it also launched a range of new development-finance initiatives at subsidized interest rates seeking to ease the impact of COVID-19 on households and SMEs. Furthermore, support was provided to pharmaceutical companies, health practitioners, and SMEs to respond to the pandemic by injecting up to ₦400 billion in loanable funds.[5] The new funding is equivalent to about 2 percent of private sector bank credit at end-March 2020. In the event while real private sector banking credit growth decelerated sharply from about 12-13 percent (y/y) in the first couple of months of the pandemic to around 2 percent (y/y) in mid-2021, it did not turn into a credit crunch. A material role in this outcome was played by the credit provided by CBN and microfinance banks that saw their share in private sector credit rise by some 200bp between end-2019 and August 2021.

The regulatory forbearance granted by the CBN for restructuring loans impacted by COVID-19 was crucial to keep the banking system sound, but NPLs are expected to rise as measures taper off. Restructuring peaked at some 40 percent of the

[5] ₦100 billion is available from the Health Sector Intervention Facility and ₦300 billion from the Targeted Credit Facility. In November 2020, disbursements were ₦61 billion from the former and ₦149 billion from the latter. The initial funding for the Targeted Facility was ₦50 billion which was raised three times, reaching ₦300 billion in March 2021.

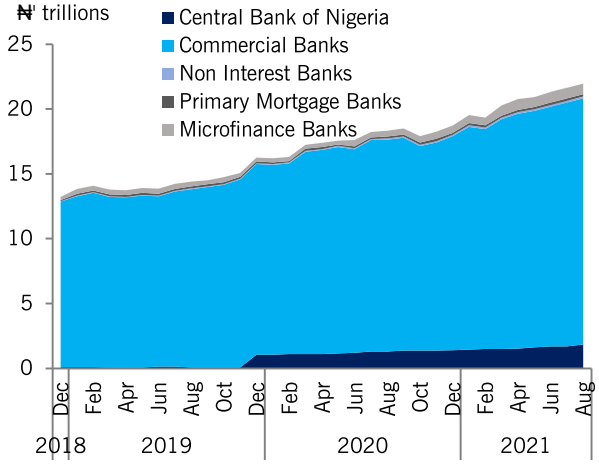
banking system loans in mid-2020. There is some evidence that repayments on restructured loans have started to normalize--particularly as the rally in crude oil prices improve cash flows of upstream firms accounting for some 25 percent of private sector banking credit. Troubled loans (IFRS Stage II and III) range from about 13 percent to about 30 percent for the larger banks in the systems in H1 2021. Loans are roughly one third of the system's assets. It is expected that a more supportive operating environment for banks and firms–higher crude oil prices, declining inflation, and continued economic growth, albeit with some headwind in still limited FX access–should help avoid a drastic surge in loan impairment when regulatory forbearance is removed Overall, banking system capitalization levels have remained above minimum requirements and banks profitable, but a thinly capitalized systemic bank could be under stress as support measures are removed.

There is a risk that a continued accommodative monetary policy stance could entrench inflation at an elevated level, well above the upper limit of CBN's target band. It is noted that inflation has been gradually declining but at around 16 percent (September 2021) is still elevated. That policy stance also risks continued portfolio capital outflow pressures and financial disintermediation—albeit the highly negative real yields on CBN and Government fixed income short-term securities narrowed as rates have risen in the last few months. The surge in crude oil prices and the IMF's SDR allocation by shoring up international reserves lessen the risk of a disorderly sizable exchange rate depreciation—such an event would have material consequences on bank capitalization given the extent of portfolio dollarization and un-/limited-hedged corporates.

The authorities must however take special care in managing the process of withdrawing forbearance and other pandemic-related support measures. Reversal of the bank-debt repayment moratorium and forbearance measures present distinct risks to CBN as supervisor of banks and of other financial institutions. Policymakers need to balance continued support for businesses and households in a highly uncertain pandemic-dependent environment against the risk that low-quality (impaired) assets will become entrenched in the system, intensifying liquidity risks and eroding the culture of loan repayment.[6] Rolling back pandemic-related support measures would likely reveal previously hidden deterioration in asset quality, raising solvency risks for the more thinly capitalized banking institutions. Managing the consequences of this process will test the adequacy of the processes for dealing with banks in distress and resolving failed institutions. Early regulatory development of the tools and powers to deal with banks in distress provided in the 2020 Banks and Other Financial Institutions Act is warranted aw well as the further development of the Nigeria Deposit Insurance Corporation capacity to deal with systemically important domestic banks. It is noted that in September 2021, CBN communicated to banks the resumption of the process of implementing Basel III standards, notably including the adoption of capital add-on under Pillar II that would better align capital with the risk profile of individual entities inter-alia strengthening the risk-based supervisory approach. Implementation of the Basel III standards would run in parallel with current standards for a six-month period commencing in November 2021 (that could be extended for an additional three months).

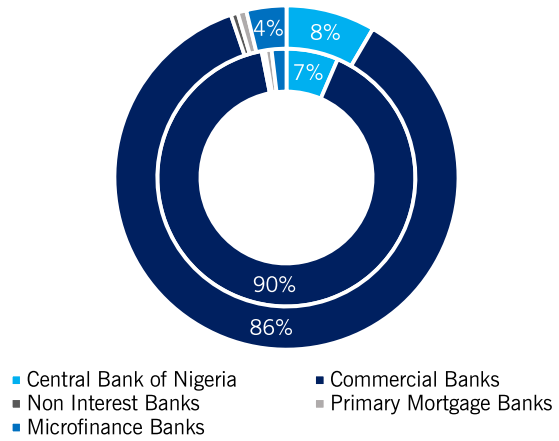
[6] On March 3d, 2021, the CBN announced that it would extend the reduction from 9 to 5 percent of the interest rate on its development intervention facilities for one year through February 28, 2022, and that a one-year extension of the repayment of credit facilities would be considered case-by-case.

Figure 1.21: Nigeria avoided a credit crunch
Credit to the Private Sector



Source: CBN.

Figure 1.22: CBN played a key role in expanding credit to SMEs
Share in Private Sector Credit Origination (end 2019 'inside' Vs. end August 2021 'outside')



Source: CBN.

Fiscal Policy: Elevated risks as federation revenues decline despite the rise in oil prices

As the economy recovers from the COVID-19 crisis, Nigeria's fiscal deficit is projected to rise to its highest level in 2021 (5.7 percent of GDP) for over a decade. Consolidated government revenues in Nigeria continue to be among the lowest in the world (6.5 percent of GDP in 2020[7]), and heavily reliant on oil, while expenditure growth remains high. The volatility of oil prices and production has jeopardized the stability of revenues for Nigeria, constraining fiscal space. In 2021, consolidated government revenues are estimated to recover modestly to 7.1 percent of GDP against 6.5 percent of GDP in 2020, on the back of rising oil prices. Nonetheless, despite this recovery, consolidated revenues are projected to remain below the levels seen before 2015. Capital expenditures are projected to reach 4.1 percent of GDP as compared to 2.8 percent of GDP in 2020. This is expected to push consolidated government expenditures to their highest level since 2013–12.7 percent of GDP, compared to 11.9 percent in 2020.

Rising global oil prices may not translate into higher general government revenues for Nigeria, making a strong case for diversification of revenue sources. In the first half of 2021, revenues have been declining year-on-year. In 2021 H1, total Federation Account Allocation Committee (FAAC) distributable revenues declined by 1.3 percent as compared to H1 2020, of which oil revenues declined by 18.7 percent year-on-year. The decline in oil revenues is due to two factors: lower oil production and lower transfers year-on-year by the NNPC. While oil prices have been higher in 2021 as compared to 2020, the PMS subsidy deducted by NNPC prior to the transfer to the Federation Account results in a significantly lower oil and gas revenue available for distribution from this source. In the first half of 2021, ₦541 billion was claimed for subsidy reimbursement by

[7] As per World Economic Outlook (October 2021), Nigeria has the third lowest general government revenue to GDP ratio for 2020 out of 196 countries

the NNPC, corresponding to 44 percent of the net oil revenues in the Federation Account. Uncertainties about future oil prices and PMS consumption make deductions difficult to forecast, creating fiscal and budget management issues. Non oil revenues (NCS and FIRS collections) increased year-on-year by 14.5 percent Given the unreliability of oil revenues, Nigeria is implementing reforms to generate non-oil revenues. Some of the results of these reforms are evident as net VAT revenues increased as compared to the same period last year by 66 percent.

Volatility in oil revenues adversely affects States' revenues, especially for those that predominantly rely on federal transfers. In 2020, States' share (not including FCT) of the FAAC transfers by 8.2 percent while Internally Generated Revenues (IGR) of the States only declined by 0.6 percent. However, since States rely on FAAC transfers for majority of their revenues (65 percent on average), total States' revenues declined by 5 percent. There is considerable discrepancy between States, with those relying more on federal transfers likely to suffer more. For example, with the decline in federal revenues in 2020, Bayelsa, that gets 91 percent of its revenues from federal transfers, saw a 22 percent decline in per capita revenues, while Lagos that only relies on federal transfers for 29 percent of its revenues saw its per capita revenues increase by 6 percent.

Figure 1.23: Despite higher oil prices, fiscal deficit in 2021 has widened.

Federal Government Revenue, Expenditure and Fiscal Deficit.

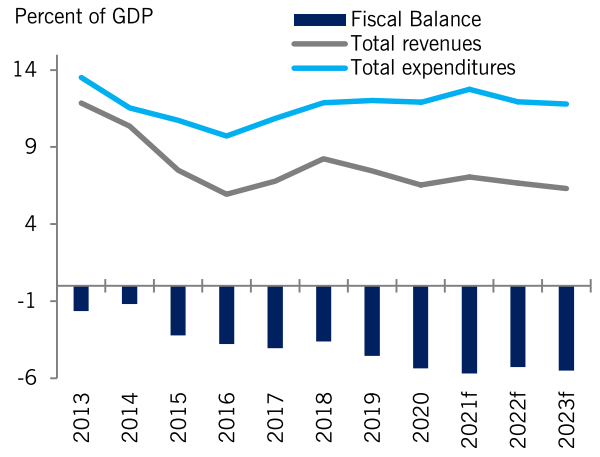
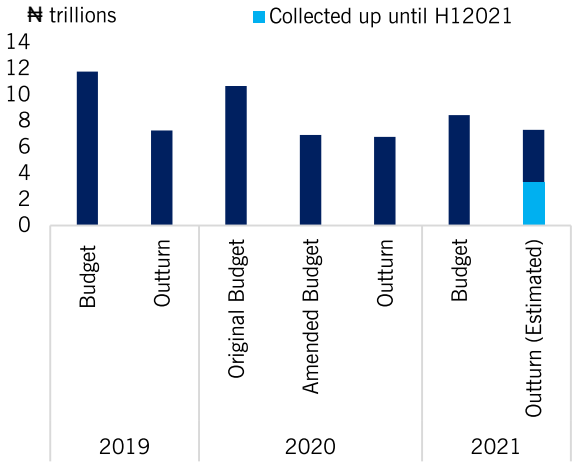


Figure 1.24: Net FAAC revenues have been consistently lower than the budget estimates, highlighting volatility of oil revenues, and weaknesses in planning and fiscal management

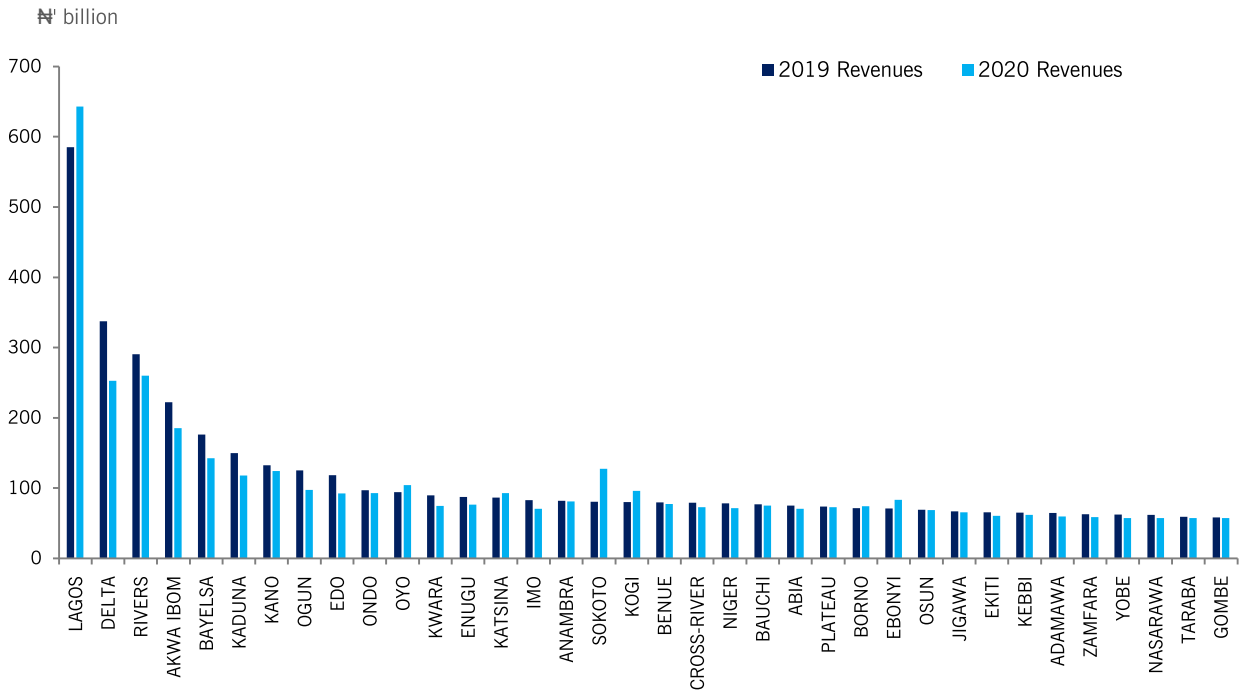
Federal Government Revenues



Source: OAGF, BoF, and World Bank estimates.

Figure 1.25: Of the 36 states, only 7 saw their revenues increase in 2020…

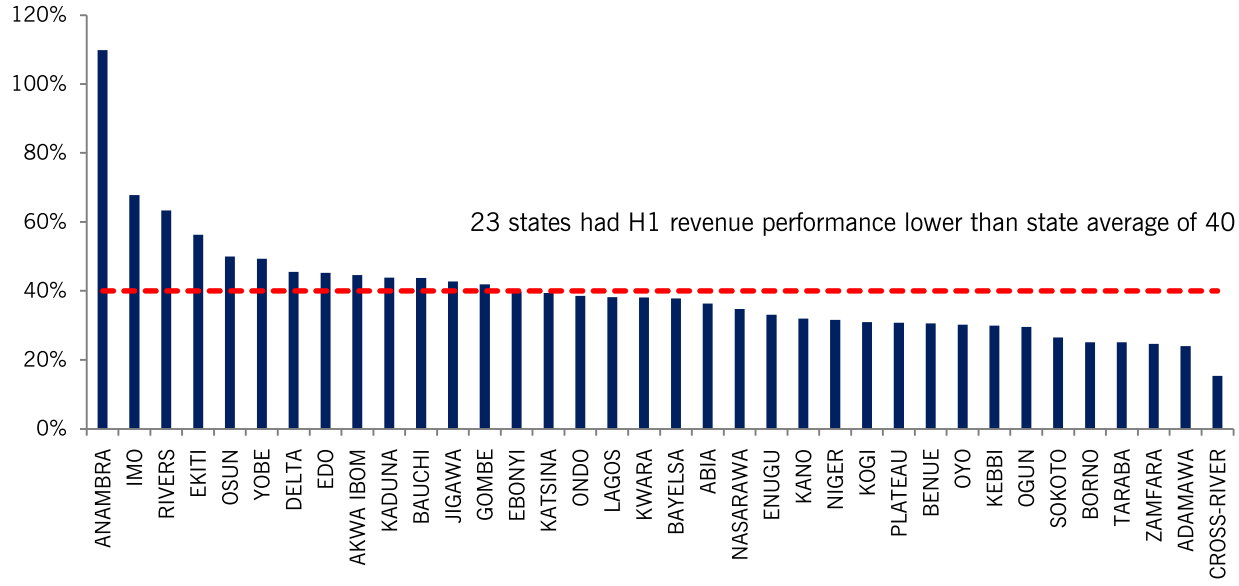
2019-2020 revenue outturns



Source: State Budget Performance Reports and World Bank estimates.

Figure 1.26: ….and States' revenue outturns continue to remain low in 2021 as compared to the budget

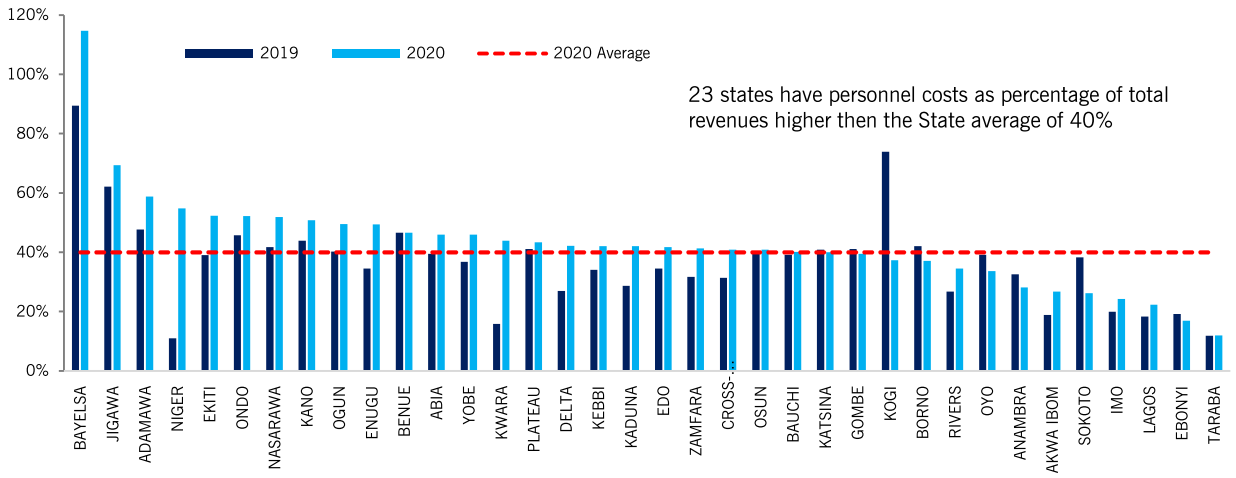
H12021 revenue outturns against budget – percentage



Source: State Budget Performacne Reports and World Bank estimates.

Figure 1.27: Rising personnel costs shrink States' fiscal space…

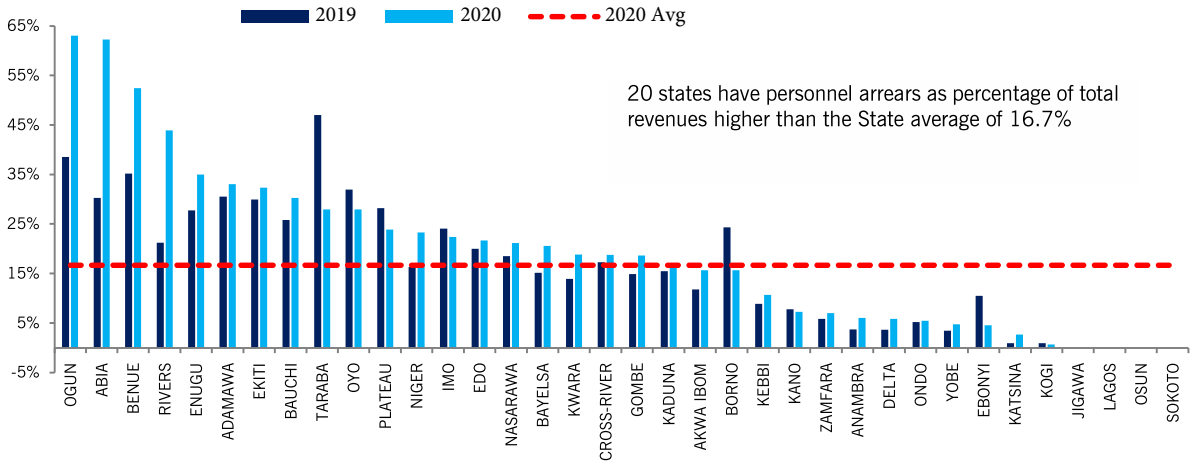
Personnel costs as a percentage of total revenues



Source: State Budget Performacne Reports and World Bank estimates.

Figure 1.28: …often leading to rising personnel cost arrears

Salary and pension arrears as a percentage of total revenues



Source: State Budget Performacne Reports and World Bank estimates.

Fiscal sustainability of states is worsening as revenues decline and expenditure needs increase. Given the non-discretionary nature of expenditure, expenditures of States (not including FCT) in 2020 only reduced by 2 percent, putting potential pressure on State debt stocks and future fiscal sustainability. Personnel costs for the States' increased by 11.1 percent between 2019 and 2020, while personnel cost arrears have increased by 15.3 percent.

The Federal Government has accelerated efforts to diversify its revenue stream; however, risks to the implementation of these reforms remain high. These reforms include improving tax administration, especially for VAT, while also undertaking some significant policy reforms, such as implementing a levy on electronic money transfers, and additional excise taxes on alcohol and tobacco (Table 1.1). While these reform efforts are expected to generate additional revenues of over ₦ 3 trillion a year, they may be challenging to

politically implement in the run up to the national elections, planned for 2023. In addition, issues of fiscal federalism associated with any new revenue measures have to be considered before they are rolled out.

Table 1.1: Policy Options to Boost Non-Oil Revenues

Area	Reforms
VAT reforms	The Federal Government is implementing various VAT administration reform as well, including expansion of e-filing, enhancing and automating the taxpayer database, implementing taxpayer education programs for VAT taxpayers, and implement a control-visit program for VAT.
Electronic Money Levy	The Federal Government has already started the process of imposing an electronic money levy on money transfers that can help boost revenue collections by about ₦ 308 to ₦ 462 billion in 2021 alone. The levy can be administered at very low administrative cost given that the banks will be able to apply the charge electronically, and the burden is borne by bank customers. The Federal Government is expected to issue regulations, under section 48 of the Finance Act 2020, defining key aspects of the Electronic Money Transfers Levy that enable banks to levy the charge and the designated federal agency to collect it.
Excise on sin goods	The government plans to raise excise on alcohol and cigarettes in line with peer countries and introduce excise on sugary products expected to raise ₦ 30-40 billion annually.
Tax administration	Tax administration reforms are being introduced in the form of expansion of technology services for database management, especially introducing the FIRS Digital Transformation Strategy and Implementation plan and introducing TaxProMax ICT system. Other administration reforms that are planned include risk- and case-based audits and signing Memorandum of Understanding (MoUs) for information exchange.
Rationalizing tax expenditures	The Federal Government is also planning to rationalize tax expenditures in 2022. The government plans to remove or sunset at least one tax expenditure with a revenue forgone of ₦ 100 billion or more. For financial services, federal government aims to replace relief with deductions for income tax, and with zero rate for VAT. There are also plans to sunset any firm specific tax expenditures and ensure new tax expenditures are available to all qualified applicants.
Customs reform	Several reforms are being undertaken for improvements in customs administration. These include simplification of processes for traders, and introduction of a National Single Window (NSW) and establishing a Trusted Trader Program that will make processes easier and smoother for pre-approved businesses.

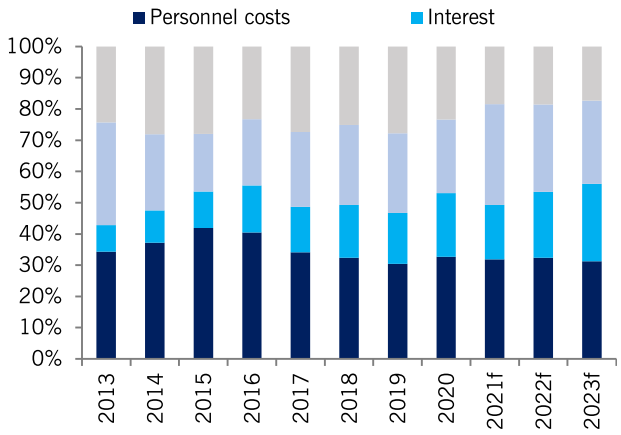
Expenditure pressures are elevated in 2021 as government increases its capital expenditure despite fiscal space being constrained due to higher interest payments. In the first half of 2021, Federal Government's half-year expenditure increased year-on-year by 26 percent, as federal debt servicing rose by 25.2 percent year-on-year. However, federal capital expenditures also saw a 193.3 percent increase year-on-year. Due to a reduction in capital expenditure in 2020 as COVID induced a contraction in revenues and an increase in COVID related expenditure, capital expenditures were postponed, and are thus seeing a large increase in 2021. There is little room for consolidated government expenditures to adjust downwards to make fiscal space for these required capital expenditures, as they continue to be under pressure from non-discretionary spending, especially rising interest expenditure and personnel costs. This eventually pushes expenditure growth to a level that higher than what is fiscally prudent.

Nigeria's debt remains sustainable, albeit vulnerable and costly, especially due to large and growing financing from the Central Bank of Nigeria (CBN). While currently the debt stock of 27 percent of GDP[8] is considered sustainable, any macro-fiscal shock can push debt to unsustainable levels. However, debt to GDP in Nigeria is rising quickly, and the total stock of debt in absolute value has almost doubled between 2016 and 2020, and without a policy change is expected to reach 40 percent of GDP by 2025. The cost of debt servicing is also a concern as it is potentially crowding out public investment and critical service delivery spending. Interest costs have been above 2 percent of GDP since 2018, reaching 2.4 percent of GDP in 2019 and then falling to 2.2 percent of GDP in 2020. Cost of debt is high as federal government also resorts to overdraft (Ways and Means financing) from CBN to meet in-year cash shortfalls. At end of 2020, the stock of CBN Ways and Means financing was estimated at ₦13.1 trillion or 8.5 percent of GDP. There are on-going efforts (expected to be concluded by the end of 2021) by the Federal Government to negotiate terms with CBN to convert the stock of overdraft financing into a long-term debt instrument, thus lowering cost of debt for the government and improve fiscal sustainability over the medium-long term.

[8] 33.3 percent if Ways and Means financing from CBN and AMCON debt is considered part of public debt. If these are included in the public debt, short-term debt vulnerabilities are enhanced raising more immediate concerns about debt sustainability.

Figure 1.29: General Government expenditures are increasingly under pressure from non-discretionary expenditure

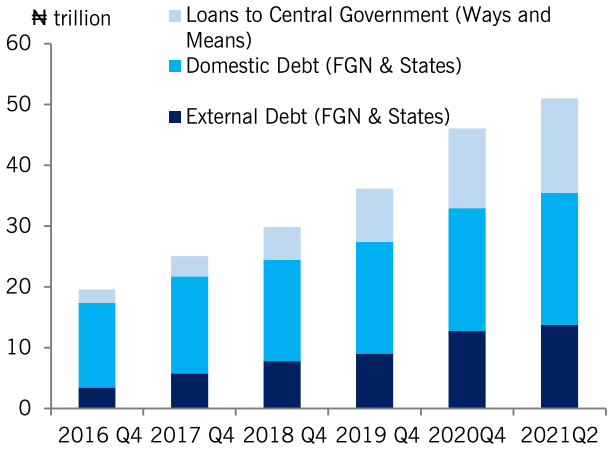
Federal Government Expenditure Component



Source: OAGF

Figure 1.30: Debt stock is rising rapidly especially on the back of increasing stock of Ways and Means financing from CBN

Public Debt Stock



Source: CBN and DMO

Box 1.4: Federal Government's 2022 Budget Proposal

The 2022 Budget proposal by the Federal Ministry of Finance, Budget, and National Planning (FMFBNP) is focused on fiscal consolidation through higher revenue generation. Proposed budget for 2022 shows an increase of 55.4 percent in FAAC revenues against 2021 budget (inclusive of supplementary budget) with gross oil and gas revenues increasing by 64.4 percent. According to the 2022 Budget, higher oil revenues are expected on the back of rising oil prices and the introduction of Company Income Tax on oil and gas companies that is estimated to generate over ₦1 trillion of revenue in 2022. Building on higher growth estimates and revenue reforms, increases are also projected in non-oil revenues, including VAT (32.8 percent against 2021 budget target) and Customs (64.1 percent increase compared to 2021 budget).

Federal fiscal deficit (including Government-owned enterprises and project-tied loans) is projected to be 3 percent lower as compared to 2021 budget estimates. Federal revenues are expected to increase by 27 percent, while federal government is projecting only a 13 percent increase in its expenditure. Interest payments are projected to be 15.5 percent higher in 2022 as compared to 2021 budget estimates, while non-debt recurrent expenditure is budgeted to increase by 18.5 percent. However, capital expenditure (not including statutory transfers) is budgeted be 2 percent lower as compared to 2021 estimates. Market based borrowings are budgeted to be 8.7 percent lower, as the federal government is expecting a 62.9 percent increase in multilateral and bilateral project-tied loans in 2022.

Table B.1.4.1: Higher oil prices and higher growth projections are behind higher revenue projections

	2021 Budget (including the supplementary budget)	2022 Budget Estimates
Crude Oil price (US$/bbl)	40	57
Crude oil production (mbpd)	1.86	1.88
Exchange rate (₦ /US$)	379	410.15
Inflation (percent, annual average)	15	13
Real GDP growth (percent)	2.5	4.2
Net FAAC revenues	6.7	10.5
Federal Government revenues	7.7	9.8
Federal Government expenditure	14.6	16.4
Federal fiscal deficit	6.9	6.6
Financing	6.9	6.6
Domestic Borrowing	2.7	2.5
External Borrowing (including multilateral and bilateral loans)	3.4	3.7
Privatization	0.2	0.1
Others	0.6	0.3

Source: Federal Government's 2021 Budget Proposal

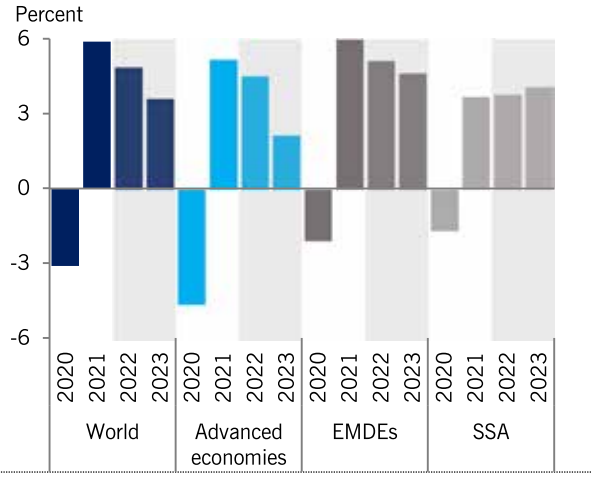
Economic Outlook

Global growth is expected to moderate in 2022

Following a strong rebound in 2021, the global economic recovery is projected to slow in 2022-23. The average global growth rate is expected to reach just 4.3 percent, reflecting a deceleration among EMDEs amid continued viral outbreaks and highly uneven vaccination rates. In SSA, output growth is projected to remain strong but below its long-term average in 2022-23. However, national growth forecasts are uneven, and a very slow vaccine rollout, heightened poverty and food insecurity, rising political instability, and a deteriorating security situation in some SSA countries will continue to inhibit the recovery in domestic demand, deter private investment, and undermine long-term growth.

In 2022, the annual average oil price is expected to be similar to that in 2021. Driven by the economic recovery among advanced economies, oil prices in 2021 are expected to reach an average of US$66 per barrel (bbl), 60 percent higher than in 2020. In 2022 they are expected to remain broadly stable at US$65/bbl.[9] In July 2021, OPEC+ agreed to phase out its 5.8 million bpd quota by September 2022, which should ease upward price pressures.

Figure 1.31: SSA experienced a relatively limited economic contraction in 2020, but the region's recovery is projected to lag the average for EMDEs worldwide.



Source: World Economic Outlook October 2021 and World Bank calculations

Nigeria's Outlook: A fragile recovery is expected amid a more favorable external environment

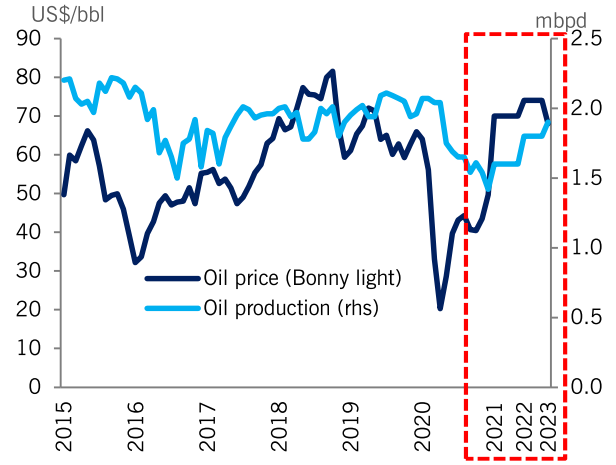
While the price of oil remains the key exogeneous variable affecting Nigeria's growth outlook, higher oil prices would not necessarily improve the fiscal position. For instance, several factors complicate the influence of oil prices on Nigeria's fiscal position. First, production constraints limit the benefits of higher prices, as Nigeria's output remains well below both the OPEC+ production cap and the country's full production capacity. Second, because the PMS subsidy applies to gasoline imports, rising oil prices increase the cost of the subsidy and reduce the net oil revenue transferred to the Federation. Whereas the fiscal benefit of oil exports is a function of global oil prices and the volume of domestic oil production, the fiscal cost of the PMS subsidy is a function of global gasoline prices and domestic demand for gasoline. Because international oil and gasoline prices are closely correlated, the PMS subsidy erodes the fiscal benefits of higher oil prices.

[9] IMF World Economic Outlook October 2021

Moreover, the other variables—domestic oil production and gasoline import demand—are only tenuously related and can move in opposite directions. If oil production declines while gasoline demand rises, higher oil prices could *weaken* Nigeria's fiscal balance, as the mounting cost of the PMS subsidy could more than offset the increased value of oil exports. While this example is purely illustrative, the negative macro-fiscal implications of the PMS subsidy are embedded in the scenario analysis presented below.

Figure 1.32: Despite rebounding oil prices, Nigeria's oil output in 2021 was the lowest in the last two decades due to sectoral underinvestment and inefficiencies.

Oil prices and production volumes



Source: CBN, NNPC, OPEC, and World Bank estimates.

In the baseline scenario, oil prices are expected to remain broadly stable while oil production is expected to increase during 2022 and 2023. Bonny Light oil price is assumed to average US$70/bbl between 2021 and 2023, and crude oil production rises to 1.5 million bpd at the end of 2021 and ranges between 1.7 and 1.9 million bpd in 2022–23.

After a bold but short-lived reform effort in 2020, the government's policy stance has reverted to a business-as-usual framework that is wholly unsuited to its domestic and external challenges. Multiple exchange rates, trade restrictions, and CBN financing of the public deficit continue to undermine the business environment, compounding longstanding weaknesses in revenue mobilization, foreign investment, human capital development, infrastructure investment, and good governance. The authorities face a shrinking window of opportunity to accelerate the recovery by easing macroeconomic imbalances, addressing fiscal vulnerabilities, and protecting the welfare of poor households. The authorities' ability to implement lasting reforms in the following five policy areas will greatly influence the pace and quality of future growth:

- **Reducing inflation in a way that supports the economic recovery** through a sequenced and coordinated mix of exchange rate, trade, fiscal, and monetary policies.
- **Catalyzing private investment** to boost job creation by fixing the policy-induced impediments, which are exchange rate management issues that limit access to FX and trade restrictions, in addition to the usual agenda on business enabling reforms.
- **Addressing fiscal pressures** by safeguarding oil revenues to the Federation by eliminating the NNPC deductions associated with the PMS subsidy, which is costly, mainly benefits the rich, harms the environment, and discourages private investment; and by mobilizing non-oil revenues by rationalizing tax expenditures and expanding the tax base.
- **Protecting the poor and vulnerable** through (i) a targeted and time-limited cash transfer program, financed through the elimination of the PMS subsidy, as part of a broader and well-communicated compact with the Nigerian population, and (ii) widespread vaccination.

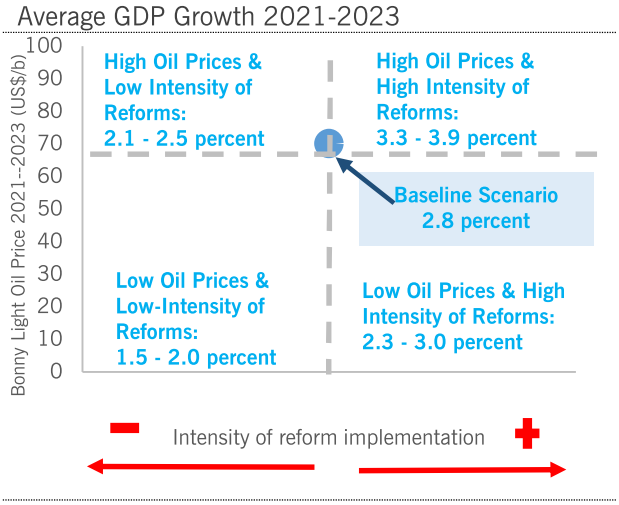
Nigeria's economic outlook is subject to considerable uncertainty, as it hinges on the

global economic recovery, the trajectory of oil prices and production, and the scope and pace of reforms. The outlook scenarios presented in this edition of the NDU combine different assumptions for oil prices and public policy, including the public health response to the COVID-19 pandemic. Oil prices now exceed pre-pandemic levels, but Nigeria's modest projected recovery faces risks related to oil-price and production volatility, as well as weaknesses in the financial sector, high inflation, and worsening unemployment. Even in the most favorable global context, the strength and speed of the policy response to support growth and create jobs will be crucial to lay the foundation for a broad-based and sustainable post-crisis recovery.

Growth scenarios: Policy reforms are expected to have a greater influence on Nigeria's growth than oil prices

In the baseline scenario, Nigeria's GDP growth rate is projected to recover to an annual average of 2.7 percent in 2021 before gradually rising to 2.8 over the medium term. Growth in 2021 will be led by services, trade, agriculture, and construction, with the oil sector contracting during the remainder of the year. In 2022, growth in the manufacturing and services sectors will moderate but remain positive, with high oil prices contributing to the rapid growth of oil output. The baseline scenario assumes that the authorities will sustain and deepen the 2020 reforms, especially measures to curb electricity and fuel subsidies, which are necessary to generate fiscal space to support the economic recovery. However, the policy framework will remain inadequate to fully address the two main sources of macroeconomic imbalances: sub-optimal exchange-rate management and high inflation (Figure 1.33). Higher oil production (exceeding 1.6 million bpd) will boost exports and fiscal revenue, increasing the disposable income and purchasing power of households and promoting domestic investment. However, the relationship between the oil sector's performance, household purchasing power, and domestic investment will be weakened by high inflation and excessively rigid exchange-rate management. Inflation rates are expected to decrease but will remain among the highest in Sub-Saharan Africa, and with no credible policy to anchor inflationary expectations, investment and consumption decisions will remain suboptimal. Meanwhile, mounting pressure on the parallel exchange rate will constrain the CBN's ability to clear the forex backlog and promote growth via higher investment (Figure 1.34).

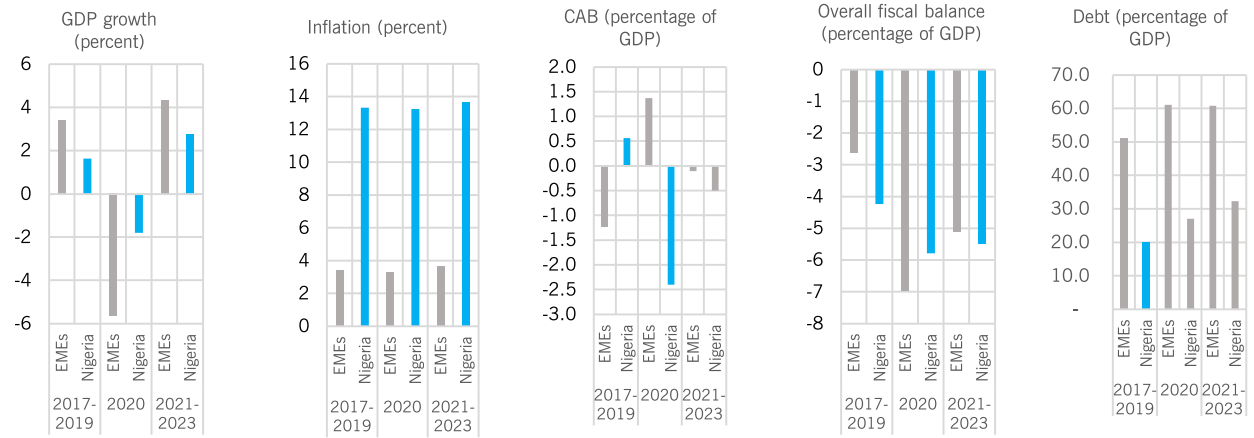
Figure 1.33: Policy reforms are expected to have a greater influence on Nigeria's growth than oil prices.



Source: World Bank estimates.

Figure 1.34: Unless reform momentum is restored, Nigeria's GDP growth will lag peers' growth.

Macroeconomic projections

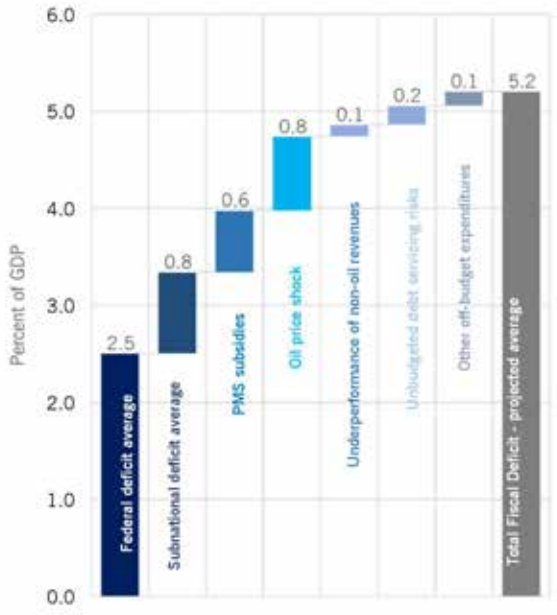


Source: WEO database and World Bank estimates.

Under alternative scenarios in which the government implements more aggressive reforms to boost growth and job creation, GDP growth will exceed population growth by 2023. These scenarios assume that the authorities will adopt urgently needed fiscal, monetary, and trade reforms that effectively curb inflation, shore up macroeconomic stability, and accelerate inclusive growth and job creation. Critically, these measures would also enable Nigeria to weather a decline in oil prices and other exogenous shocks. Easing import and FX restrictions would lower prices both for imported goods and domestic substitutes. Improving exchange-rate management would reduce pressure on the external accounts and improve the business environment, encouraging foreign and domestic private investment. Finally, strengthening social protection would mitigate the impact of inflation on poor and vulnerable households.

Figure 1.35: Unless appropriate reforms are implemented, an adverse external environment could cause the fiscal deficit to double between 2021 and 2023.

Fiscal Deficit by Component, 2021-23



Source: OAGF, World Bank estimates.

Under a set of alternative scenarios in which reform efforts are weak and recent improvements are reversed, Nigeria's recovery would be significantly slower, and growth would remain below the baseline even if oil prices rose. The reversal of reductions in electricity and

gasoline subsidies, ineffective efforts to control inflation, and the maintenance of tight FX controls would diminish foreign and domestic investment, significantly dampening Nigeria's growth prospects. Meanwhile, diminished public spending would widen Nigeria's already substantial gaps in human and physical capital, further erode the quality of public services, and damage investor confidence. Consequently, per capita GDP growth would return to negative terrain, and the poverty rate would increase.

Key risk factors for Nigeria's outlook include the PMS subsidy, oil-price volatility, weak nonoil tax mobilization, and the underbudgeting of core expenditures. PMS subsidies are not budgeted and are expected to continue putting pressure on the consolidated government accounts. Following their recent recovery, oil prices are expected to stabilize or even decline over the medium term, and the inherent volatility of oil prices continues to weaken the reliability of revenue projections. In the absence of major improvements to nonoil tax policy and administration, nonoil revenues will fall short of their targets, compounding the volatility of oil revenues. Expenditure-side pressures stem primarily from off-budget expenditures and the rising cost of debt servicing. As Ways and Means financing is not adequately integrated into the fiscal accounts, debt service is typically underbudgeted. Without appropriate measures to reduce Ways and Means financing and restructure the existing stock of Federal arrears to the CBN, the rising cost of debt servicing will government's continue to constrain the government's already limited fiscal space, and make government planning and budgeting difficult and unrealistic.

Policy Options: Reducing macroeconomic imbalances to attract private investment at scale, while protecting the poor against shocks

In 2020, Nigerian authorities carried out several long-delayed policy reforms that created additional fiscal space. The government began to harmonize exchange rates; began to eliminate gasoline subsidies; started adjusting electricity tariffs to more cost-reflective levels; cut nonessential spending and redirected resources to COVID-19 responses at both the federal and the state levels; and enhanced debt management and increased public-sector transparency, especially for oil and gas revenue flows. By creating additional fiscal space and maximizing the impact of the government's limited resources, these measures were critical in protecting the economy against a much deeper recession and in laying the foundation for earlier recovery, which started in Q4 2020.

However, in 2021 the authorities are failing to sustain the reform momentum and Nigeria has returned to a "busines-as-usual" scenario, similar to that of 2016–2019. Several critical reforms are as yet incomplete, in particular the elimination of the PMS subsidy, and the risk of reform slippages has increased. A business-as-usual policy scenario would hinder the renewed economic expansion and undermine progress toward Nigeria's development goals. Failure to sustain the reform momentum would threaten both macroeconomic sustainability and the government's policy credibility and would further limit the government's ability to address gaps in human and physical capital—all of which would discourage private investment. The PMS subsidy has re-emerged with the recent rise in oil prices, and a reversal of fiscal consolidation efforts on the

revenue side is an especially threatening risk. Slow growth would put more pressure on the financial sector, reducing credit growth, and thus the financing of new domestic investment. In a low-growth scenario, social conflicts are more likely to fuel insecurity.

This edition of the *Nigeria Development Update* proposes immediate policy actions to reduce inflation, restore growth through higher private investment, expand fiscal space, and protect the lives and livelihoods of Nigerians. Because inflationary pressures arise from multiple sources, stabilizing and reducing inflation will require a sequenced and coordinated package of reforms that encompasses exchange-rate management and monetary, fiscal, and trade policy. By correcting these macro distortions, the authorities will also set the foundations to promote private investment growth. To expand fiscal space, the authorities need to protect oil revenues by eliminating the PMS subsidy, and mobilizing non-oil revenues through the rationalization of tax expenditures. Because such action could hit poor households hard in the short term, social protection systems that emanate from a well-communicated compact must be reinforced to prevent any further deterioration in consumption and welfare. Half-measures will not be enough to divert the current growth and poverty trends and lay the foundation for robust recovery.

Table 1.2: Near-term policy options to address macroeconomic pressures for investment and job creation at scale

Area	Options for the next 3 to 6 months	Options for the next 6 to 18 months
Reducing inflation	• Adopt a single, market-driven exchange rate, and enhance exchange rate management (see further below). • Fully reopen land borders to trade and strengthen regional cooperation to combat smuggling. • Facilitate imports of staple foods and medicines by removing them from the list of FX restrictions and replacing import bans with tariffs that reflect the ECOWAS Common External Tariff. • Review FX restrictions and import bans currently applied to nonfood goods and assess the implications of replacing them with tariffs. • Define key monetary-policy priorities and objectives and signal the Central Bank's commitment to price stability as the primary objective. • To further reduce the federal government's recourse to CBN financing, improve the accuracy of revenue forecasting in the budget. Overoptimistic revenue forecasts and the resulting shortfalls lead to larger-than-anticipated deficits. • Reduce CBN lending to medium and large corporates under its subsidized funding schemes to expand the scope for commercial banks to intermediate funds at a risk-adjusted lending rate.	• Adopt a mechanism to allow increased borrowing (while managing costs) to cover additional financing needs arising from revenue shortfalls. • To help contain the growth of the money supply, enforce the legal limit for the use of CBN overdrafts to the allowed maximum of 5 percent of the previous year's fiscal revenues.
Catalyzing private investment to boost job creation	• Adopt a single, market-driven exchange rate, and clearly communicate the exchange-rate management strategy to build credibility and improve the availability and accessibility of FX. For example, assure market participants using the Secondary Market Intervention Sales (SMIS) and IEFX windows of a well-defined schedule of FX auctions (e.g., for the next 3 months and then on a rolling basis), consistent with projections for FX inflows. The amounts to be auctioned should respond to the CBN's need to rebuild the stock of international reserves	• Reduce trade and transportation costs by addressing delays in border and port clearance by simplifying and harmonizing documents, streamlining, and automating procedures, and making more information available. • Carry out measures to deepen the FX market, such as re-establishing the dollar interbank market and re-enabling commercial banks to trade FX on their own behalf and not solely to fill client orders. This would help increase the depth and liquidity of the FX market while improving

Area	Options for the next 3 to 6 months	Options for the next 6 to 18 months
	to safer levels. • Regulate the auction processes, at least initially, by using pre-defined exchange-rate bands to control possible immediate overshooting. These bands could be relaxed as the market develops and the system gains credibility. Reserve extraordinary FX interventions (e.g., unscheduled auctions) for episodes of intense market volatility. • Introduce risk-based management of customs interventions and trusted trader program.	price discovery. Banks would also be able to absorb some unexpected FX demand and supply shocks, gradually lessening the need for CBN interventions, while still being subject to net open position limits and other prudential requirements. The reestablishment of the dollar interbank market would also help participants reallocate FX liquidity and comply with prudential standards. • Deepen power sector reforms and expansion of grid and renewable energy. • Improve land administration. • Improve the PPP framework at the Federal and State levels. • Loose credit constraints for non-farm enterprises.
Addressing fiscal pressures 	• A move to full market-based pricing of PMS is urgently needed to free up fiscal resources for the federation. Removing the PMS subsidy could lead to a one-time 2 to 3 percentage point increase in inflation at the time of the subsidy removal. This increase can be contained through other complementary measures over the next few months. • Include the PMS subsidy spending in the budget. The regular practice is to have it off-budget, undermining fiscal transparency. • Raise excise taxes on "sin" goods, e.g., alcohol and cigarettes • Implement the Electronic Money Transfer levy. • Introduce a new, sustainable revenue source from Green surcharge on imported vehicles through amendment of CETA • Launch VAT compliance improvement initiatives. • Craft the Digital Transformation Strategy for ICT in FIRS, laying the foundation for a tech-driven, efficient tax administration.	• Either deregulate PMS pricing or set price levels or price ceilings that cover costs of efficient supply. • Rationalize ineffective tax incentives. • Fully implement VAT and CIT compliance programs. • Make tax audits more effective. • Review CIT law; bring international tax rules in line with global good practices. • Ensure prompt VAT refunds, after putting in place strong controls, to encourage higher voluntary compliance.

Area	Options for the next 3 to 6 months	Options for the next 6 to 18 months
Protecting the poor and most vulnerable	• Implement a large-scale (covering 25% to 50% of the population) and time-bound targeted cash-transfer program to alleviate the potential negative impact of the PMS subsidy removal. The proposed cash transfer program will provide NGN 5,000 per month per household to 20 million households (50-60 million individuals or half the population), and would cost NGN 100 billion per month, or NGN 600 billion for a time-limited 6-month program. Even with a cash transfer of this size, with NGN 3 trillion in savings from the removal of the PMS subsidy, NGN 2.4 trillion would be available for other priorities, at all three levels of government. • Authorize the additional social spending required by the cash-transfer program in the 2022 Federal Budget. • The cash transfer program may be politically desirable if developed and (strategically) communicated as one component of a broader package that mitigates adverse economic effects and protects the poor. • Combined with a financial inclusion drive (BVN registration) and digital or mobile money payments, the program could be implemented more robustly while bringing millions of financially excluded Nigerians into the financial system • Expand COVID-19 vaccination, to enable the economy open up more rapidly especially to private sector investment.	• Integrate the NHGSFP and other social assistance programs into the National Social Register (NSR) and State-level social registers. Expand the NSR and State-level social registers so that other existing and future social programs could use the available data to quickly identify and enroll households for future support and ensure that programs effectively reach targeted groups. • Graduate existing NASSP beneficiaries into productive-inclusion activities such as workforce training, asset and livestock transfers, and livelihood grants. • Reduce the impact of the pandemic on human capital accumulation by bridging the learning loss through adjusting curriculum to help catch up the nearly yearlong school closure. • Redouble efforts to collect detailed and consistent evidence on Nigeria's workers, through labor force surveys, and Nigeria's firms through enterprise surveys.

Part 2: Taking A Closer Look

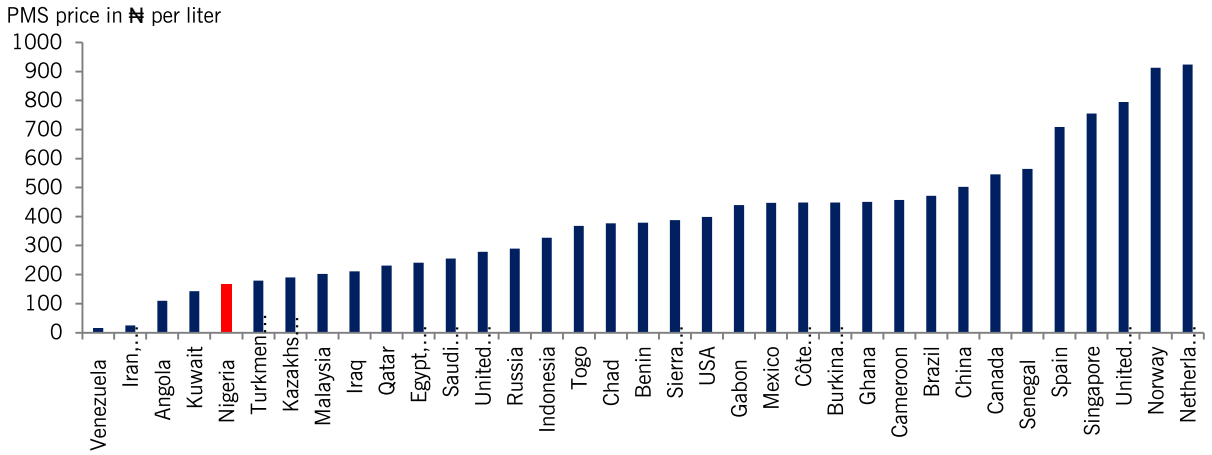
Nigeria's Petrol Subsidy: Unique, Opaque, Costly, Unsustainable, Harmful, and Unfair

Summary: The subsidy for PMS is ostensibly designed to ease the burden of gasoline costs on households and the private sector, but in practice its benefits overwhelmingly accrue to the wealthy, as the poor purchase only an estimated 3 percent of subsidized gasoline. The cost of the PMS subsidy rose from 4 percent of Federation oil and gas revenue captured by the NNPC in 2020 to 35 percent during the first eight months of 2021, an untenable fiscal burden for a country with Nigeria's enormous infrastructure deficit and vast underserved population. Moreover, the PMS subsidy distorts efficiency incentives, promoting its nonessential or inefficient use. The subsidy also creates a very large price differential between Nigeria and neighboring countries that encourages smuggling, benefitting criminal syndicates at the expense of the public. While some of these weaknesses can be mitigated through improvements in the design of the policy, no version of the PMS subsidy would be superior to its alternatives. Following the expansion of social protection policies during the pandemic, the government has an opportunity to phase out the PMS subsidy while utilizing cash transfers to safeguard the welfare of poor and middle-class households.

Nigeria's premium motor spirit (PMS) subsidy is unique globally

Nigeria is the only country in the world with a universal price subsidy that applies exclusively to PMS. Universal price subsidies for liquid fuels are almost always regressive, as the rich consume far more fuel than the poor. PMS subsidies are especially regressive because PMS is used primarily in light- and medium-duty motor vehicles, which are rarely owned by the poor. Since raising PMS prices tends to have minimal adverse effects on poor households, governments worldwide have typically prioritized eliminating PMS subsidies over those that apply to other fuels. However, Nigeria has done the opposite—eliminating all subsidies for liquid fuels other than PMS. Moreover, the Nigerian PMS subsidy is exceptionally generous, and in October 2021 the PMS pump price was the seventh lowest among 168 economies surveyed at just ₦495 per liter (Figure 2.1).

Figure 2.1: Due to the PMS subsidy, Nigeria's pump prices are among the lowest in the world.



Source : https://www.globalpetrolprices.com/Nigeria/gasoline_prices/.
Note: Of the 168 economies in the database, 35 countries are shown

Attempts to eliminate the subsidy have repeatedly failed, but the recently approved PIA effectively mandates the elimination of the subsidy by February 16, 2022. The government removed the PMS subsidy in January 2012 after months of high global oil prices, but after two weeks of protests the policy was reinstated. The government ended the subsidy again in May 2016, this time as the world oil price had just hit a new low, and the authorities introduced a price band designed to move with international PMS prices. However, the government failed to adjust the price band when the naira depreciated sharply later in 2016, and by 2017 the subsidy had returned. In March 2020, amid another oil-price collapse, the government replaced the subsidy with market-based pricing regulations for PMS.[10] However, when global oil prices recovered the PMS subsidy returned, and since January 2021 the gap between the government-controlled retail price and the cost of supply has been steadily widening. The PIA allows the subsidy to persist for up to six months as a transitional measure, but in mid-February 2022 the government's authorization to reimburse the NNPC for losses suffered from selling PMS at a loss will expire.

PMS subsidy is opaque

The PMS subsidy has always been an off-budget expenditure immune to annual scrutiny by the National Assembly. In 2006, the government launched the Petroleum Support Fund (PSF) in part to smooth PMS prices, a concept that has been tried repeatedly by multiple government and that has consistently failed to achieve its objectives. The approach is simple and intuitively appealing: when global fuel prices fall below the domestic fixed prices, the PSF accumulates resources, which are used to finance the subsidy when global fuel prices rise. In practice, however, the PSF became insolvent. The last transactions reported by the Petroleum Products Pricing Regulatory Agency date from October 2011,[11] and the PSF was officially closed in December 2015. The budget-implementation reports published by the Budget Office of the Federation in the 2010s show withdrawals from the Excess Crude Account to cover some of the subsidy expenditures.[12]

After 2016, when the government stopped reimbursing fuel marketers for selling PMS at a loss, the NNPC became the supplier of last resort due to its ability to finance the shortfalls from PMS imports through deductions from Federation oil and gas revenue. The government administered the so-called Price Modulation Mechanism from January to May 2016 and the Appropriate Pricing Framework beginning in May 2016. Neither scheme explicitly envisaged a PMS price subsidy, and no provisions were made to reimburse fuel marketers, but currency depreciation combined with rising global oil prices caused the price subsidy to return. Because the NNPC is the only fuel seller that can reimburse itself when selling PMS at a loss (via deductions from Federation oil revenue), it emerged as the monopoly wholesaler.[13]

Annual audits by the Nigeria Extractive Industries Transparency Initiative (NEITI) indicate that fuel price subsidies have been deducted in full from the payments due to the

[10] http://pppra.gov.ng/wp-content/uploads/2020/09/FGN-OFFICIAL-GAZETTE-ON-MARKET-BASED-PRICING-REGIME-FOR-PMS-REGULATIONS.pdf.

[11] These data are from *Role of the Petroleum Products Pricing Regulatory agency in the Administration of the Petroleum support Fund (PSF) Scheme*, undated publication by the PPPRA, available at https://docplayer.net/137792960-Role-of-the-petroleum-products-pricing-regulatory-agency-in-the-administration-of-the-petroleum-support-fund-psf-scheme.html. The final transactions are through August 2011 for the NNPC and through October 2011 for retailers.

[12] https://www.budgetoffice.gov.ng/index.php/resources/internal-resources/reports/quarterly-budget-implementation-report

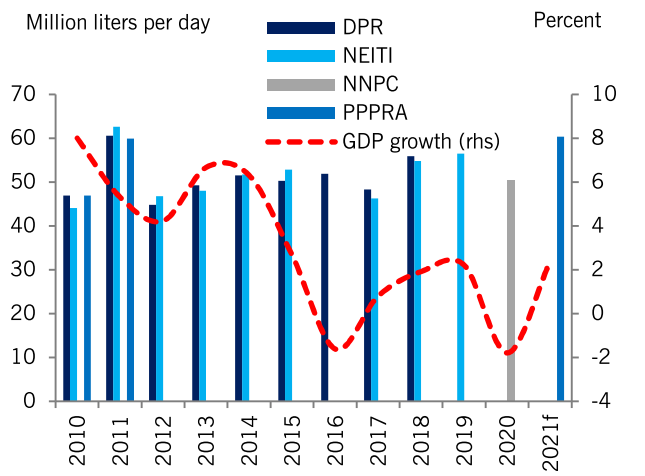
[13] http://pppra.gov.ng/wp-content/uploads/2019/01/PRESS-STATEMENT.pdf

Federation Account, but information recently made available suggests that the NNPC uses other mechanisms to reimburse itself for the cost of the PMS subsidy. While reporting on this issue is sparse, the NNPC's financial statements[14] mention other means of recovering the losses from PMS subsidies. According to the 2020 financial statement of the Nigerian Petroleum Development Company (NPDC), an NNPC subsidiary, its reimbursement arrears to the NNPC peaked at more than US$8.5 billion and were repaid by two means. The NNPC borrowed US$5.5 billion against Nigerian Liquefied Natural Gas (NLNG) dividends, and used the Pre-Export Financing (PXF) scheme to cover the remaining US$3 billion. The PXF was established in 2013 and is based on an agreement allowing the future sale of an agreed quantity of crude oil (20,000bpd) produced by the NPDC. As of December 31, 2020, US$0.65 billion remained to be repaid. In addition, the NNPC's financial statements and submissions to the Federation Account Allocation Committee (FAAC) reported that the National Fuel Support Funding Scheme had ₦445 billion in liabilities as of December 31, 2020. It is unclear when, how, and in what amount this scheme had been funded, and what these liabilities are for.

PMS consumption figures are difficult to understand, and year-to-year trends are inconsistent across government sources. Under standard economic assumptions, PMS consumption should follow trends in GDP, but in practice this has not always been the case. For example, a sharp drop in GDP in 2016 was accompanied by an increase in PMS consumption.[15] Similarly, a large spike in PMS consumption in 2011 was not consistent with changes in economic activity, suggesting that the elections held that year may have influenced PMS purchases. Likewise, the 20-percent rise in PMS consumption observed in 2021 far exceeds the GDP growth rate for this year, further underscoring the role of noneconomic factors in determining PMS consumption (Figure 2.2).

Figure 2.2: Domestic PMS consumption does not correlate with economic growth.

PMS consumption and annual GDP growth rates in Nigeria



Source: PPPRA (undated) for 2010 and 2011, DPR annual reports at DPR.gov.ng for 2010–2018, https://www.neiti.gov.ng/audits/oil-and-gas for 2010–2018, NNPC monthly financial and operations reports at https://nnpcgroup.com/NNPC-Business/Business-Information/Pages/Monthly-Performance-Data.aspx for 2020, daily trucked out PMS at https://pppra.gov.ng/o/daily-truck-out-report/ for 2021 through October, and https://data.worldbank.org/ for GDP growth.

The PMS subsidy imposes an unsustainable fiscal burden

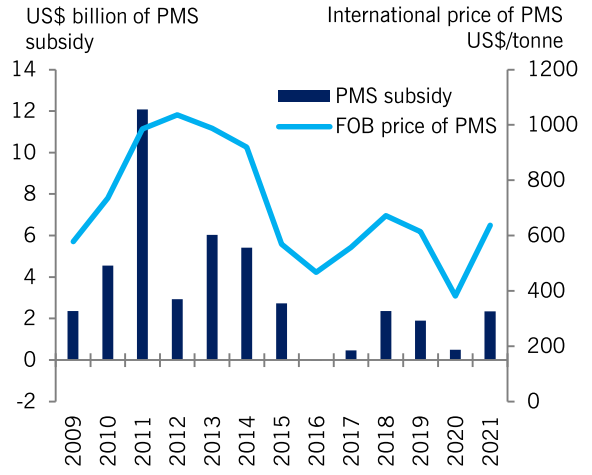
The total cost of the PMS subsidy reached an all-time high in 2011. The magnitude of the subsidy depends on the unit price gap and consumption volume. PMS consumption peaked in 2011, and the fiscal cost of the subsidy reached US$12 billion before moderating to US$8.5 billion in 2012 and US$8 billion in 2014. In recent years, the annual cost of the PMS subsidy has tracked developments in the global PMS price.

[14] https://nnpcgroup.com/NNPC-Business/Business-Information/Pages/Monthly-Performance-Data.aspx

[15] As reported by the Department of Petroleum Resources (DPR)

Figure 2.3: The total PMS subsidy bill has varied broadly in line with the oil price.

PMS Price and Subsidy



Source: NEITI Oil and Gas Industry Audit Reports for 2009 to 2018, NNPC's submissions to FAAC thereafter for the annual PMS subsidy supplemented by the NNPC Group's 2020 financial statement for the 2020 subsidy, and free-on-board (FOB) prices of PMS in Rotterdam.

The price gap has widened rapidly in 2021, slashing the NNPC's oil revenue transfers to the Federation Account. The NNPC is empowered to monetize Federation equity oil and gas, and additionally it receives oil and gas directly from producers as an in-kind payment of taxes, royalties, and the government's share of profit oil in production-sharing contracts. The NNPC does not transfer the full value of the oil and gas it receives, and instead deducts large amounts at the source of income. In 2020, just 42 percent of the value of the total oil and gas received by the NNPC was transferred to the Federation Account,[16] and during the first nine months of 2021 this share plunged to 20 percent. Meanwhile, the share of total Federation oil and gas revenue received first by the NNPC and subsequently used to finance the PMS subsidy rose from 4 percent in 2020 to 35 percent in 2021.[17] In the absence of the PMS subsidy, rebounding oil prices would have more than offset a modest decline in daily production, causing the Federation's net oil and gas income captured by the NNPC to surpass its 2020 level by nearly one quarter during the first nine months of 2021. Moreover, as of September 2021 the NNPC had not yet fully deducted the cost of the PMS subsidy, leaving ₦40 billion for either a future deduction or possibly a withdrawal from the National Fuel Support Funding scheme.

The PMS subsidy is a factor that reduces the oil and gas revenues received by the three tiers of the Nigerian government

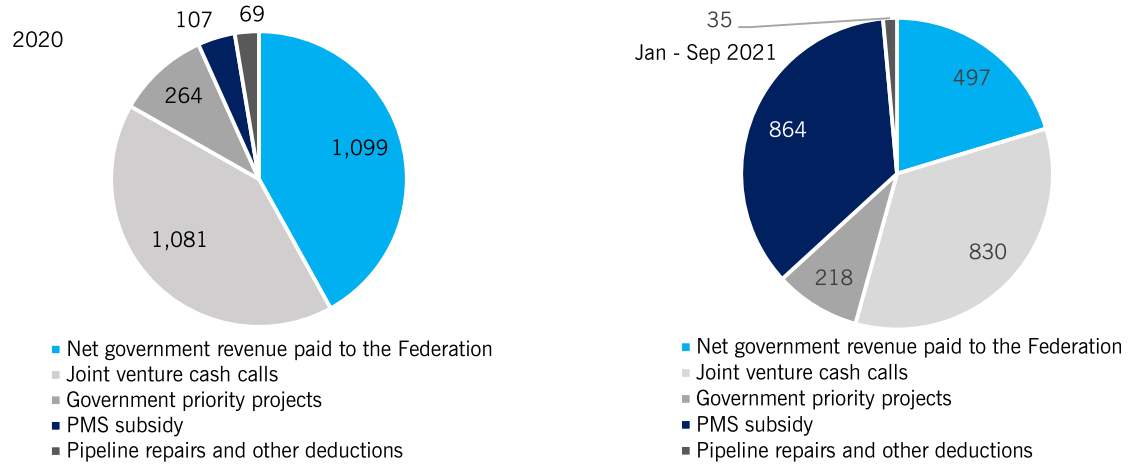
All NNPC deductions are taken from in-kind payments of oil and gas. The NNPC obtains cash by selling oil and gas owed to the Federation, and it deducts expenses incurred on behalf of the Federation from the amount paid to the Federation Account. These deductions cover capital and operational expenditures related to the production of the Federation's equity oil and gas, execution of the Federation's priority projects—with the largest share going to domestic gas development, followed by refinery rehabilitation, renewable energy development, and oil exploration—as well as pipeline repairs and maintenance, strategic petroleum reserves, and product losses. However, the PMS subsidy is by far the most volatile component of NNPC deductions, and has emerged since 2020 as the single largest deduction, severely eroding the revenue accruing to the Federation Account (Figure 2.4).

[16] Not all revenue is transferred directly to the Federation Account, as the Department of Petroleum Resources previously and now the Nigerian Upstream Petroleum Regulatory Commission collects the proceeds of royalty oil sales and the Federal Inland Revenue Service collects tax oil sales proceeds from NNPC, which in turn transfer the revenues to the Federation Account.

[17] The NNPC's reports to the Federation Account from January to October 2021 capture revenue transfers for the first nine months of the year and deductions for the PMS subsidy for the first eight months.

Figure 2.4: Rising global PMS prices have slashed the NNPC's transfers to the Federation

Breakdown of revenues received by the NNPC, ₦ billion



Source: World Bank calculations based on data from the FAAC reports at https://nnpcgroup.com/NNPC-Business/Business-Information/Pages/Monthly-Performance-Data.aspx.
Note: The PMS subsidy in 2021 is for the first eight months of the year and all others are through September, as reported in the NNPC's submission to FAAC for its October 2021 meeting.

The most transparent approach to revenue collection would be to require that all payments be made in cash and transferred directly into the Federation Account. In almost all other countries, oil-sector taxes in production-sharing contracts are paid in cash, not in kind, whereas royalties may be paid either in cash or in kind and only profit oil is exclusively paid in kind. Switching to cash tax payments will make revenue flows more transparent while also curtailing the lawsuits periodically filed against the NNPC for deducting more oil than it is entitled to. According to a 2020 financial statement from the NNPC, courts in the United States have ordered the NNPC to pay a total of US$4.157 billion plus interest to settle three lawsuits in oil blocks governed by production-sharing contracts, and all three payments are still pending. The PIA provides for a variety of contractual arrangements, including profit-sharing contracts. Issuing production-sharing contracts instead of profit-sharing contracts in the future would enable the government to receive the same amount of revenue from its agreements with oil companies, but with payments made in cash, not in kind.

At the global PMS prices and official exchange rate that prevailed in October 2021, PMS subsidies could cost Nigeria as much as ₦240 billion each month. During the first eight months of 2021, the NNPC reported PMS-subsidy losses totaling ₦904 billion[18] despite using an overvalued exchange rate (₦384 per US versus an official rate of ₦411) from June to August 2021. As of end-October, the price gap at the official exchange rate had risen to more than ₦130 per liter. Brent futures prices as of mid-November 2019 gradually declined to their September 2021 level by September 2022 and remained above US$75/bbl, implying that the price gap would narrow to ₦100 per liter over this period. Assuming an average price gap of ₦119 per liter and an average daily trucked-out volume of 60.4 million liters recorded during the first ten months of 2021,[19] the estimated PMS subsidy for the year starting in October 2021

[18] The difference of ₦40 billion between ₦755 billion and ₦715 billion in Figure 2. 4 is the amount that the NNPC had not yet deducted as of August 2021.

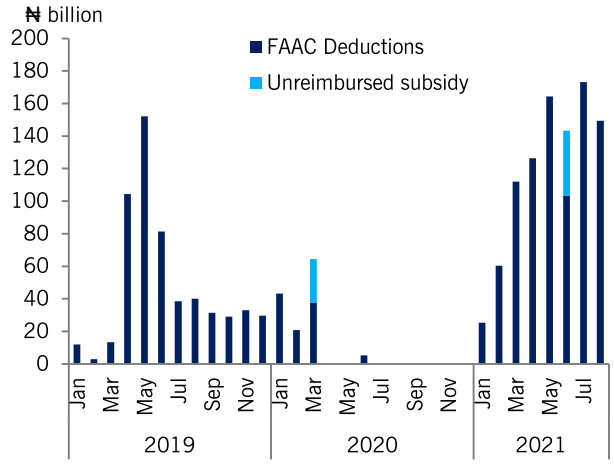
[19] See: Petroleum Products Pricing Regulatory Agency (2021) https://pppra.gov.ng/o/daily-truck-out-report/

is projected to cost ₦2.6 trillion in forgone revenue, equivalent to about one-fifth of the FY2021 budget.

Nigeria is sacrificing investments in essential goods and services to pay for the PMS subsidy. Global gasoline prices rose from less than US$200 per metric ton in April 2020 to more than US$840 per metric ton during the first two weeks of November 2021. The NNPC's deductions from the oil and gas revenue due to the Federation Account to finance the PMS subsidy now exceed their 2019 level in nominal naira terms. Based on global PMS prices and futures prices as of mid-November 2021, the government is on track to spend more than four times as much on the PMS subsidy as it spends on public health.[20]

Figure 2.5: The PMS subsidy's cost in forgone revenue now exceeds its 2019 level.

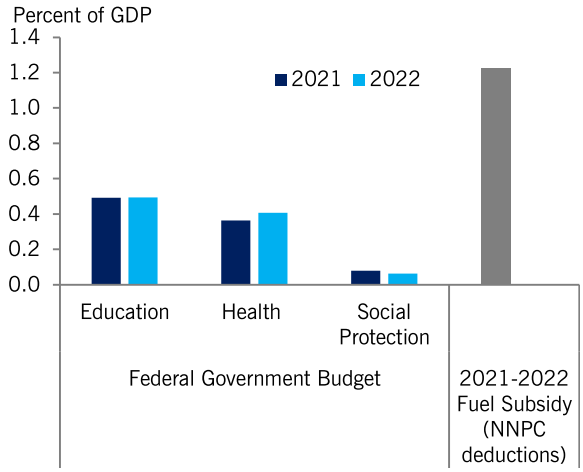
NNPC deductions for the PMS subsidy, ₦ billions



Source: World Bank calculations based on FAAC reports and NNPC financial statements.
Note: The non-deducted portion of the subsidy in March 2020 was later deducted from the National Fuel Support Fund, and the non-deduced portion from June 2021 is similarly likely to be deducted in the future.

Figure 2.6: The PMS subsidy is eroding Nigeria's limited fiscal space to provide essential services.

Social spending and the PMS subsidy as a share of GDP



Source: World Bank calculations based on OAGF.

The PMS subsidy is harmful because it distorts incentives, encourages smuggling, and does little to benefit poor households

Subsidizing PMS creates inefficiencies that slow medium-term growth. To finance the subsidy, the government must increase its borrowing, raise additional revenue elsewhere, or reduce spending on other public goods and services, hindering growth and weakening the fiscal accounts. By stabilizing retail prices, the PMS subsidy prevents consumers from adjusting their purchasing behavior in response to changes in the cost of supply, and creates financial incentives to overconsume PMS, resulting in a loss of consumer surplus. The subsidy also distorts relative fuel prices, encouraging the use of PMS even when other energy sources would be more efficient. Moreover, all fuel importers and refiners must sell

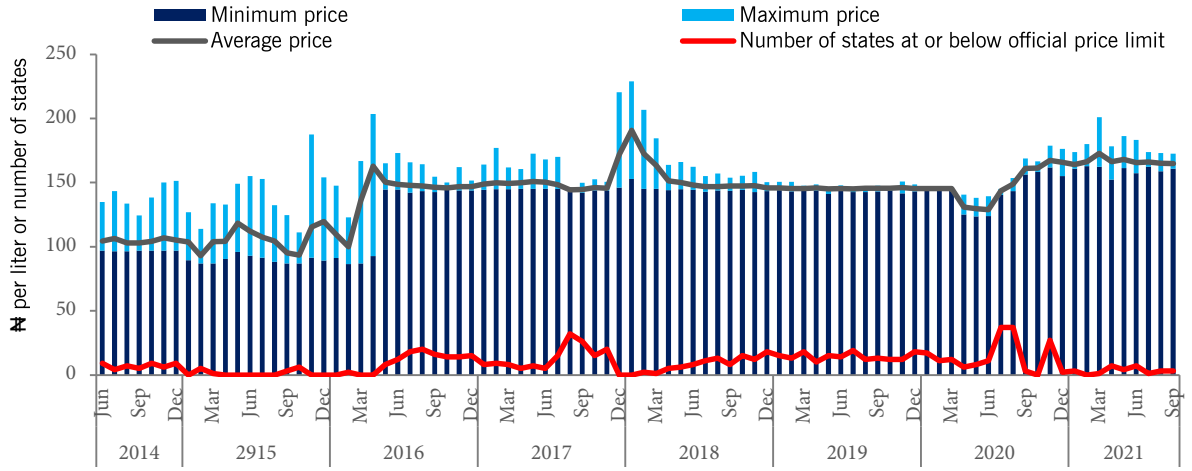
[20] This comparison is not on the same basis. 13,000 per capita is from Oct 2021 to Sep 2022. 3,000 per person is from Jan 2021 to Dec 2021.

PMS at below-cost prices, but the government cannot ensure their timely and full reimbursement, which deters new firms from entering the market. Without new entrants and infusions of capital, the fuel sector becomes increasingly inefficient and undercapitalized, further intensifying its reliance on government support. Finally, unlike electricity or natural gas, liquid fuels such as PMS are easy to store and transport, making them ideally suited for smuggling and diversion to black markets. In effect, the PMS policy subsidizes criminal activity by enabling smugglers and black marketeers to capture the price differential created by the government.

The PMS subsidy creates fuel shortages, and rationing through the black market increases prices paid by end-users. Monthly fuel-price surveys covering all 36 States and the Federal Capital Territory show great variation in actual PMS prices paid (Figure 2.7).[21] These variations reflect supply shortages and conditions in the domestic black market. The data also reveal several instances in which PMS was not sold at the official price in any State, underscoring the extent to which black marketeers capture the subsidy.

Figure 2.7: The price ceiling has often been breached and spatial price differences can be large despite the use of the Petroleum Equalisation Fund

PMS retail price and compliance with price band



Source: World Bank calculations based on data available at https://nigerianstat.gov.ng/elibrary.

The differences in PMS prices between Nigeria and its neighbors provide powerful financial incentives to smuggle PMS out of the country. PMS prices in Cameroon and Ghana are nearly three times the official price in Nigeria, creating a potential profit margin that easily offsets the risks and costs involved in smuggling (Figure 2.8). A sharp spike in PMS consumption observed in 2011, when fuel subsidies had soared to the point of triggering several commissions of inquiry in the government, strongly indicates an increase in "ghost imports"—apparent fuel sales claimed and reimbursed without the fuels actually having been procured and sold in Nigeria—and fuel smuggling. Eliminating the subsidy would substantially reduce incentives to import PMS for sale in other countries and make PMS imports no different from diesel fuel imports, which have been deregulated for many years.

Poor households benefit little from the PMS subsidy. The 2018–19 Nigerian Living Standards Survey showed that only about one-quarter of PMS

[21] These surveys are by the National Bureau of Statistics.

sold in the country was purchased by households, while purchases by firms, public transport operators, and government agencies, as well as cross-border smuggling, accounted for the remaining three-quarters (Figure 2.9). Moreover, Nigerians in the top 40 percent of the income distribution purchased 77 percent of all PMS consumed by households, while those the bottom 40 percent purchased just 10 percent. Overall, Nigerians in the bottom 40 percent of the income distribution purchased less than 3 percent of all PMS sold in Nigeria.

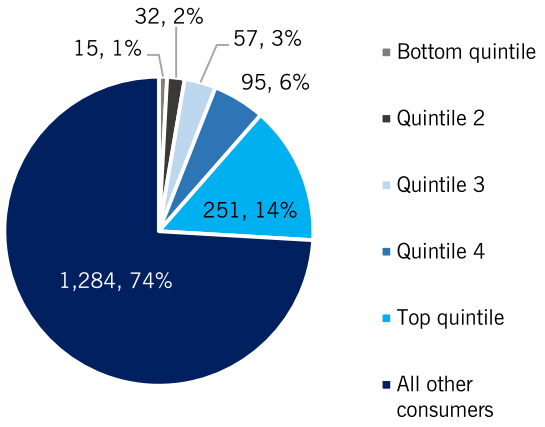
Figure 2.8: Large PMS price differentials between Nigeria and its neighbors create strong incentives for fuel smuggling.

PMS prices in Nigeria and neighboring countries

Source: https://www.globalpetrolprices.com/Nigeria/gasoline_prices/ and https://www.sonidep-niger.com/ for Niger.

Figure 2.9: Households consume only a small fraction of PMS sold in Nigeria, and higher-income households dominate household PMS purchases.

Monthly purchase of PMS in million liters and share of the total purchased



Source: World Bank calculations based on the 2018–19 Nigerian Living Standards Survey, PMS price surveys available at https://www.nigerianstat.gov.ng/, and total PMS sold available at https://nnpcgroup.com/NNPC-Business/Business-Information/Pages/Monthly-Performance-Data.aspx.

Neither self-sufficiency in fuel refining nor a transition to compressed natural gas would eliminate the need to phase out the PMS subsidy

Increased domestic PMS refining will have little or no effect on the cost of PMS production and will not reduce the fiscal burden of the subsidy materially. Nigeria can supply PMS to consumers by (i) selling crude oil to the highest bidder and importing PMS from the lowest-price bidder, or (ii) refining domestic crude into PMS. The oil revenue accruing to the government should be the same in both cases, as domestic refineries should purchase crude at the prevailing international price. The savings from switching from imports to domestic refining would arise from shipping costs, which are about US$0.01–0.015 per liter. Benchmark PMS prices are set in the major global refining centers, where economies of scale and other sources of efficiency enable refiners to keep the cost refining low, offsetting the disadvantage incurred by the shipping cost.

Some have argued that the government should set benchmark prices below global prices, but doing so would entail an enormous economic

and fiscal cost. The government could shield consumers from the volatility of global oil prices by requiring oil companies to sell crude at prices that are just enough to cover the cost of production and delivery to domestic refineries. However, this approach would discourage investment in new oil production by artificially lowering the returns to investment. Without new capital inflows, oil production would swiftly fall, as Nigeria's oilfields have a natural production decline rate of about 10–15 percent a year. Meanwhile, the government's oil revenue would plunge because taxes are levied on profits, which would be far lower, and because new investment would fail to arrest the decline in production. Finally, keeping PMS prices artificially low would perpetuate incentives for fuel smuggling and excessive consumption.

Substituting compressed natural gas (CNG) for PMS is technically difficult and would have little impact on PMS subsidies. A proposed program would support the conversion of one million vehicles from PMS to CNG. The available distribution infrastructure for CNG in the near term is such that conversion would substitute less than 10 percent of the PMS currently being consumed. Further, the international experience points to several potential problems with this proposal. First, the process of converting one million vehicles will likely take years. Second, the location of gas pipelines in the south raises regional challenges, as the northern States would have to rely on liquified natural gas transported by truck, which adds substantially to the cost of supply. Third, in all successful CNG conversion programs elsewhere in the world CNG has displaced fuels that are heavily taxed, and there is no immediate plan to start taxing PMS heavily after the subsidy removal. The high taxes are needed because CNG vehicles are more expensive than PMS or diesel vehicles, and vehicle owners must be able to recover the cost of the vehicle conversion or the higher purchase price of an equivalent CNG vehicle through lower fuel prices. In Nigeria, the proposal is to subsidize the entire costs of the first one million conversions, thereby replacing one subsidy with another. Conversions may not be entirely free to the first million vehicles owners because vehicles will have to be inspected and possibly repaired before conversion.

The PMS subsidy can be eliminated while mitigating negative impacts on poor and vulnerable Nigerians

The PIA has several provisions that affect the future PMS pricing policy. First, the PIA allows any PMS subsidy to be retained for a maximum of six months, marking February 16, 2022 as the date by which the subsidy has to be ended. Second, it closes out the Petroleum Equalisation Fund (PEF), the instrument used until now to set uniform prices throughout the country. In the absence of PEF, PMS prices will vary from location to location depending on the distance from the closest port of entry or refinery as well as the economies of scale in a given market. Third, the PIA requires that the Nigerian Midstream and Downstream Petroleum Regulatory Authority (the Authority hereinafter) base pricing on "unrestricted free market pricing conditions" unless there is a monopoly or "an excessively dominant supplier" in the market. That is, as long as there are conditions for adequate competition in the market, PMS pricing is to be deregulated.

The conditions enabling adequate competition in the PMS market determine whether PMS pricing should be deregulated or continue to be regulated by the Authority. The first pre-requisite for competition is adoption of a single, market-driven exchange rate, whereby all qualified PMS importers have nondiscriminatory access to the same exchange rate. NNPC was able to use an overvalued exchange rate of ₦384 to the dollar for PMS imports from June to August 2021, signaling an exchange rate subsidy. Absent such a reform, the NNPC will continue to be a monopoly importer, thereby requiring economic regulation by the Authority. Downstream of the import

terminals and refineries, there are enough fuel suppliers to enable competition. All other fuels in Nigeria—diesel fuel, liquefied petroleum gas (cooking gas), aviation fuel, household kerosene, and heavy fuel oil—have been deregulated for years despite being much smaller markets. The size of the PMS market dwarfs those of all other fuels, providing ample market conditions for vigorous competition.

An important task for the Authority is to foster and sustain effective and fair competition in which cost savings are passed onto consumers in the form of lower prices. There are several ways consumers end up subsidizing fuel suppliers. One is a market structure in which inefficient fuel suppliers are allowed to remain in business, raising prices charged by all fuel suppliers, or in which price collusion among fuel suppliers results in unnecessarily high prices. Another is tolerance for commercial malpractice, two forms of which damaging to consumers are short-selling and fuel adulteration. Short-selling raises the effective prices paid by consumers, while fuel adulteration not only reduces the cost of supply without benefiting consumers but can damage vehicles and power backup generation units using the fuel. The proper role of the government is to set sensible rules and standards, monitor compliance, and enforce the rules across all market participants. Markets with weak monitoring and enforcement have seen degradation of quality and a "race to the bottom," with responsible firms leaving the market. If the market conditions are assessed to be inadequate for competition, the Authority needs to start taking active steps to foster and enhance competition to enable a transition to unrestricted free market pricing. If the PMS market is deemed to have sufficient competition, the Authority should continue to monitor and enforce competition rules and other standards and regulations.

The government could end the PMS subsidy through two different approaches depending on whether the PMS market conditions are already ripe for adequate competition:

1. ***Deregulating PMS pricing***. The Authority will issue a new PMS pricing regulation that would remove the subsidy and allow retail prices to rise immediately to their market levels without government intervention. Once they have been persuaded that the policy is credible, oil-marketing companies other than the NNPC would start importing PMS. Pump prices would be driven by global oil prices, the exchange rate, and the efficiency of supply systems in Nigeria, and domestic PMS prices would vary by location just as diesel prices do. The new regulation can have specific clauses designed to enhance competition. Fuel marketers can be required to post fuel prices that are clearly visible from a distance. The Authority can also require all fuel marketers to upload prices on a designated website as well as an app accessible by smartphones and other devices, and give a time window within which price changes have to be uploaded, such as no earlier than within 15 minutes of the next price change. The website and the app can enable consumers to list filling stations in order of decreasing price where they live to promote price competition.

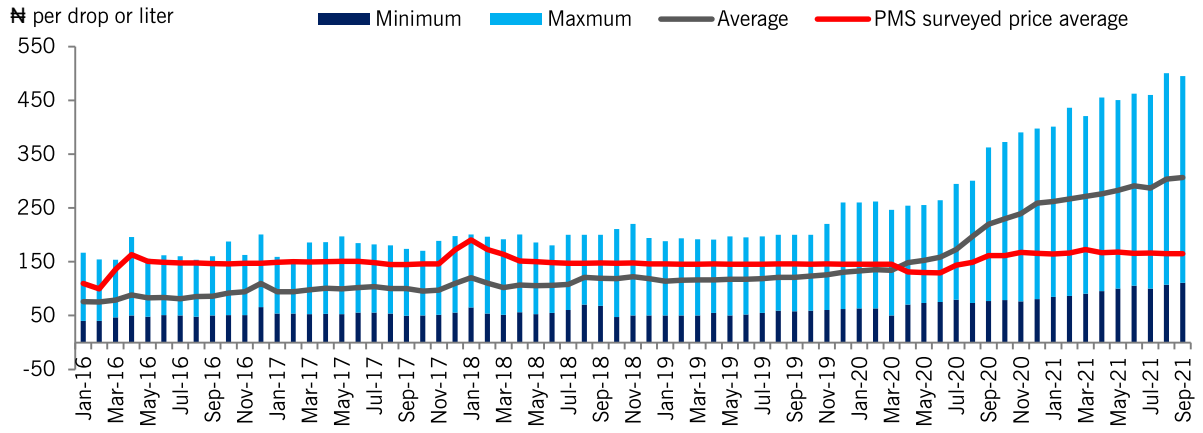
2. ***Setting administrative prices based on market factors.*** The Authority will issue a new PMS pricing regulation, aligning domestic prices with market forces. Administrative pricing should be relatively short-lived because there is no reason why the PMS market should take years to attain adequate competition when all other fuel markets are already deemed to be competitive. The regulation should include provisions for fostering and promoting competition and define benchmark performance indicators, the fulfilment of which signals an end to

administrative pricing and the start of deregulation. To that end, the Authority can set price ceilings for PMS that are adequate to cover the costs of efficient supply while preventing price fixing or other forms of anticompetitive behavior, and use the degree of departure from the price ceilings as a measure of emerging competition. Price ceilings will mitigate the risk of above-market price increases in a market with inadequate competition. However, the main drawback is that PMS pricing will continue to be politicized. The government's previous failure to honor commitments to market-based pricing have weakened its policy credibility, which could discourage oil-marketing companies from resuming PMS imports.

Phasing in market-based administrative prices gradually over time would is no longer an option considering fiscal pressures. A gradual subsidy reform would reduce the PMS subsidy over many months or years until the pump price for PMS aligned with the market price. The Indian government successfully phased out its diesel subsidy between January 2013 and August 2014 by gradually increasing the fixed price by about 1 percent of the retail price until the two prices aligned. The process would have continued for much longer had it not been the steep decline in the global oil price in the last four months of 2014. The main advantage of this approach is that consumers will not face an abrupt price increase and will have more time to adjust; the main drawback is that, given the much larger unit subsidy in Nigeria compared to that for the diesel subsidy in India, the length of the phase-out process (and thus the persistence of the subsidy) will be much longer, while the PIA requires the subsidy to be ended by February 2022. Even without such a deadline, the magnitude of the PMS subsidy has reached the point where it would be irresponsible to prolong the subsidy reimbursements into 2022 and beyond.

Figure 2.10: Despite PMS prices remaining fixed in 2021, the average motorcycle taxi fare has steadily increased.

Motorcycle taxi (okada) fare by drop and PMS price per liter

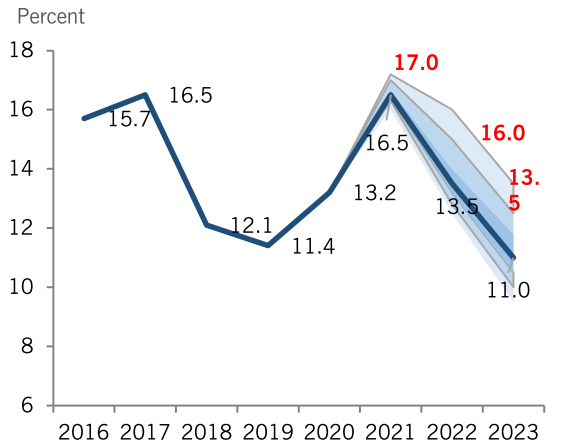


Source: https://nigerianstat.gov.ng/elibrary.

Distinguishing between the inflationary impact of higher PMS prices and other factors is critically important in assessing policy options and outcomes. The inflationary impact of subsidy elimination is a key reason behind the persistence of the PMS subsidy. Fuel-price increases have direct and indirect inflationary effects: direct effects are experienced by fuel purchasers, while indirect effects arise when the fuel is used as an intermediate good. Unlike diesel, which is widely used as an intermediate good in many commercial and industrial processes, PMS is rarely used as an intermediate good except when employed as an automotive fuel for light- and medium-duty vehicles transporting goods and passengers. Higher PMS prices will therefore pass through to transportation prices, although wage rates, vehicle purchase and maintenance costs, and other factors unrelated to PMS will also affect transportation prices. For example, the average motorcycle taxi fare increased by 17 percent between January and September of 2021 despite no increase in the price of PMS over the period (Figure 2.10).

Figure 2.11: The inflationary impact of removing the PMS subsidy is expected to be limited, and the headline inflation rate would fall significantly between 2021 and 2023.

Projected Inflation Trajectories under Different Scenarios



Source: NBS and World Bank estimates.
Note: The darkest blue line represents the baseline scenario without the PMS subsidy removal. The upper bound is the maximum expected inflation after the removal of the PMS subsidy and the colored areas represent probable outcomes, with the darker shaded areas being the most probable outcomes.

Lower-income households purchase little PMS directly, but removing the subsidy could impact their welfare through higher transportation costs. In many countries, diesel dominates bus and freight transportation, but Nigeria's history of

diesel-price deregulation and the continuing PMS subsidy have encouraged the widespread use of PMS as an automotive fuel. Assuming a 20-percent pass-through effect of PMS prices to inflation, removing the PMS subsidy in January 2022 could cause the headline inflation rate to rise by an additional 2.0–2.5 percentage points over the following two years. Though non-negligible, this inflationary effect would be relatively modest, and the headline inflation rate would continue to decline (Figure 2.11).

The removal of the PMS subsidy may be followed by price increases that are only indirectly related to the policy change. While the change in fuel prices will be visible to all Nigerians immediately, changes in wage rates, vehicle parts and maintenance, and other costs will be known only to a much smaller group of people. As a result, service providers may take advantage of fuel-price increases to charge much more than the price increase itself would warrant. For example, when the government of Bangladesh raised the price of diesel by 11 percent in 2011, one large trucking company increased the trucking fare by 22 percent, while a food-transport company announced that transportation prices would rise by 50 percent. While these disproportionate increases in transportation prices were driven by factors unrelated to the price of diesel, the firms involved cited higher diesel prices as the sole reason for rising fares.[22] The Nigerian authorities should be prepared for similar behavior by domestic transportation companies following the removal of the PMS subsidy.

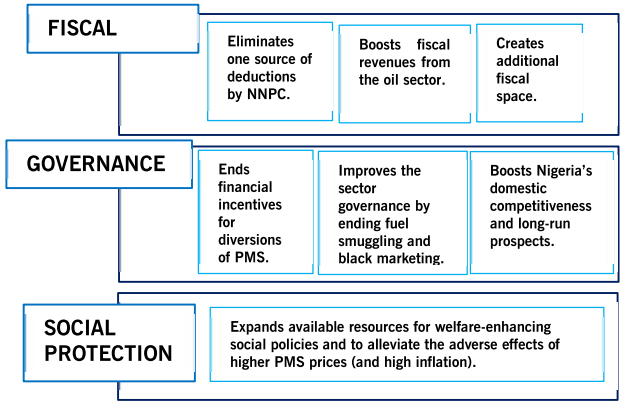
One policy option is to immediately eliminate the PMS subsidy while providing targeted and time-bound cash transfers to poor and vulnerable Nigerians

Removing the PMS subsidy can deliver benefits far beyond fiscal savings. The opportunity cost of the subsidy is forgone investment in productive infrastructure and human capital, and redirecting resources to national development priorities would accelerate growth while advancing the government's policy objectives. Moreover, removing the financial incentives for smuggling and black marketing would go a long way toward improving the governance and transparency of the oil sector. Reducing corruption, curtailing criminal activity, and minimizing economic distortions would attract more investment both in the oil sector and the broader economy, strengthening Nigeria's long-run growth prospects.

The government can eliminate the PMS subsidy while protecting lower-income households. Ending the PMS subsidy would generate enormous fiscal savings, but it would also adversely affect consumers via higher pump prices and the inflationary pass-through effect on transportation costs. Establishing a redistribution mechanism that uses a portion of the fiscal savings to protect lower-income households could minimize the negative impact on consumer welfare while still yielding a large net gain in government revenues. The government has made considerable strides in expanding its social protection systems—an effort that has been accelerated by the exigencies of the COVID-19 pandemic—and the authorities can leverage these systems to shield lower-income households from the effects of higher PMS prices.

[22] Financial Express (2011); New Nation (2011)

Figure 2.12: Eliminating the PMS subsidy will yield a wide range of benefits.



Source: World Bank.

To build public support for eliminating the subsidy, the government could propose a compact with Nigerian citizens. The authorities can publicize the compensatory cash transfers, explaining their relationship to the PMS subsidy reform, as well as the eligibility criteria and transfer mechanisms involved. The government can also outline new targets for public service delivery that will be achieved with the fiscal savings from ending the PMS subsidy. This compact should define specific actions to be undertaken by different government ministries, departments, and agencies, enabling the media and civil society to monitor compliance.

Government credibility is vital to garner public support for ending the PMS subsidy. If the public believes that the savings generated by eliminating the subsidy will not be put to good use, pressure to maintain the policy or reverse the reform will intensify. A survey conducted in July 2018[23] found that respondents who had faced PMS shortages or black-market prices were more inclined to support subsidy reform, but the survey also revealed low levels of public trust in the Nigerian government. Although overall trust in the government was not correlated with support for subsidy reform, respondents who believed that the government was corrupt or that it would not use the savings from eliminating the subsidy effectively favored keeping the policy in place by a very large margin. These findings underscore the critical importance of effectively publicizing the launch of the cash-transfer program, clearly linking it to subsidy reform, and forming a credible compact with the Nigerian public that emphasizes the tangible benefits of ending the PMS subsidy.

Box 2.1: The Petroleum Industry Act Fundamentally Overhauls the Oil and Gas Sector

The PIA introduces risks but also provides opportunities. The PIA gives the new upstream regulator, Nigerian Upstream Petroleum Regulatory Commission (the Commission hereinafter), the sole discretionary power to decide whether to ask the newly restructured NNPC, the Nigerian National Petroleum Company Limited (NNPC Ltd), to lift royalty oil, potentially entrenching the custom of taking royalties in kind. The PIA can be interpreted as redirecting gas flaring fees—which amounted to US$308 million collected in 2019[24] and much more billed to oil and gas producers—away from the Federation Account to gas infrastructure development and environmental remediation in host communities. The PIA restructures the fiscal regime in production-sharing contracts in such a way that the Federation's share of profit oil increases, but earmarks 30 percent for exploration in inland and northern basins, considerably more than what is being spent today. The PIA provides for profit-sharing contracts, which are presumably similar to production sharing except profits in cash rather than production in barrels are shared. If the government signs only profit-sharing contracts in the future and rules out taking royalties in kind altogether, then it would be possible to end all in-kind payments

[23] McCulloch, Moerenhout, and Yang (2021). The survey included 16,000 Nigerians, and the researchers also conducted focus-group discussions.

[24] https://www.neiti.gov.ng/audits/oil-and-gas. This figure is for collections only. The total gas-flaring fees owed to the government are estimated at about $500 million per year.

The PIA transfers many powers and responsibilities previously assigned to the Minister of Petroleum Resources to two new regulators. The PIA establishes the Commission for oil and gas exploration and production and the Authority for activities downstream of oil and gas production. The Minister is in charge of policy formulation and plays an important role in international relations but is no longer tasked with issuing regulations. The Commission has considerable powers, ranging from drafting and issuing regulations to deciding when fiscal payments should be made in kind and recommending to the Minister of Petroleum which licenses should be granted or revoked. The PIA assigns collection of revenues other than taxes in the upstream petroleum sector to the Commission.

The PIA earmarks several revenue streams, which will not be available for general use by the three tiers of the government. The PIA establishes a new Midstream and Downstream Gas Infrastructure Fund, which is financed in part by 0.5 percent of the wholesale prices of all petroleum products and natural gas sold in the country as well as all gas flaring penalties, the latter of which have until now been transferred to the Federation and totals about US$0.5 billion annually if paid in full. The Authority is funded in part by 0.5 percent charged to the wholesale prices of petroleum products. The restructuring of the fiscal terms for production-sharing contracts in the PIA increases the Federation's share of profit oil compared to previously, but 30 percent is earmarked for exploration by the NNPC Ltd.

The new fiscal terms are more attractive and internationally competitive, which should potentially bring in more investment over the long run and increase production but will reduce government revenues in the short run. In formulating fiscal terms for petroleum production, there is usually a trade-off between short-term and long-term government revenues, and the objective of most governments is maximization of cumulative government revenues over the long run. Raising tax and royalty rates would immediately increase the government revenues but reduce investments, resulting in lower petroleum production than otherwise over the long run. Mindful of Nigeria's global competitiveness, the PIA makes the fiscal terms more lenient, reducing the government take and increasing what can be retained by petroleum producers for any given project. Such a move would still earn more income for the government if the lower government take from any given project is more than offset by increased investments and higher overall production.

If enforced as written, the largest claim on the budget in the near term will likely be the initial capitalization of the NNPC Ltd. Section 54 (9) of the PIA requires the NNPC Ltd to be incorporated within six months and all of the NNPC's assets and liabilities to be transferred to the NNPC Ltd within 18 months. The PIA requires the initial capitalization of the NNPC Ltd to be not less than its financial requirements to effectively discharge its commercial role and deal with its obligations and liabilities transferred from the NNPC to NNPC Ltd. A fundamental principle in this regard is that no asset should be transferred without its associated liabilities, and no liabilities should be separated from associated assets or, if separated, be without appropriate guarantees from the government. Based on information provided in its financial statements, the NNPC's liabilities amount to billions of dollars, which the Federation does not seem to be in a position to fund by February 2023, 18 months from the effective date of the PIA.

The NNPC Ltd is to act strictly on a commercial basis but in practice will continue to play some pseudo-regulatory roles. According to section 64 (b), the NNPC Ltd, not the Commission, signs all production-sharing, profit-sharing, and risk-service contracts on behalf of the Federation. Currently the Federation's share of profit oil in production-sharing contracts belongs to the Federation, but in the future it may belong to the NNPC Ltd, as implied in section 64(c) and 9(4). More generally, the NNPC Ltd appears in every contractual arrangement, arguably making its status even less commercially oriented and more favored than today. The NNPC Ltd retains 30 percent of profit oil and profit gas in production-sharing, profit-sharing, and risk-service contracts for exploration in inland and northern basins, increased from 10 percent of the acreage rental fees—which would be much smaller—in the Petroleum Industry Bill circulated for public consultations. Contractors in current and all future production-sharing contracts are denied the right to commercialize gas, which is granted only to the NNPC Ltd.

References

Financial Express (Bangladesh). 2011. "Trucks, lorries hike fares." September 21, 2011.

New Nation (Bangladesh). 2011. "Higher transport fares blamed for commodity price hike."

October 2, 2011.

McCulloch, Neil, Tom Moerenhout, and Joonseok Yang. 2021. "Fuel subsidy reform and the social contract in Nigeria: A micro-economic analysis." *Energy Policy* 156: 112336. doi: 10.1016/j.enpol.2021.112336.

PPPRA (Petroleum Products Pricing Regulatory Agency). Undated. "PPPRA did not pay itself N312 billion naira: the facts." https://financedocbox.com/70701467-Tax_Planning/Petroleum-products-pricing-regulatory-agency-pppra.html

Jobs for a New Generation: Rebuilding Nigeria's Labor Market after COVID-19

Summary: The labor market is the main vehicle for sharing the proceeds of growth to households, and hence reducing poverty. There has long been a need to create jobs for Nigeria's young people, who continue to aspire to good, professional jobs and remain optimistic about their chances. Yet Nigeria's labor market is dominated by informal, precarious work, with the vast majority of workers engaging in household farms or non-farm household enterprises and many working relatively few hours each week. With wage jobs being rare and social protection being limited, most Nigerians cannot afford to be unemployed, that is, to take time out of work to search for productive employment. The prevalence of informal, precarious work and underemployment means that recent shocks—including the 2016 oil-price recession and the COVID-19 crisis—have prompted households to adopt negative coping strategies, including young people cutting short education so they can contribute to household income. The crises also appear to have pushed people further towards work in small enterprises; in agriculture during the 2016 oil-price recession and in retail trade during the COVID-19 crisis. Nevertheless, evidence-based policy action that promotes investment in human capital, effects the macroeconomic reforms needed to boost job creation, and supports small enterprises, can enable Nigeria to seize the "demographic dividend" of its young population and lay strong foundations for future inclusive growth.

The labor market is the main vehicle for sharing the proceeds of growth to households, and hence reducing poverty. This is because labor is the main asset for the poor; they do not have financial assets, rents, or other income sources on which they can draw. Therefore, understanding the labor market is crucial to achieve Nigeria's aspiration to lift 100 million people out of poverty by 2030. This is an ambitious objective, since even before the pandemic around 40.1 percent of Nigerians (about 82.9 million people) were living below the national poverty line and projections suggest that the COVID-19 crisis could push the poverty rate even higher (World Bank, 2020).

This section uses individual labor market data in Nigeria, both in the decade prior to, and then during, the COVID-19 crisis.[25] Between 2010 and 2019, Nigeria's National Bureau of Statistics (NBS) collaborated with the World Bank to collect four rounds of the General Household Survey (GHS), capturing key socioeconomic information—including on labor market outcomes—from Nigerian households. Between April 2020 and April 2021, the Nigeria COVID-19 National Longitudinal Phone Survey (NLPS), also implemented by NBS, captured similar socioeconomic data from a sub-sample of GHS households, interviewed at monthly intervals. With these data, this section examines the make-up of Nigeria's labor market and assesses how it responded to two recent crises: the 2016 recession sparked by falling oil prices and the health and economic "double shock" caused by COVID-19.

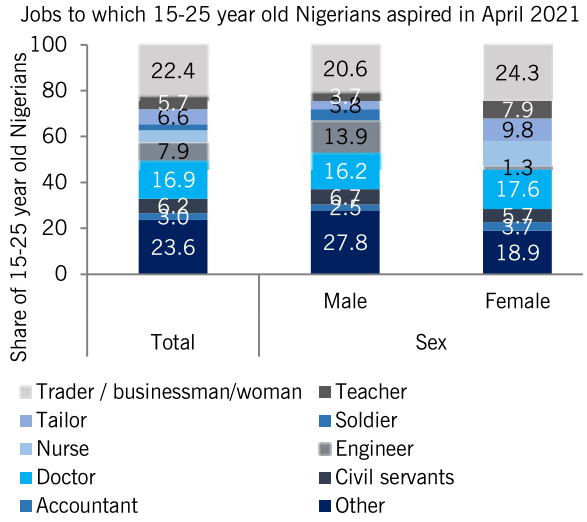
The promise of Nigeria's young people

Even before the COVID-19 crisis, ensuring that there were enough jobs for young Nigerians was an urgent concern. In 2018/19, about 54.3 percent of Nigerian youth—those aged 15-29—were

[25] The section highlights the keys messages from a new World Bank report entitled "Good Jobs for a New Generation: Delivering Quality Jobs for Young Nigerians After COVID-19" (Jenq, Lain, & Vishwanath, 2021). The section also draws on the Nigeria COVID-19 National Longitudinal Phone Survey (NLPS) synthesis report, "COVID-19 in Nigeria: Frontline Data and Pathways for Policy" (Lain, et al., 2021).

working.[26] If this share remains the same, 30.8 million young Nigerians would need jobs in 2021, and according to the most recent population projections, around 40.2 million young Nigerians would need jobs by 2030. This is a natural consequence of Nigeria's extremely youthful demographics: more than two-thirds of Nigerians are aged less than 30 years. Unlike other countries in Sub-Saharan Africa—including Ethiopia, Ghana, and Kenya—Nigeria's "youth bulge" has yet to peak given the slow pace of the country's fertility transition (Fox & Gandhi, 2021).

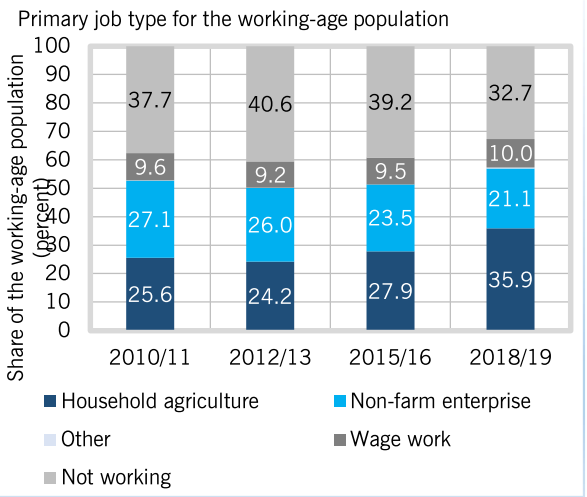
Figure 2.13: Young Nigerians aspire to good, professional jobs



Source: NLPS and World Bank estimates.
Notes: Sample focuses on 15-25-year-old Nigerians interviewed in April 2021.

Nigeria's youth population is not only large; it is also highly aspirational, and optimistic. In April 2021—as the COVID-19 crisis was still very much ongoing—the vast majority of 15-25-year-old Nigerians interviewed in the NLPS reported aspiring to good, professional jobs: 22.4 percent wanted to be businessmen or businesswomen, 16.9 percent wanted to be doctors, and 7.9 percent wanted to be engineers (see Figure 2.13). These professional aspirations were present for both young women and young men. Moreover, young Nigerians are optimistic about their labor market prospects. In April 2021, about 8 in 10 15-25-year-old Nigerians believed it "likely" or "very likely" that they would attain their "dream job".[27]

Figure 2.14: Most Nigerian workers are engaged in farm and non-farm enterprises, a situation that has not changed in at least a decade



Source: GHS and World Bank estimates.
Notes: Since information on hours worked is not available in earlier GHS waves, a hierarchical definition of the primary job is used, which prioritizes wage work, then household agriculture, then non-farm household enterprises, in that order. Estimates averaged across post-planting and post-harvest survey visits. "Other" includes trainees and those who cannot be classified by the hierarchical definition. Sample restricted to individuals with non-missing observations of working status, age, sex, and education across all waves of the GHS.

Failing to provide jobs for young Nigerians will have economic *and* political consequences. Without good jobs, it will be difficult to lift Nigerian households out of poverty or realize the returns to investments made in human capital if skills and education are not put to productive use. Yet global evidence also suggests that labor market frustration can drive people towards violence and conflict, which could have knock-on effects on development in Nigeria (Adelaja & George, 2020; Cramer, 2010; Urdal, 2006).

[26] "Young" or "youth" refers to those aged 15-29 years unless otherwise specified. "Working age" refers to those aged 15-64 years.

[27] This is among those 15-25-year-old who reported they were not already doing their "dream job".

Informal, precarious jobs dominate Nigeria's labor market

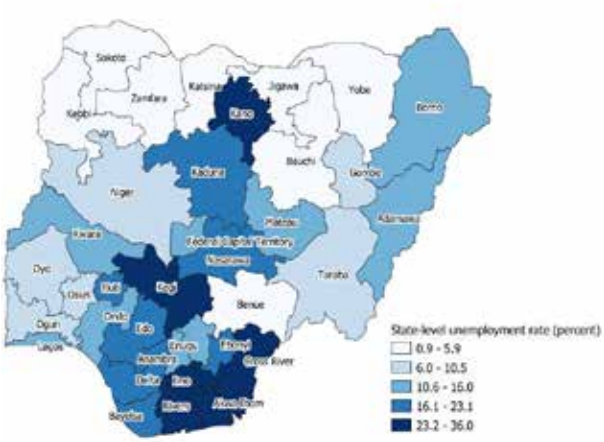
Nigeria's labor market has long been dominated by informal and precarious work in farm and non-farm enterprises. Between 2010/11 and 2018/19, the share of working Nigerians primarily engaged in farm or non-farm enterprises hovered around 85 percent; this represents more than half of the working-age population (see Figure 2.14). Such jobs are "precarious" insofar as they have low, uncertain earnings, and therefore fail to offer clear pathways out of poverty. Nigerian farms are not generally commercialized or well linked to markets, and access to key inputs, such as seeds and fertilizer, may be constrained (Ecker & Hatzenbuehler, 2021; FAO, 2018; Oseni & Winters, 2009). Non-farm enterprises were typically very small scale, with only 14.7 percent of such enterprises employing anyone from outside the household in 2018/19.

Wage jobs have remained rare in Nigeria, exemplifying the slow pace of structural transformation. Between 2010/11 and 2018/19, only around 15 percent of working Nigerians—or 10 percent of the full working-age population—held wage jobs. Such jobs may offer lower earnings risk, in-work benefits including paid leave and social insurance, and the foundations for *careers* that require a longer commitment to the labor market and allow clear advancement opportunities (Goldin, 2006). The lack of wage jobs in Nigeria partly reflects stalling structural transformation. In other countries, the development process has increased demand for labor outside of agriculture—be it in industry or services—with the mix of workers changing accordingly, but continued dependence on oil exports has slowed this evolution in Nigeria.

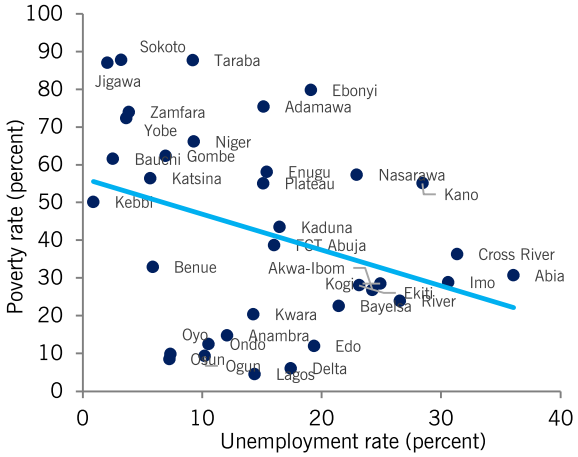
Poverty in Nigeria is largely an "in-work" phenomenon and unemployment and poverty are negatively correlated. With wage jobs being so rare and with little social protection, most Nigerians cannot afford to spend time and effort out of work, searching for jobs. Within Nigeria, this means that unemployment—the share of the labor force who are searching for jobs but not currently working—is lower in the country's poorer states (see Figure 2.15). Similarly, the unemployment rate is higher among certain groups with higher levels of education, a phenomenon observed across low and lower-middle income countries in Sub-Saharan Africa (Fox & Gandhi, 2021). Guiding labor market policies that reduce poverty relies far more on understanding the types of jobs people do, the sectors in which they engage, and the hours they work, than knowing whether they are unemployed.

Figure 2.15: State-level unemployment is negatively correlated with state-level poverty

Panel A: State-level unemployment rate (percent)



Panel B: Correlation between state-level poverty and unemployment



Source: 2018 Q3 Nigerian labor force survey, 2018/19 Nigerian Living Standards Survey, and World Bank estimates.
Notes: In the labor force survey, the unemployed are those who were not working (any number of hours) but who were "looking for work" at the time of the interview. The unemployment rate is the share of those in the labor force (those working or unemployed) who are unemployed. This follows the International Labor Organization definition. Official poverty state-level poverty rates are calculated using Nigeria's national poverty line with data from the 2018/19 Nigerian Living Standards Survey. Borno is excluded from state-level measures of poverty.

Young people cut their education short to cope with recent crises

Given the lack of resilience in Nigeria's labor market, both the 2016 oil-price recession and the COVID-19 crisis had direct impacts on livelihoods and human capital, with young people taking on additional work at the expense of education to try to cope. Between 2015/16 and 2018/19—as the oil-price recession hit—the share of working-age Nigerians who were working increased from 60.8 percent to 67.3 percent, while the share of young Nigerians who were working rose even more from 38.6 percent to 50.7 percent (see Figure 2.14). The same period was also marked by declining education: the share of 20-25-year-olds attaining secondary education (or higher) dropped from 59.5 percent to 52.2 percent. Similarly, even though employment plummeted at the start of the COVID-19 crisis, the share of working-age Nigerians who were working in fact increased from 63.7 percent in January/February 2019 to 69.6 percent in February 2021.[28] This increase in working rates was particularly pronounced among women and people from poor households, consistent with an "added worker effect" where more household members participate in the labor force in response to economic shocks (see World Bank (2021)). School closures mechanically pushed children out of school in the early part of the pandemic, but it appears that children did not return to education even as schools reopened (Dessy, Gninafon, Tiberti, & Tiberti, 2021). The learning losses during these

[28] This relies on comparing the NLPS and GHS. Directly comparing labor market outcomes from the GHS and the NLPS is challenging for three key reasons, which should be borne in mind when interpreting the results. First, the GHS was carried out face-to-face, while the NLPS was conducted over the phone. Second, the GHS surveyed all working-age individuals in the household, while the NLPS surveyed up to six working-age individuals. Third, the dates of data collection for the post-planting visit of the 2018/19 GHS – July 18, 2018, to October 5, 2018 – do not perfectly match the dates of data collection for Round 5 of the NLPS – September 7, 2020, to September 21, 2020. There is a similar but smaller disparity for the post-harvest visit of the 2018/19 GHS and Round 10 of the NLPS.

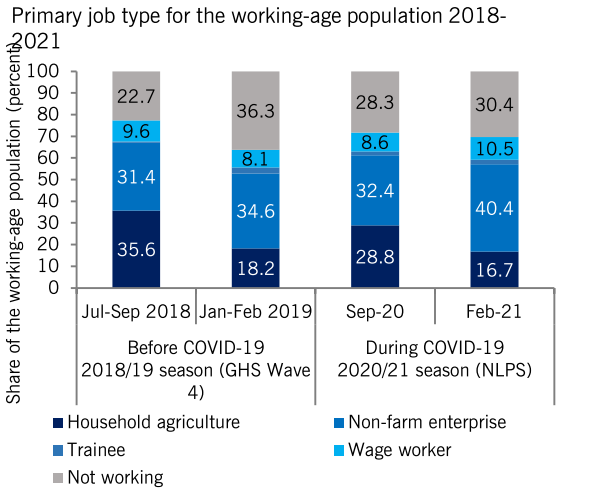
crises will therefore have long-term, intergenerational consequences for education, which Nigeria can ill afford given its weak human capital outcomes (World Bank, 2020).

Compounding precarity

The 2016 oil-price recession pushed workers towards agriculture, marking a reversal in structural transformation. Between 2015/16 and 2018/19, the share of working-age Nigerians primarily engaged in household farming rose from 27.9 percent to 35.9 percent (see Figure 2.14). Farming was the main source of additional work as households tried to cope with the 2016 oil-price recession.

The COVID-19 crisis, by contrast, heralded rising work in small-scale non-farm enterprises, especially in retail trade, alongside significant churn in people's labor market activities. Between January-February 2019 and February 2021, the share of working-age Nigerians primarily engaged in non-farm enterprises increased from 34.6 percent to 40.4 percent (see Figure 2.16). At the baseline of the NLPS, almost two-thirds of non-farm enterprises were in retail trade. Alongside these broader shifts, the COVID-19 crisis was also marked by significant churn between different sectors of the economy. For example, among those working in retail trade in February 2021, just 30.1 percent had been working in that sector in January-February 2019: around 36.8 percent had not been working at all, and 33.2 percent had flowed in from agriculture, industry, and services. The extent of this churning suggests that workers lack stability and security in their employment. The COVID-19 crisis has forced Nigerians to take on whatever activities will help them cope, even if these are not the activities to which they are best suited.

Figure 2.16: Workers turned to small-scale non-farm enterprise activities to cope with the COVID-19 crisis

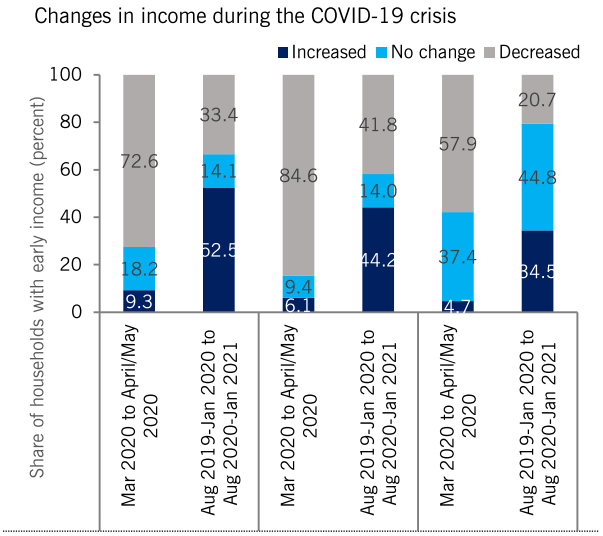


Source: 2018/19 GHS, NLPS, and World Bank estimates.
Notes: Estimates focus on primary job, defined as the job in which the individual worked the most hours. The sample is a panel of individuals observed across the relevant 2018/19 GHS and NLPS rounds.

Despite the shift towards non-farm enterprises, it was mainly agriculture that alleviated households' income losses during the COVID-19 crisis, in part due to favorable climatic conditions. With the onset of the pandemic there was widespread stress on all income sources. Yet by January 2021, incomes from some sources, especially household farms, had started to recover. Between August 2019-January 2020 and August 2020-January 2021, agricultural incomes had increased or stayed the same for 66.6 percent of agricultural households (see Figure 2.17). However, over the same period, non-farm enterprise incomes had still decreased for 41.8 percent of households with non-farm enterprises, even though this is the activity to which households were turning in order to try to cope. In this sense, agriculture may have come to the rescue and served as an insurance mechanism for many households, buoyed by climatic conditions. Data from the Food and Agriculture Organization suggests that favorable rains in 2020 benefitted crop production across Nigeria, and the country's aggregate cereal output in 2020 was estimated to be around 28 million tons, above the last five-year average (FAO,

2021). This also resonates with Nigeria's sectoral GDP figures (see Section 1), which show that agricultural output continued to grow during the pandemic.

Figure 2.17: Incomes from non-farm household enterprises remained the most precarious as the COVID-19 crisis continued



Source: NLPS and World Bank estimates.
Notes: Estimates capture the share of households with each income source in the starting period, that is, in March 2020 and in August 2019-January 2020.

Taking evidence-based action for good jobs

Recent crises have renewed the impetus for long-needed reforms to promote the creation of good jobs. Going beyond Nigeria's immediate COVID-19-related priorities—like accelerating the vaccination campaign and expanding social protection—three types of reforms will be required. First, it will be essential to invest in human capital, recouping the learning lost during the COVID-19 crisis. This equips workers with the skills they need to prosper in the labor market and create jobs themselves, but could also accelerate Nigeria's fertility transition, so that the proceeds of growth are shared among fewer people, raising living standards. Second, the macroeconomic reforms described at the end of the Outlook section, could expedite structural transformation, and generate good wage jobs that can lift people out of poverty. Investments in human capital risk being wasted if the jobs that utilize people's newly developed education and skills are not available. Third, since it could take decades before wage jobs are widespread, policies that support productivity and earnings in small enterprises will be crucial in the short and medium term. Farming—which also faces the growing challenge of the impacts of climate change—could benefit from research into improved crop and livestock varieties, while support for storage, transport, and market access could further improve agricultural productivity (Beegle & Christiaensen, 2019). For non-farm enterprises, evidence from within Nigeria demonstrates the potential benefits of loosening credit constraints (see McKenzie (2017)), while building infrastructure and market access could further bolster productivity, profits, and ultimately employment at small and medium firms.

These policy actions can help ensure good jobs are available, enabling Nigeria to seize the "demographic dividend" of its young population and lay strong foundations for future inclusive growth; but good policies will continue to rely on evidence. It is therefore vital to redouble efforts to collect detailed and consistent evidence on Nigeria's workers, through labor force surveys, and Nigeria's firms, through enterprise surveys. As Nigeria emerges from the COVID-19, evidence on workers and firms will be more important than ever for realizing the demographic dividend and ultimately for reducing poverty.

References

Adelaja, A., & George, J. (2020). Is Youth Unemployment Related to Domestic Terrorism? *Perspectives on Terrorism, 14*(5), 41-62. Retrieved from https://www.jstor.org/stable/26940038

Beegle, K., & Christiaensen, L. (2019). *Accelerating Poverty Reduction in Africa.* Washington DC: World Bank. doi:10.1596/978-1-4648-1232-3

Cramer, C. (2010). *Unemployment and Participation in Violence.* Washington DC: World Bank.

Dessy, S., Gninafon, H., Tiberti, L., & Tiberti, M. (2021). *COVID-19 and Children's School Resilience: Evidence from Nigeria.* Washington DC: World Bank. doi:10.1596/1813-9450-9736

Ecker, O., & Hatzenbuehler, P. (2021). Food consumption–production response to agricultural policy and macroeconomic change in Nigeria. *Applied Economic Perspectives and Policy*, 1-21. doi:10.1002/aepp.13161

FAO. (2018). *Small Family Farms Country Factsheet: Nigeria.* Rome: Food and Agriculture Organization. Retrieved from http://www.fao.org/3/i9930en/I9930EN.pdf

FAO. (2021). *Global Information and Early Warning System - Country Brief: Nigeria.* Rome: Food and Agriculture Organization. Retrieved from http://www.fao.org/giews/countrybrief/country.jsp?code=NGA&lang=en

Fox, L., & Gandhi, D. (2021). *Youth employment in sub-Saharan Africa: Progress and prospects.* Washington DC: Brookings. Retrieved from https://www.brookings.edu/research/youth-employment-in-sub-saharan-africa-progress-and-prospects/

Goldin, C. (2006). The Quiet Revolution That Transformed Women's Employment, Education, and Family. *American Economic Review, 96*(2), 1-21. doi:10.1257/000282806777212350

Jenq, C., Lain, J., & Vishwanath, T. (2021). *Good Jobs for a New Generation: Delivering Quality Jobs for Young Nigerians After COVID-19.* Washington DC: World Bank.

Lain, J., Viswanath, T., Amankwah, A., Contreras-Gonzalez, I., Jenq, C., Lagrange, A. A., . . . Sagesaka, A. (2021). *COVID-19 in Nigeria: Frontline data and pathways for policy.* Washington DC: World Bank.

McKenzie, D. (2017). Identifying and Spurring High-Growth Entrepreneurship: Experimental Evidence from a Business Plan Competition. *American Economic Review, 107*(8), 2278-2307. doi:10.1257/aer.20151404

NBS. (2021). *Nigerian Gross Domestic Product Report: Q1 2021.* Abuja: Nigerian National Bureau of Statistics. Retrieved from https://nigerianstat.gov.ng/download/1241027

Oseni, G., & Winters, P. (2009). Rural nonfarm activities and agricultural crop production in Nigeria. *Agricultural Economics, 40*(2), 189-201. doi:10.1111/j.1574-0862.2009.00369.x

Urdal, H. (2006). A Clash of Generations? Youth Bulges and Political Violence. *International Studies Quarterly, 50*(3), 607-629. Retrieved from https://www.jstor.org/stable/4092795

World Bank. (2020). *Human Capital Index 2020: Nigeria country brief.* Washington, DC: World Bank. Retrieved from https://databank.worldbank.org/data/download/hci/HCI_2pager_NGA.pdf?cid=GGH_e_hcpexternal_en_ext

World Bank. (2020). *Rising to the Challenge: Nigeria's COVID Response.* Washington DC: World Bank. Retrieved from https://documents.worldbank.org/en/publication/documents-reports/documentdetail/152691607607461391/nigeria-development-update-rising-to-the-challenge-nigerias-covid-response

World Bank. (2021). *Resilience through Reforms.* Washington, DC: World Bank. Retrieved from https://documents.worldbank.org/en/publication/documents-reports/documentdetail/389281623682704986/resilience-through-reform

Part 3: Spotlights on Nigeria’s Development Agenda

SPOTLIGHT 1: Investing in Nigeria's Digital Infrastructure

Summary: Nigeria's digital economy can transform economic activities by unleashing new productivity gains, offering new services, and improving the government's efficiency. It can also lead to greater citizen engagement, rebuilding trust and enabling access to service. Nigeria has the potential to accelerate its digital transformation by leveraging its relatively strong mobile broadband infrastructure, expanding e-commerce markets, and growing digital financial services. However, Nigeria continues to face significant challenges which have hindered the country's ability to reap the full benefits of the digital economy. One leading barrier is Nigeria's underdeveloped fixed broadband infrastructure, which is attributable to high Federal and State taxes and an insufficient wholesale regulatory regime. This weak infrastructure base creates a ripple effect across the economy, contributing to low levels of financial inclusion, and persistent geographic and gender gaps in access to and use of digital technologies. The ongoing conflict in the Northern region exacerbates these challenges, due to heightened security risks. By investing in its digital infrastructure and strong foundational ID systems, Nigeria can promote economic development, security, governance, and efficient delivery of services thereby accelerating progress toward an inclusive digital economy.

Harnessing Nigeria's digital potential

Digital technologies have the potential to transform all aspects of the economy, by lowering the cost of economic and social transactions for firms, individuals, and the public sector. Digital investments boost economic growth, expanded job opportunities, and improved service delivery. Rather than focusing solely on the information and communication technology (ICT) sector, the digital economy refers to a modern economy enabled by digital technologies.

Nigeria is well positioned to reap the benefits of the digital economy. Nigeria has the largest mobile market in Sub-Saharan Africa, supported by strong mobile broadband infrastructure and improved international connectivity. Digital platforms have gained traction, especially in the private sector. These platforms have the potential to connect government, businesses, and consumers, creating market efficiencies and reducing entry barriers. Digital financial services (DFS) are well-positioned to address the needs of the poor, as financial institutions leverage economies of scale to expand into underserved communities. Further, the large youth population has generated a robust digital entrepreneurship ecosystem in Lagos comprised of youth-led start-ups, innovation hubs, and digital businesses. Additionally, government agencies, firms, and civil society organizations are increasingly investing in digital skills programs to bring all Nigerians into the digital economy.

However, Nigeria is only capturing a fraction of its digital economy growth potential. Minimal fixed broadband infrastructure and a lack of accessible and affordable connectivity in rural areas are exacerbating the digital divide. The country also faces several additional challenges, including suboptimal management of its telecom and power networks, security, and transparency issues, and constraining fiscal policies. Closing the digital literacy gap that persists in the most vulnerable communities will be critical to enabling Nigeria to benefit from digital transformation across all sectors of the economy. The implementation of a robust digital ID system will also enable delivery of social safety nets to the poorest and financial inclusion. Firms will be able to, offer innovative products and services to consumers and there will

be use of Internet, payments, and skills for a vibrant digital economy in Nigeria.

The government has prioritized the development of a digital-led strategy to make its economy more competitive. In 2019, Nigeria published the new ten-year National Digital Economy Policy and Strategy (NDEPS) 2020-2030 and the National Broadband Plan (NBP) 2020-2025. The NBP specifies targets to be achieved by 2025, including a 70 percent penetration rate for the population over 15 years old, 90 percent 4G/5G population coverage, and 60 percent digital literacy. Based on the estimated 54 percent data penetration rate for unique individual data users over 15 years of age,[29] the challenge of meeting these objectives by 2025 is substantial.

Table 3.1: Top 10 African Countries in the UNCTAD B2C E-Commerce Index, 2018

	Nigeria	World	Developing Countries	Africa
COVERAGE				
Population covered by a mobile cellular network, % (2020)	91	96.7	96.1	88.4
Population covered by at least a 3G network, % (2020)	74	93.2	92.2	77.4
Population covered by at least a 4G network, % (2020)	41	84.7	82.2	44.3
MOBILE PHONE OWNERSHIP				
Individuals owning a mobile phone, % (2017)	41	n/a	n/a	n/a
Female mobile phone ownership as a % of total female population (2017)	32	n/a	n/a	n/a
Male mobile phone ownership as a % of total male population (2017)	49	n/a	n/a	n/a
ICT ACCESS AT HOME				
Households with Internet access at home, % (2017)	8	57.4	47.8	14.3%
Households with a computer at home, % (2018)	6	47.1	36.1	7.7%
Households with a computer at home, urban, % (2017)	18	63.4	53.5	17%
Households with a computer at home, rural, % (2017)	2	25.3	17.1	2.2%
MOBILE AND FIXED TELEPHONE SUBSCRIPTIONS				
Mobile-cellular subscriptions per 100 inhabitants (2020)	99	105	99.3	82.3
Fixed-telephone subscriptions per 100 inhabitants (2020)	0.1	11.9	7.4	0.7
MOBILE AND FIXED BROADBAND SUBSCRIPTIONS				
Active mobile-broadband subscriptions per 100 inhabitants (2020)	42	75	65.1	33.1
Fixed broadband subscriptions per 100 inhabitants (2020)	0	15.2	11.5	0.5
International bandwidth per Internet user (kbit/s) (2019)	6	131.3	96.4	30.8
INTERNET USE				
Individuals using the Internet, total, % (2017)	28%	51.4	44.4%	28.6%
Individuals using the Internet, female, % (2017)	n/a	48.3	40.4	20.2%
Individuals using the Internet, male, % (2017)	n/a	55.2	48.9	37.1%

Source: UNCTAD, 2018.

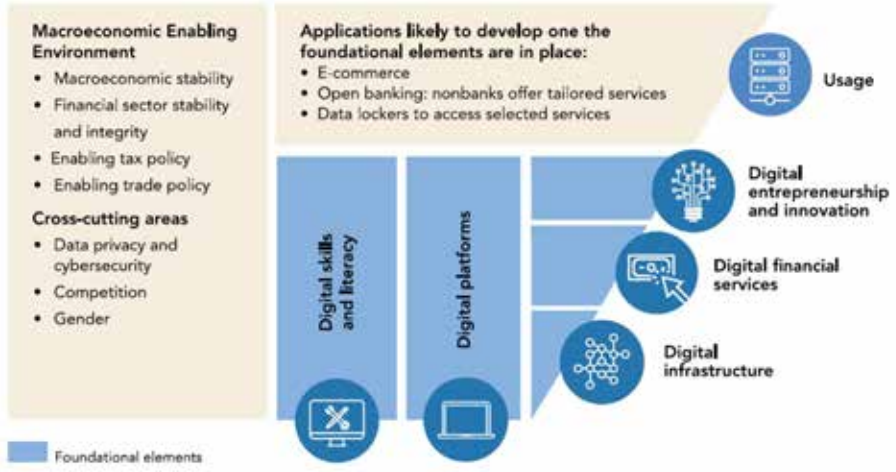
[29] GSMA estimates 51 percent data penetration rate of total population for unique data SIMs in 2019. However, many Nigerian data users have several SIMs including dongle and multiple mobile devices, so unique data user penetration rate is likely in range of one third of population. Assuming 56 percent of the population is over 15 years and 5 percent of data users are 15 or under, the actual data penetration rate for individual unique data users over 15 is likely in the range of approximately 54 percent, assuming a small portion (roughly 3 percent) of users under 15 years old have data.

The state of Nigeria's digital economy ecosystem

To achieve the objectives outlined in the NDEPS and NBP, the first step is developing a robust digital ecosystem. For a vibrant, inclusive, and safe digital economy, Nigeria must build five key foundational elements:

1. Digital Public Platforms: Digital platforms offer products and services, accessible through digital channels, such as mobile devices, computers, and the Internet. They facilitate digital exchange and transactions, enabling producers and users to create value by interacting with each other. Governments, for example, operate digital platforms to offer citizen-facing government services and share information. Commercial firms and non-profit foundations also operate digital platforms to offer a growing array of products, services, and information.
2. Digital Financial Services: Digital financial services enable individuals and businesses to conduct transactions electronically and open a pathway to a range of digital financial services in addition to digital payments, including credit, savings, and insurance. Access to affordable and appropriate digital financial services is critical for the participation of individuals and businesses in the digital economy.
3. Digital Entrepreneurship: Digital entrepreneurship and innovation create an ecosystem that helps bring the digital economy to life, by spurring new, growth-oriented ventures, products, and services that leverage technology. By enabling the transformation of existing businesses, digital entrepreneurship contributes to net employment growth and helps to enhance competitiveness and productivity.
4. Digital Skills: Economies require a digital-savvy workforce in order to build robust digital economies and competitive markets. Digital skills constitute technology skills, together with business skills for building or running a startup or enterprise. Greater digital literacy further enhances adoption and use of digital products and services amongst governments and the larger population.
5. Digital Infrastructure: Digital infrastructure provides the means for people, businesses, and governments to get online, and link with local and global digital services, thus connecting them to the global digital economy. High-quality and affordable Internet connectivity is a critical foundational component of the digital economy.

Figure 3.1: Key Components of the Digital Economy Ecosystem



Source: World Bank, 2019.

Digital platforms

Digital platforms facilitate the exchange of information, goods, and services, helping to serve people, businesses, and government agencies in all aspects of life, including healthcare, education, and commerce. In 2019, the Government of Nigeria launched the '*Nigeria e-Government Master Plan 2020*' to improve the efficiency of public service delivery. The Government also launched the *Central Portal for Government Services,* a centralized portal which aims to transform public administration efficiency, enhance government accountability, and improve the delivery and quality of public services. Since the launch of the E-government Master Plan, much remains to be done to promote institutional coordination, improve government transparency and fight corruption, and improve the effectiveness of public service delivery to citizens. Limited institutional coordination leads to a proliferation of platforms, and a lack of a shared services contributes to limited interoperability between platforms. Critically, millions of Nigerians lack the formal identification necessary to access and leverage the benefits of digital platforms. There is also a strong correlation between e-government and improvements in government effectiveness, which makes government technology essential to the fight against corruption.

One of the biggest strengths of Nigeria's digital ecosystem is the country's e-commerce market. Nigeria ranked second in UNCTAD's 2018 business to customer (B2C) report and boasted the largest B2C market in Africa in terms of revenue and shoppers (Table 3.2).[30] In 2018, e-commerce spending in Nigeria was estimated at USD 12 billion and was projected to increase to USD 75 billion in revenues by 2025. E-commerce has continued to expand as shopping behaviors change, in part due to social distancing measures introduced since the onset of the COVID-19 pandemic. For example, a survey from Visa found that 71 percent of respondents in Nigeria bought groceries online for the first time because of the pandemic.[31] As the COVID-19 crisis further established the importance of e-commerce, Nigeria-based online retailer Jumia reported increased demand from sellers across the region

[30] UNCTAD, 2018.

[31] "Visa launches new 'Where You Shop Matters' initiative to support small businesses in Nigeria." *Nairametrics*, https://nairametrics.com/2020/06/17/visa-launches-new-where-you-shop-matters-initiative-to-support-small-businesses-in-nigeria/.

during the first half of 2020.[32] Almost 90 digital platforms provide e-commerce services in Nigeria, employing 2.9 million people in the country. The government's NDEPS commits to supporting the launch of growth of more platforms to continue the growth of the e-commerce market.

Table 3.2: Top 10 African Countries in the UNCTAD B2C E-Commerce Index, 2018

Rank (Africa)	Economy	Share of individuals using the Internet (2017 or latest)	Share of individuals with an account (15+, 2017 or latest)	Secure Internet servers (normalized) (2017)	UPU postal reliability score (2017 or latest)	Index value (2017 data)	Index value change (2016-17 data)	Rank (World)
1	Mauritius	55	90	56	66	66.9	-7.2	55
2	Nigeria	42	40	52	85	54.7	5.5	75
3	South Africa	59	69	83	0	52.9	-1.0	77
4	Tunisia	56	37	51	63	51.7	2.1	79
5	Morocco	62	29	54	59	50.9	N/A	81
6	Ghana	39	58	45	53	48.8	7.6	85
7	Kenya	39	82	37	27	46.2	3.7	89
8	Uganda	17	59	31	58	41.5	-3.2	99
9	Botswana	47	51	41	26	41.4	0.1	100
10	Cameroon	23	35	25	78	40.3	3.6	101

Source: UNCTAD, 2018.

Digital financial services

Digital financial services (DFS) comprise of a range of digitally-enabled financial products and services—such as payments, transfers, savings, and credit—which are critical in providing individuals and firms with convenient and affordable channels to pay, save, and borrow. Approximately 60 million Nigerians lack access to a formal financial account. Unbanked Nigerians tend to be female, be younger, and live predominantly in rural areas without bank branches and ATMs, which are expensive to establish. In 2018, approximately 39.7 percent of adults had a bank account, compared to 38.3 percent reported in 2016, and only 15.5 percent of respondents reported making at least one digital payment in the past year. Access to other financial services, including credit and savings products, and insurance packages, also remains low. There is also a very large gender gap in financial account ownership, with account ownership among men (51 percent) being almost double the rate among women (27 percent). This gender gap is also reflected in ID ownership were only 40% of National Identification Number enrollments are women.

The Nigerian economy stands to benefit from the growth in supply and usage of digital financial services. The 2017 Global Findex survey found that only 1.7 percent of respondents had a registered mobile wallet, with Nigerian mobile money providers largely reaching customers that already have formal accounts. The usage of digital payment services in Nigeria is also relatively low. In 2017, approximately 30 percent of Nigerians over 15 years old had made or received a digital payment in the past year. Nigeria also had the second lowest share of adults using mobile phones or the Internet

[32] GSMA, 2021a.

to access a financial account, and ranked second-to-last in share of adults that have sent or received domestic remittances using a mobile phone (Table 3.3). Strikingly, Nigeria is the only large economy of Sub-Saharan Africa where the proportion of the population making or receiving digital payments decreased between 2014 and 2017.

Table 3.3: Usage of Financial Services, Selected Countries

	Made or Received Digital Payments in the Past Year	Used a Mobile Phone or the Internet to Access an Account	Sent or Received Domestic remittances Through a Mobile Phone
Nigeria	30% (-7 p.p.)	8%	7% (+4 p.p.)
Kenya	79% (+10)	72%	63% (-1)
South Africa	60% (+1)	21%	19% (+7)
Uganda	55% (+15)	47%	47% (+3)
Ghana	49% (+24)	35%	43% (+26)
Tanzania	43% (+8)	37%	41% (+5)
Côte d'Ivoire	38% (+8)	33%	38% (+11)
Ethiopia	12% (+7)	0%	0% (0)
Cameroon	29% (+21)	16%	20% (+19)

Source: Findex, 2017.
Note: The percentage refers to the share of all adults (aged 15 and higher) who have used the service. Numbers in parentheses indicate change since 2014. Data unavailable for Sudan and Angola.

Nigeria must address security risks associated with DFS to effectively financial inclusion and the DFS market. The largest threats associated with DFS are due to pervasive online and financial fraud, and an ongoing struggle with terrorism and armed conflict in northern states. Adequate regulation and oversight can reduce the risks associated with the ease of obtaining instant credit and making real-time domestic and international money transfers using DFS. Nigeria's status as the largest economy in Sub-Saharan Africa creates economies of scale necessary to sustain many low-margin DFS business models. Nigeria's large economy also makes it more economically viable to design and market DFS products addressing niche markets, since reaching 1 to 2 percent of Nigerians effectively means capturing millions of customers.

Digital entrepreneurship

The performance of Nigeria's digital entrepreneurship ecosystem lags behind regional and global competitors. Digital entrepreneurship refers to the creation of new ventures and the transformation of existing business through digital technologies. Digital entrepreneurs include: (i) new firms (digital start-ups) and mature firms (digital scale-ups) that utilize digital technologies at the core of their business model; and (ii) digitally enabled businesses, which utilize digital technologies to improve business operations, sharpen business intelligence, and engage with customers and stakeholders through new (digital) channels. Nigeria ranks 101 out of 137 countries on the Global Entrepreneurship Index.[33] Nigeria ranks 116 out of 141 countries on the World Economic Forum's Global Competitiveness Index (GCI), which serves as an economic compass for a country's productivity based on 12 pillars, including ICT adoption, skills, business dynamism, and innovation capability. According to this index, Nigeria ranks 118 for ICT adoption and 129 for skills. On a positive note, Nigeria ranks 79 for business dynamism, and 94 for innovation capacity, indicating the potential of the country's young entrepreneurs.

[33] Global Entrepreneurship and Development Institute, 2018.

Given its large youth population, digital entrepreneurship has the potential to become a powerful engine of economic transformation in Nigeria. Nigeria has consistently ranked in the top four of the most funded countries in Africa. Nigeria is also home to two unicorns—fintech startup, Flutterwave, and the e-commerce giant, Jumia Group. Lagos is a mature ecosystem with dynamic incubators, venture capital companies, and digital start-ups in a variety of sectors, and digital entrepreneurship ecosystems are also growing in the cities of Abuja and Port Harcourt. Nigerian startups are gaining increasing access to large, international accelerators. As of 2019, thirteen out of twenty-eight African start-ups admitted to YCombinator have been Nigerian, and the majority raised USD 150,000 to USD 1.2 million in funding.[34]

Despite these advancements, Nigeria's digital entrepreneurship ecosystem still faces challenges. Many startups suffer from lack of funding at the proof of concept and early stages of firm development, while more mature firms lack access to capital markets as a source of funding. Although urban SMEs are increasingly using digital platforms for trading, digitalization of firms in traditional industries and rural locations remains limited. In addition to facing infrastructure challenges, digital entrepreneurs are particularly constrained by a cumbersome tax system and public procurement processes which are difficult to navigate. Furthermore, existing policy incentives are underutilized by digital entrepreneurs because of burdensome requirements, confusing application processes, and a lack of transparency.

Digital skills

The digital skills ecosystem in Nigeria is characterized by illiteracy and skills gaps. Nigeria's education system continuously suffers from poor funding and deteriorating teaching capabilities at all levels. The low quality of education is exacerbated regional disparities among school enrollment rates, and gender gaps in school enrollment and completion. While online training initiatives are expanding, low enrolment in and poor quality of basic education coupled with a lack of digital skills in curricula is excluding the most vulnerable communities from the benefits of the digital economy.

The importance of digital skills is underscored by the COVID-19 pandemic, which has led to a rise in transactions and interactions via digital platforms. Nigeria accounts for 20 percent of the population of Sub-Saharan Africa, and, is projected to be the third most populous country in the world by 2040, with over 400 million people. Yet, Nigeria is not making optimal use of its human capital potential. In 2020, Nigeria ranked 117 out of 134 countries in the Network Readiness Index and 99th under the index's people pillar, which measures the usage and skills of digital technologies by individuals, businesses, and governments in the digital economy.[35] According to the World Economic Forum's 2019 Global Competitiveness Report, Nigeria ranks 122 out of 141 countries for digital skills among active population and 97 out of 141 for ease of finding skilled employees.[36]

Digital infrastructure

Fast, reliable, accessible, and affordable broadband Internet is the foundation of the digital economy, and key to enhancing productivity, facilitating information exchange, and improving service delivery. While potential

[34] World Bank, 2018b.
[35] Portulans Institute, 2020.
[36] WEF, 2019.

impacts vary by country, studies estimate that a 10 percent increase in mobile broadband penetration can lead to a minimum of 0.8 percent additional GDP growth.[37] Estimates for the Africa region are even higher, with projections of up to 2.46 percent of additional GDP growth per 10 percent higher broadband penetration.[38]

However, despite recent growth in fiber installations, national fixed-line infrastructure remains underdeveloped in Nigeria. At the end of 2018, Nigeria's household penetration rate for fixed broadband was 0.04 percent, which is below the African regional average of 0.6 percent and far behind the world average of 13.6 percent. Fiber optic backbone deployment has been focused on middle mile deployments within and across major urban areas, while last mile deployments remain limited.

The COVID-19 pandemic has amplified the importance of access to fixed broadband to underpin a robust, inclusive digital economy ecosystem—not only for increasing productivity and efficiency, but also for enabling business as usual during crises. To deliver on the 2030 aspirations of greater access to the digital economy and to meet the bold EGRP's objective of lifting 100 million Nigerians out of poverty, the Government needs to continue to strategically invest in the foundational elements of its digital economy.

Investing in Nigeria's digital infrastructure

Fixed broadband

Approximately 23 percent of Nigerians use broadband services, and roughly 36 percent of the population has Internet access. The average cost of fixed broadband is US$80 per month, making Internet access unaffordable to most households. With the high cost of Internet and mobile connectivity, small entrepreneurs, microenterprises, and SMEs generally face poor quality in Internet services, impacting their efficiency and productivity.

Nigeria needs three times more the fiber infrastructure that it currently has to reach the NBP targets by 2025. Nigeria needs roughly between 120,000 to 167,000 kms of fiber infrastructure—in addition to the existing 55,000 kms—at a cost of US$3.4 billion. This amount includes approximately USD870 million in fiber deployment costs plus an estimated USD2.5 billion for 10 years (DCF) cost of Rights of Way fees, which would be payable by operators deploying the fiber if current ROW fees remain in place. If Rights of Way fees charged by all states are reduced to 145N per meter, then the cost of this dark fiber deployment including ROW fees would decline dramatically from USD3.4 billion to USD 1 billion, as the DCF of 10 years of ROW fees would decline from USD2.5 billion to only approx. USD150 million. Currently, the lack of an open-access wholesale network, combined with ineffective wholesale access regulation, varied Federal and State levies, and excessive rights of way fees, continues to hamper investments in the sector. Unlike West African peers, such as Ghana and Senegal, Nigeria does not have a pervasive, open-access national backbone network through which high-speed Internet connectivity can be affordably extended across the entire country. As such, most telecommunications operators in Nigeria continue to self-provision their own infrastructure**.** This has resulted in unnecessary duplicative investments, with high-traffic intercity routes often having three or more fiber-optic links whilst others have none.

Federal and state levies from a multiplicity of government agencies and departments, as well as excessive rights of way (ROW) fees, have artificially increased the costs for this much-needed deployment thereby. These fees have

[37] Edquist et al., 2018; ITU, 2020.

[38] ITU, 2020.

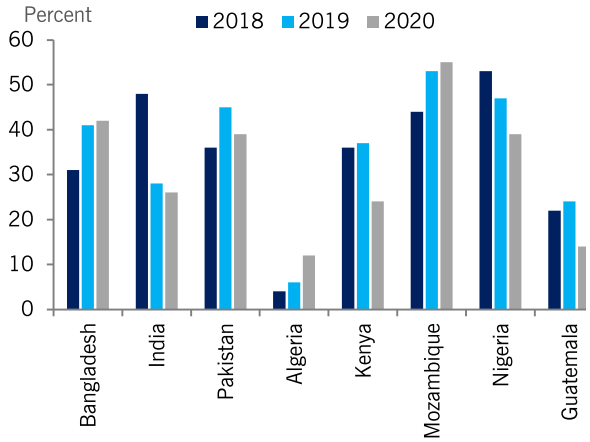
further disincentivized private sector infrastructure investment. Only about 7 of Nigeria's 36 States have agreed to apply the flat 145N/meter ROW rate. However, even some of these States have restructured the abolished ROW fees into new administrative fees payable by telecom operators. The World Bank estimates that approximately US$900 million in ROW fees could be payable annually to deploy the fiber required to achieve the NBP penetration rate targets while removing the obstacle that these excessive and uncertain fees cause in achieving the Government's goals. In addition, Internet Service Providers (ISPs)—which are mainly small business enterprises—have reported difficulty in obtaining wholesale access to existing fiber optic networks at cost-based prices.

Barriers to entry are further exacerbated by the lack of effective regulation of the wholesale market, which MTN has dominated. To further the Open Access Model and address duplicative investments, the NBP licensed seven Infrastructure Companies (InfraCos) in assigned geographical zones with an aim to stimulate building fiber infrastructure in the unserved and less commercially viable areas. The viability of these InfraCos remains unclear, given the lack of agreement on government subsidies, as well as the limited technical and financial capacity of most of the InfraCos, none of which has yet deployed substantive infrastructure over two years after licensing. NCC is tasked to review the InfraCos framework for the development of more sustainable funding options.[39] NCC has also recently conducted a review of the overall licensing framework with a view to rationalizing licenses and improving investment and service.

Mobile connectivity

Mobile systems remain the primary means for carrying retail and enterprise data traffic. In 2019, Nigeria reached 3G geographic coverage of 78 percent, with 20 million people having access to 3G networks. The first 4G network rolled out in 2016 and since then, operators claim to have achieved 45 percent 4G coverage. Nigeria also has one of the most affordable handset device costs in the world. In 2017, the cheapest internet-enabled phone cost 42 percent of monthly GDP per capita and this fell to 12 percent in 2019. Similarly, mobile tariffs have become more affordable, as the cost of a 1 GB monthly plan fell from 3.3 percent to 1.5 percent of monthly GDP per capita between 2016 and 2019. This has helped drive an increase in smartphone ownership among adults, which increased from 28 percent in 2017 to 44 percent of total connections in 2019.

Figure 3.2: Rural-Urban Gaps in Mobile Internet Use, Selected Countries (2018-2020)



Source: GSMA, 2021a.

Integration of 5G networks is another enabler for the digital economy growth and universal broadband access. With the right choice of policy measures, countries with under-developed telecom infrastructure and lower 4G coverage, may improve the commercial viability of the telecom

[39] PRESS STATEMENT: NCC Reviewing InfraCo Framework, Funding Options. 19 October 2020 https://www.ncc.gov.ng/media-centre/news-headlines/887-press-statement-ncc-reviewing-infraco-framework-funding-options.

networks by deploying 5G technology.[40] In September 2021, the Federal Government of Nigeria announced the implementation of a phased roadmap for the deployment of 5G across the country and ensuring effective deployment of 5G to cover major urban cities by 2025.[41]

Approximately 63 percent of Nigerians living in rural areas are unconnected, compared to 40 percent of people living in urban areas. Although awareness has significantly improved, it remains lower among those living in rural areas compared to their urban counterparts. In 2019, rural populations were 19 percent less likely to be aware of mobile internet than urban residents, compared to 56 percent in 2017. The rural-urban gap in mobile internet use has also steadily decreased from 53 percent in 2018 to 39 percent in 2020 (Figure 3.2). There is also a north-south divide within the country, with southern regions (including major cities such as Lagos) well ahead of northern counterparts in access within a household to mobile phones. The quality of service is an issue across the country, particularly in the north, where mobile phone coverage is uneven and impacted by conflict zones. Unequal access to mobile services, as well as lower literacy levels and information campaigns that do not reach last mile communities, mean that the geographic gaps continue to persist.

There are significant bottlenecks which inhibit growth of high-speed Internet in Nigeria. Expanding broadband markets into underserved areas is challenging given high costs of infrastructure deployment and low revenues when compared to urban areas. High price sensitivity of markets contributes to lack of innovative service propositions. The affordability of broadband-enabled devices for the bottom of the pyramid is also a major barrier to access in Nigeria. While costs of devices and data packages have fallen, 43 percent of urban residents and 48 percent or rural residents cite affordability as the biggest barrier to mobile Internet use.[42] Additional demand-side barriers include high rates of digital illiteracy, lack of local content, and low electrification rates.

In addition to the geographical digital divide, Nigeria also faces significant gender gaps in internet usage and smartphone ownership. A 2020 survey by the GSM Association found that, while the gender gap in mobile ownership has narrowed to 4 percent, the gap in mobile internet users remains wide at 29 percent (Figure 3.3).[43] A closer look at the existing gap reveals that the gender digital divide is dynamic and multifaceted. The gender gap is wider among the unemployed in Nigeria, with the gender gap in mobile internet use at 19 percent among the employed compared to 41 percent among the unemployed. Similarly, the gender gap is wider in rural areas: in the urban gender gap is 23 percent, lower than 38 percent gap in rural areas. Survey respondents report affordability as the single biggest barrier to using mobile internet for women in Nigeria, followed by the lack of digital literacy and skills, and the lack of perceived relevance to adopting mobile internet.

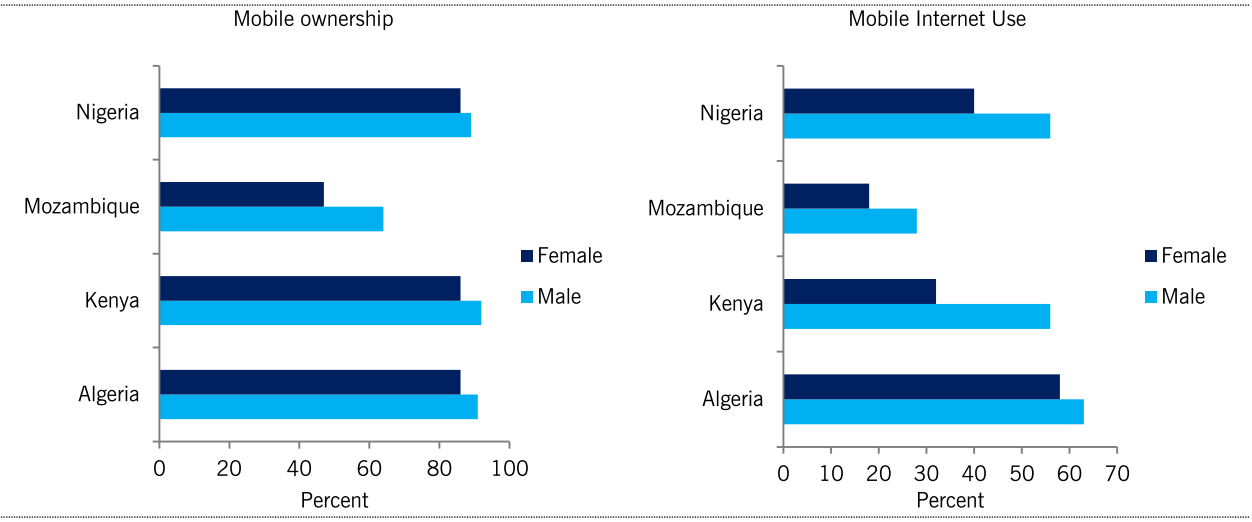
[40] A case study of Senegal, Kenya and Pakistan included in "Policy Choices Can Help Keep 4G and 5G Universal Broadband Affordable", Foster Vivien, Oughton Edward J., Jim W. Hall, Niccolò Comini. Policy Research Paper. World Bank, 2021.

[41] Press Statement: Federal Government Approves 5G Deployment in Nigeria. 09 SEPTEMBER 2021. https://www.ncc.gov.ng/media-centre/news-headlines/1054-press-statement-federal-government-approves-5g-deployment-in-nigeria

[42] GSMA, 2021a.

[43] GSMA (2021b). Connected Women: The Mobile Gender Gap Report 2021.

Figure 3.3: Male and Female Mobile Ownership and Mobile Internet Use, Select Countries.[44]



Source: GSMA, 2021b.

Increasing mobile internet adoption among women will require increased smartphone ownership. However, Nigeria's gender gap in smartphone ownership widened from 9 percent in 2019 to 14 percent in 2020, indicating a possible disproportionate impact of the COVID-19 pandemic on women's smartphone and broader mobile ownership.[45] The widened gender gap is also attributable to the decrease in the share of women owning smartphones from 29 percent in 2019 to 37 percent in 2020, combined with the increase in the share of men owning smartphones from 48 percent to 51 percent over the same period. Addressing this gap in smartphone ownership is particularly critical for addressing the existing gender gap in the mobile internet usage, as 93 percent of female smartphone owners use mobile internet, compared to 12 percent of women who have access to a basic or feature phone only.

Digital Identification

At a systemic level, strong foundational ID systems are essential to countries' economic development, security, governance, and efficient delivery of services—enabling them to accelerate progress toward an inclusive digital economy. Foundational ID systems comprise both the national ID system and the CR system, which must work in tandem to ensure that the population is identified from birth to death and that national ID systems remain up-to-date. Digital foundational ID systems can generate significant benefits across the public and private sectors by increasing accountability (chiefly through the reduction of fraud, leakages, and waste) as well as driving innovation in service delivery (through the use of mobile or digital payments, for instance). Moreover, such systems can generate reliable and continuous data for policy makers to measure development progress and identify areas needing additional investment.

Nigeria's existing foundational ID systems — comprising the national ID system and civil registration (CR) — suffer from low coverage across the population. The United Nations

[44] Base: Total population aged 18+. A mobile owner is defined as a person who has sole or main use of a SIM card (or a mobile phone that does not require a SIM) and uses it at least once a month. Mobile internet users do not have to personally own a mobile phone. The gender gap in mobile ownership and mobile internet use refers to how much less likely a woman is to own a mobile (or to use mobile internet) than a man.

[45] GSMA, 2021b.

Children's Fund (UNICEF) birth registration statistics show that only about 30 percent of children under the age of five have had births registered. This figure drops to 19 percent in rural areas and to 7 percent for children in the poorest quintile of the population. Less than 50 percent of residents have any functional ID at all, while only 18 percent of individuals have a NIN. The CR system is not functioning optimally and remains primarily paper based without the ability to link to the national ID system. A civil registration and vital statistics (CRVS) assessment, carried out by National Population Commission (NPopC), found that many aspects of the CRVS system are not functioning well. A digitized CR system linked to the national ID system will be necessary to realize a fully functional and sustainable foundational ID system in Nigeria.

The government incurs significant costs due to Nigeria's fragmented identification landscape. Currently, over 13 government agencies and at least three state agencies offer ID services in Nigeria. Many of these capture biometrics and issue ID cards independently without establishing registries with the ability to query, be queried by, or to otherwise communicate with other systems, resulting in duplication and waste of resources. For instance, Nigeria registered 70 million voters at a cost of US$627 million during a one-off biometric voter registration exercise. Based on an illustrative analysis done in 2015, the government could have spent US$4.3 billion across all ID programs in Nigeria, of which US$1.2 billion has already been spent and US$3.1 billion is in the pipeline to support multiple, disconnected, and duplicative systems under the current fragmented approach. At a cost of US$10 spent per person over five years, the spending on identification is significantly over good practice benchmarks, which puts the cost of such systems at US$4–US$7 per person.

The World Bank is currently co financing the Nigeria Digital Identification for Development (ID4D) project which seeks to increase the number of persons with ID in Nigeria to 148 million over the next five years. The project is addressing the fragmented ID landscape in Nigeria by implementing an ecosystem approach that will leverage public and private stakeholders to enroll NINs as licensees. The project also prioritises legal reforms to remove barriers to enrollment, promote inclusive and non discriminatory enrollment, support women; marginalized groups and rural populations and protect personal data and privacy.

Policy Options

To realize the immense potential offered by digital economy, Nigeria must improve its digital infrastructure. Innovative solutions and strategic interventions and investments are required in order for Nigeria to gain the critical number of Internet subscribers needed to build its digital ecosystem and kickstart its digital transformation. These strategies will promote the deployment of networks in underserved areas, support the reduction of broadband costs, provide additional complementary public access, and stimulate demand by addressing the digital economy foundations with an ecosystem approach (Table 3.4).

Table 3.4: Policy Options for Expanding Digital Infrastructure

Immediate & Short-Term	Medium-Term	Long-Term
Improve regulatory framework and enforcement, including by providing for effective wholesale access and sharing regulations and implementation.	**Set and enforce harmonized rights-of-way policies and cost-based fees for accessing public infrastructure.** **Mandate infrastructure-sharing, dig-once, and open access to critical infrastructure** to allow faster	**Leverage future civil works projects for cross-sector infrastructure sharing** **Establish a coordinating agency within NCC to**

Increase access to FOREX by operators for rural telecom extension programs. **Issue grants or offer low- or zero-interest loans for digital devices, with a targeted approach to reduce digital gaps.** **Provide broadband connectivity and equipment to educational and health institutions at cost.** **Expand communal broadband access to connect the unconnected by constructing more Community Resource Centers (CRCs), equipping libraries, clinics, and other public spaces with Wi-Fi, and leveraging a Rural Broadband Initiative (RUBI) network.** **Rationalization of licensing regime to encourage new wholesale and retail entrants.**	deployment and greater rural push in middle and last mile connectivity. **Promote innovative Public-Private Partnerships (PPP)**, with competitive awards of subsidies to private and social purpose operators to support infrastructure development in the last mile. **Consolidate rights to government-owned, telecom-useful rights and infrastructure into a single vehicle** to provide efficient wholesale access to operators to expedite rural broadband deployment **Improve the efficiency of radio spectrum utilization** by adopting spectrum sharing rules and making more spectrum available at reasonable cost to both large and small operators	**mediate between the regulator, operators, ISPs, and infrastructure providers for planning and routing** and implement a "dig once" approach to infrastructure development and consolidation.

References

African Union. 2020. *The Digital Transformation Strategy for Africa (2020-2030).* Addis Ababa, Ethiopia: African Union.

Edquist, Harald, Peter Goodridge, Jonathan Haskel, Xuan Li, and Edward Lindquist. 2018. "How important are mobile broadband networks for the global economic development?" *Information Economics and Policy* 45, pp. 16-29.

Federal Ministry of Communications and Digital Economy, Government of Nigeria. *2019. For a Digital Nigeria: National Digital Economy Policy and Strategy (2020-2030).* Abuja, Nigeria: Federal Ministry of Communications and Digital Economy, https://www.ncc.gov.ng/docman-main/industry-statistics/policies-reports/883-national-digital-economy-policy-and-strategy/file.

GSMA. 2021a. *Connected Society: The State of Mobile Internet Connectivity 2021.* London, UK: GSMA Intelligence, https://www.gsma.com/r/wp-content/uploads/2021/09/The-State-of-Mobile-Internet-Connectivity-Report-2021.pdf.

GSMA. 2021b. Connected Women: The Mobile Gender Gap Report 2021. London, UK: GSMA Intelligence, https://www.gsma.com/r/wp-content/uploads/2021/07/The-Mobile-Gender-Gap-Report-2021.pdf.

ITU. 2020. "How broadband, digitization and ICT Regulation impact the global economy. Global Econometric Modelling – Expert Report." *GSR-20 Discussion Paper*, https://www.itu.int/en/ITU-D/Conferences/GSR/2020/Documents/ITU_Global_Econometric_Modeling_GSR-DiscussionPaper.pdf.

Portulans Institute. 2020. *The Network Readiness Index 2020: Accelerating Digital Transformation in a post-COVID Global Economy.* Washington, DC: Portulans Institute, https://networkreadinessindex.org/wp-content/uploads/2020/11/NRI-2020-V8_28-11-2020.pdf.

UNCTAD. "UNCTAD B2C E-Commerce Index 2018: Focus on Africa." *UNCTAD Technical Notes on ICT for Development* No. 12, https://unctad.org/system/files/official-document/tn_unctad_ict4d12_en.pdf.

World Bank. 2019. *Nigeria Digital Economy Diagnostic Report.* Washington, DC: World Bank Group.

WEF. 2019. *The Global Competitiveness Report 2019.* Geneva, Switzerland: World Economic Forum (WEF), http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf.

SPOTLIGHT 2: Banking Small and Medium Size Enterprises to Build Back Better

Summary: In 2020, Micro, Small and Medium Sized Enterprises (MSMEs) accounted for 84 percent of total employment and about 49 percent of GDP. Banking MSMEs is a necessary condition to achieving sustainable job creation and to instilling a strong and resilient recovery. However, several factors disincentivize financial intermediation, including widening spreads between bank lending rates and the monetary policy rate on newly approved loans, systemic gaps in the credit contracting environment, and the pervasive impact of macroeconomic uncertainty. This note provides an overview of how these factors are impacting MSMEs' access to credit and suggests policy options, including (i) the need for re-aligning roles and responsibilities in the conduct of monetary and financial sector policies, (ii) strengthening the institutional infrastructure for financial intermediation, (iii) building financial resiliency through managing loan forbearance, (iv) providing banks with access to long-term funding to finance lending to MSMEs, (v) scaling up existing–properly designed—partial credit guarantees targeting MSMEs and (vi) leveraging private capital mobilization to support MSMEs and create sustainable jobs for Nigerians.

The banking system could play a more significant role in supporting access to finance in Nigeria

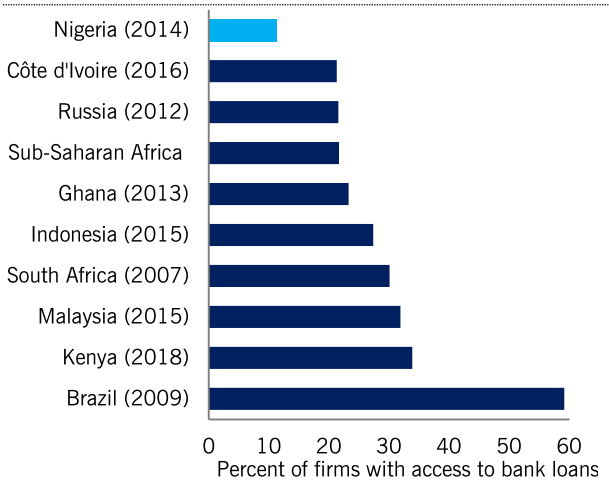
Access to finance and financial inclusion in Nigeria is limited when compared to peer countries. According to the latest FinDex survey (2017)[46] only 40 percent of Nigeria's population age 15 years and older has a bank account, compared with 85 percent in Malaysia, 70 percent in Brazil, 57 percent in Ghana, 85 percent in Kenya, and 69 percent in South Africa. Latest enterprise survey data reveal that only 11.4 percent of firms in Nigeria have access to finance,[47] which is low when compared with the SSA average and with aspirational peers (Figure 3.4). Domestic credit to the private sector as a percent of GDP rose by about one percentage point between 2019 and 2020 to reach 12.1 percent of GDP, in part reflecting CBN's stepped up development finance interventions, but is still lower than 14.6 percent achieved in 2016 and is well below the levels for LMICs and aspirational peers, such as Malaysia (Figure 3.5).

[46] More recent data assembled in a survey undertaken by EFINA (2020) suggests that 45 percent of Nigeria's population age 15 years and older had a bank account, still far below levels in peer countries.

[47] Latest World Bank enterprise survey data is available for 2014 – 2015.

Figure 3.4: Relatively few Nigerian firms have access to bank credit

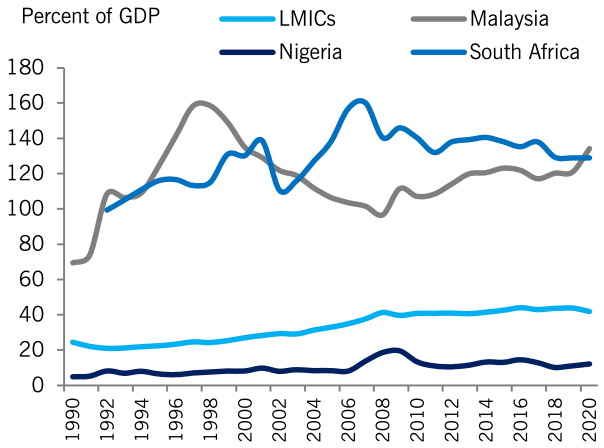
Percent of firms with access to bank loans



Source: World Bank Enterprise Surveys (various years).

Figure 3.5: Low level of private sector credit compared to peers

Domestic credit to the private sector (percent of GDP)



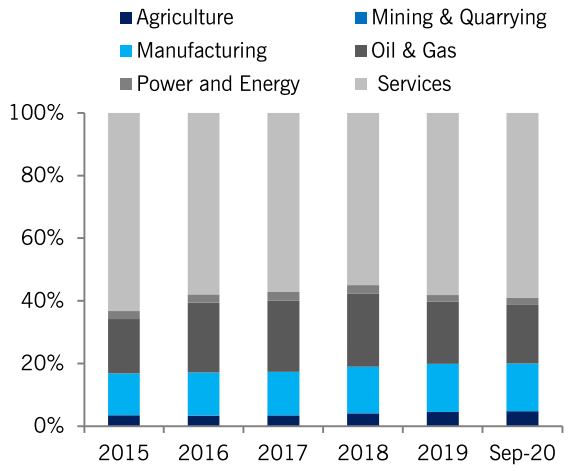
Source: WDI.

Banks are reluctant to lend to certain sectors, including agriculture, which is one of the most underfunded sectors in Nigeria. While the agricultural sector represented 24.1 percent of GDP in 2020, credit to the agricultural sector was only 4 percent of total banking sector credit (Figure 3.6). This reflects both the heightened risks associated with lending to agricultural firms that are not part of developed value chains and the weak competitiveness of Nigerian agricultural producers, in particular of medium and small-size firms.

CBN is providing funding to agriculture on highly subsidized terms, thus crowding out the space for commercial bank credit and contributing to the weakening of monetary policy and financial intermediation. CBN schemes contribute to weakening the stance of monetary policy by providing access to funding at highly subsidized interest rates, which typically do not change with evolving credit market conditions, often to high-risk marginal borrowers, such as MSMEs. Furthermore, the provision of loans on terms with which banks cannot compete undermines the incentives of those banks already engaged or considering engaging in serving these market segments (Box 3.1).

Figure 3.6: Agriculture is an important growth driver, but it receives little support in terms of access to credit from banks

Sectoral distribution of banking sector credit



Source: CBN.

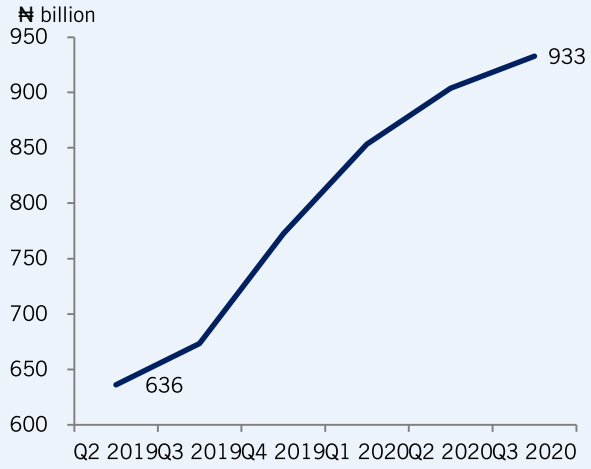
Box 3.1: Augmenting funding available to the agricultural sector has been a major focus of Central Bank of Nigeria (CBN) directed lending schemes in recent years

Augmenting funding available to the agricultural sector has been a major focus of directed finance provided by the Central Bank of Nigeria (CBN) in recent years.[48] The CBN's development finance and risk-sharing schemes, such as the Anchor Borrowers Program (ABP) launched in 2015 and the Nigeria Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL)[49], target the agriculture sector with the objective of boosting the sector's productivity and job creation while catalyzing private banks lending to agriculture. As reported by the CBN in September 2021, since the inception of the ABP program the CBN has released the sum of Naira 798.1 billion to 3.9 million smallholder farmers cultivating 4.9 million hectares of land across the country[50].

In recent years the amount of funding disbursed through this program has dwarfed the amount of new credit provided to the agricultural sector by the deposit money banks own funds (Figure B3.1.1). Future efforts of evaluating the impact of this program could consider assessing the additionality it might have brought in terms of circumventing high collateral requirements that deposit money banks usually require for this segment of targeted borrowers, possible leveraging of social capital instruments to ensure loans are repaid and how affordability of financing through imposing interest rates caps might have promoted efficiency and survival for targeted borrowers.

Figure B3.1.1: Steady climb in banks financing to the Agriculture sector since 2019

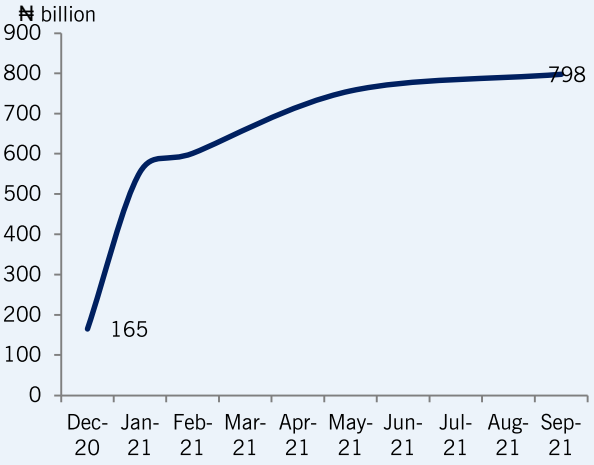
Credit to the agricultural sector (billion Naira)



Source: CBN.

Figure B3.1.2: Remarkable disbursement under ABP in 9 months

Amounts disbursed by ABP (billion Naira)



Source: CBN.

[48] Please see https://www.cbn.gov.ng/OUT/2011/PUBLICATIONS/REPORTS/DFD/BRIEF%20ON%20NIRSAL.PDF

[49] NIRSAL is a Non-Bank Financial Institution wholly owned by the CBN with capital of US$500 million created with the purpose of sharing agribusiness-related credit risks in Nigeria.

[50] Central Bank of Nigeria Communique # 138 of 281st meeting of the Monetary Policy Committee (16th/17th September 2021).

Improving credit market operating conditions is needed to boost bank lending to MSMEs

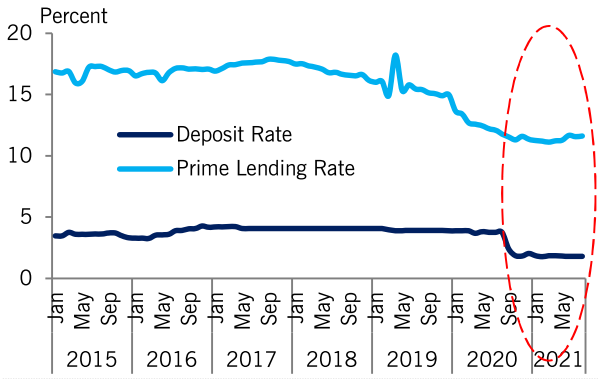
Banks' reluctance to lend to MSMEs arises due to inter-alia the costs associated with assessing and managing the credit risk of smaller borrowers. While MSMEs constitute the largest segment of credit demand, credit default is higher in this segment[51]. Given these circumstances banks prefer to lend to larger 'blue-chip' companies rather than MSMEs. In those cases where banks do lend to smaller enterprises, these smaller enterprises often operate within the value-chains of better-known larger borrowers to whom MSMEs deliver. In such cases, banks place reliance on the assurance provided by larger enterprises in the value-chain regarding the reliability and creditworthiness of the MSMEs.

Banks' reluctance to lend to MSMEs also stems from weaknesses in credit infrastructure. These arise from (i) insufficiencies in credit information sharing, particularly the quality and timeliness of information shared with credit bureaus, and the absence of coordinated information (a common database) shared among the bureaus; (ii) uncertain and unreliable loan foreclosure processes, which can result in creditors being subject to court challenge and lengthy delays; and (iii) other institutional weaknesses, such as the ongoing, but as yet incomplete, establishment of a register for movable collateral and implementation of unique borrower identification.

MSMEs hardly benefited from falling lending rates over the last couple of years. The banks' average prime lending rates declined from 16.0 percent in January 2019 to 11.6 percent in August 2021, but the upper bound of the banks' lending rates which is likely to apply to MSME lending stood at 30.4 percent in January 2019, and only fell slightly to 28.0 percent in August 2021 (Figure 3.7).

Figure 3.7: Rising spread between prime and maximum lending rates

Deposit and lending rates (percent)



Source: IMF, IFS, October 2021.

Measures to increase credit to the private sector have met with limited success

Responding to the fall in aggregate demand caused by COVID-19, the CBN introduced several measures designed to bolster banks' lending to the private sector. Cognizant of the fact that bank borrowers could face difficulties servicing their loans, and following similar practices sanctioned by central banks worldwide, in March 2020 the CBN announced that it would sanction bank loan forbearance – delaying the burden associated with banks' provisioning against and eventually writing off non-performing loans. The CBN also encouraged banks to maintain their lending by stepping up enforcement of the Loan to Deposit Ratio (LDR) regulation, first introduced in mid-2019. Finally, in May 2020, and in line with the adjustment of policy interest rates in other countries, the CBN reduced its benchmark Monetary Policy Rate (MPR) from 13.5 percent to 12.5 percent and further to 11.5 percent in September 2020 (Box 3.2).

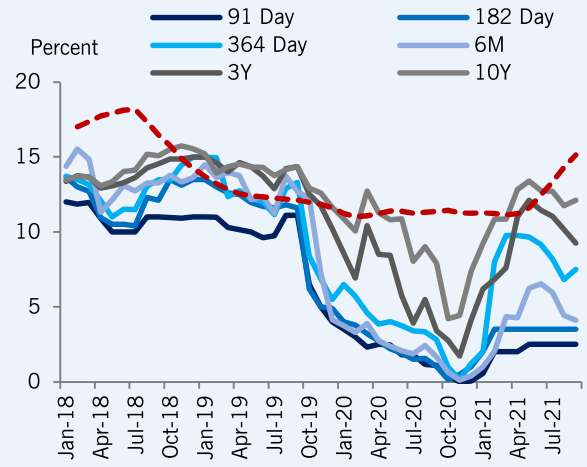
[51] https://www.cbn.gov.ng/Out/2020/STD/Q4%202020%20CCS%20REPORT.pdf

Box 3.2: Sharp fall in nominal interest rates in early 2020

While the adjustment of the MPR was an appropriate response to COVID-19, it added to the sharp drop in nominal interest rates on the money and Government securities markets that had started in the last quarter in 2019. This fall in market interest rates signaled a shift in the stance of monetary policy. By sanctioning sharply negative real interest rates on government securities (Figure B3.1.4) it appeared the authorities were losing control of domestic liquidity, and in turn exacerbating inflationary pressures. Inflation rose from 12.2 percent in March 2020 to 18.2 percent in March 2021. Although real interest rates remain deeply negative, there has been some rise in nominal interest rates in recent months with FGN T-bill rates rising to 2.5 percent and 10-year FGN bonds at 10.25 percent, and inflation has subsided somewhat to 16.6 percent in September 2021 (Figure B3.1.3).

Figure B3.1.3: Sharp fall in market interest rates in second half of 2019

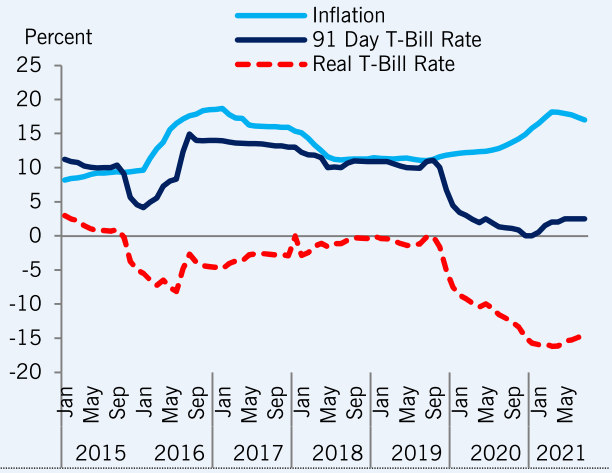
Treasury bill and bond yields (percent)



Source: FMDQ Nigeria

Figure B3.1.4: Similar fall in real rates combined with increase in inflation

Real Treasury bill yield (percent)



Source: Central Bank of Nigeria

However, these measures could not fully overcome the impact of the COVID-19 crisis on the availability of real credit to the private sector. The adjustment of the monetary policy rate and other measures taken by the CBN were intended to provide liquidity to the banking system and support the availability of private sector credit. While they helped avoid a credit crunch, they were unable to fully meet their objective. Several factors explain this outcome:

- **Over-reliance on monetization of the Government's fiscal deficit led to a vicious cycle of financial repression, whereby higher** and more volatile inflation creates uncertainty about the real return on financial assets, discourages savings, and leads banks to raise their lending rates to sustain their earnings, lessens enterprise borrowing appetite and raises the probability of default. In recent years such financial repression has been directly related to the Federal government's intensified use of the CBN's overdraft facility. While formal guidelines limit the amount that the government is allowed to borrow from the central bank to 5 percent of the previous year´s fiscal revenues, recourse to the CBN's overdraft facility has repeatedly exceeded this limit (Box 3.3).

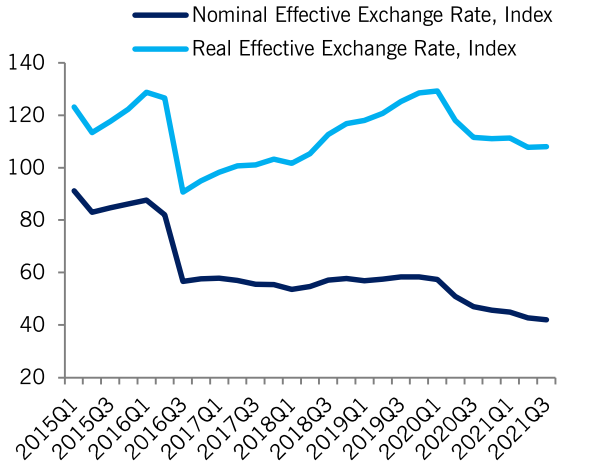
Box 3.3: Increasing Recourse to Monetary Financing of the Federal Government Deficit

The outstanding balance on the Government's overdraft facility was already equivalent to 6.7 percent of GDP at the end of 2019. In 2020 the Government continued to draw on this facility with borrowing from the central bank amounting to around 80 percent of the previous year's fiscal revenues, providing funding equivalent to another 1.9 percent of GDP, covering more than half of the Government's fiscal deficit of 3.6 percent of GDP. When governments use the central bank as a quasi-fiscal agent by tapping central bank overdraft facilities, by financing their expenses through issuing government securities directly to the Central Bank, or by placing excessive reliance on central banks to purchase government securities in the secondary market, debt monetization becomes a problem[52]. Monetizing government deficits raise doubts about the independence of monetary authorities in controlling inflation and fosters uncertainty about overall macroeconomic stability, which dampens both the availability and demand for bank credit.

- **Exchange rate management also dampened the demand for credit**. Negative domestic real interest rates added to pressures on the exchange rate due to portfolio outflows. While interest rates were historically low in many markets, Nigeria was unique in offering investors deeply negative real returns. Rather than adjust its monetary or exchange rate policies the CBN sought to ease pressures on the market for foreign exchange using administrative means to restrict access to foreign exchange. The CBN tightened enforcement and added documentation requirements with a view to lessening demand, and limited access to foreign exchange by discontinuing sale of foreign exchange to bureaux de change in July 2021. While the persistently wide black market premium suggests that efforts to stabilize the exchange rate through administrative controls were of limited effectiveness. Such a high premium gave rise to heightened uncertainty as to the overall thrust and sustainability of macroeconomic policies (Figure 3.9). At the same time, in the short-term import-competing and exporting enterprises suffered from the impact of periodic real appreciation of the exchange rate on their competitiveness, effectively reducing demand for credit due to lesser local production (Figure 3.8).

Figure 3.8: Nominal currency depreciation accompanied by periodic real appreciation

Real Vs Nominal Effective Exchange Rates

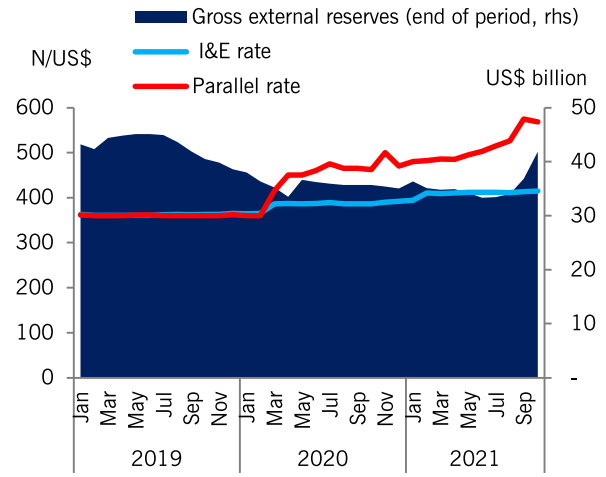


Source: IMF, IFS, October 2021

[52] From a financial management perspective using the overdraft facility to finance the Government deficit is costly. The CBN charges an interest rate of the MPR plus 300 basis points considerably exceeding current T-bill and T-bond interest rates

Figure 3.9: Black market premium forces the hand of the official exchange rate

Official Versus Parallel Exchange Rates



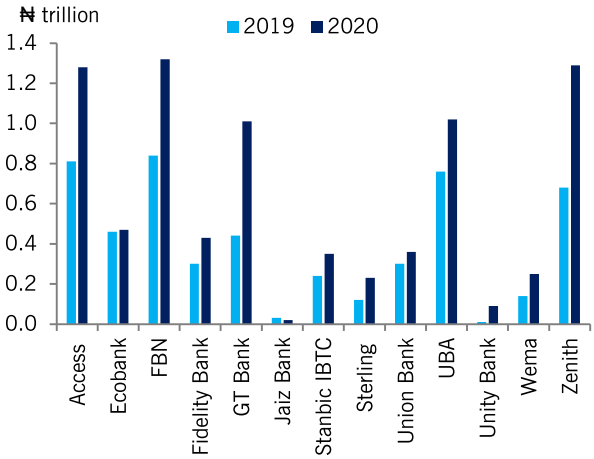
Source: FMDQ (I&E rate) and BDC (parallel rate)
* average monthly exchange rates

- **The use of cash reserve "penalties" for non-compliance with minimum LDR helped sterilize government deficit monetization.** With the introduction of the required 65 percent minimum loan to deposit rate (LDR) in mid-2019 the CBN's intention was to encourage banks to lend to the private sector. In case of non-compliance with the LDR regulation banks faced penalties in the form of augmented cash reserve requirements (CRR). In January 2020 the CBN raised the CRR from 22.5 percent to 27.5 percent just prior to the onset the pandemic. Penalties arising due to enhanced enforcement of the LDR, while varying from bank to bank depending on the degree to which they comply with the LDR ratio, rose in all banks in 2020 with the larger and more risk-averse banks suffering most (Figure 3.10).

CRR debits were increasingly used to manage liquidity. Estimates of the effective CRR (including penalties associated with LDR non-compliance) put the effective systemwide CRR at between 40 and 50 percent. While this high level of reserve requirements provides the CBN with a cheap, unremunerated source of liquidity sterilization, such elevated reserve requirements also represent a heavy burden on bank intermediation costs thereby contributing to the widening of interest rate margins (Figure 3.11). Banks are forced to increase their lending rates to compensate for the loss of earnings on their unremunerated reserves. Higher lending rates increase the burden on borrowers, reduce the demand for credit, and enhance banks' risk of incurring losses.

Figure 3.10: The differential impact of CRR debits on the liquidity of individual banks

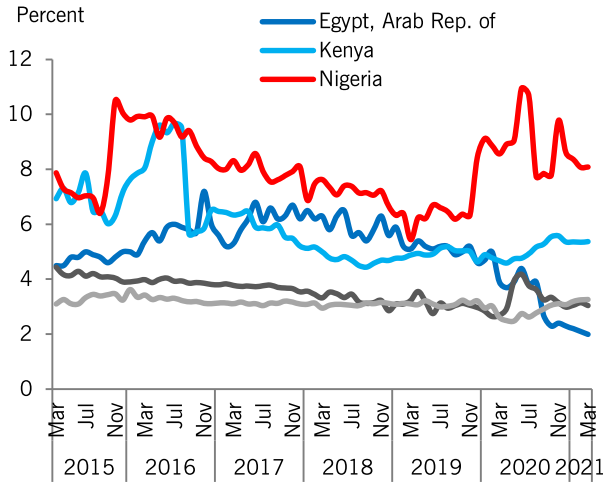
CRR debits for Nigerian listed banks (Naira trillions)



Source: https://nairametrics.com/2021/04/12/cbn-debits-banks-n8-3-trillion-as-crr-in-2020/.

Figure 3.11: Lending – Deposit Rate Spread

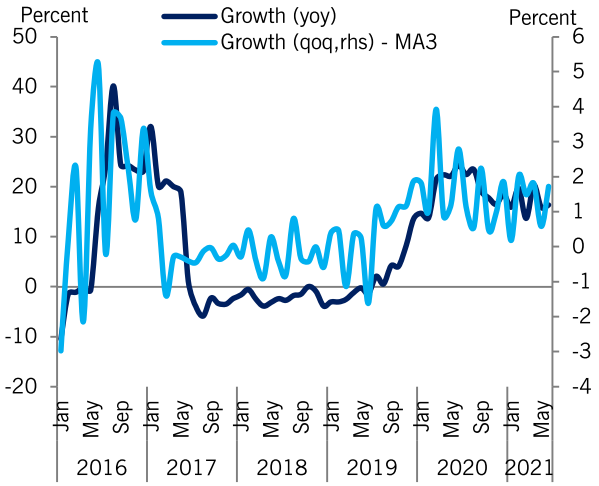
Lending Rates less Deposit Rates



Source: IMF IFS, October 2021.

Figure 3.12: Private Credit Cycle

Credit to the Private Sector



Source: IMF IFS, October 2021.

Need to monitor closely the quality of bank lending

Due to the introduction of loan forbearance in March 2020[53], it is difficult to assess the consequences of the LDR regulation on the quality of the banks' loan portfolios. The increase in bank lending may have been stimulated by the subsidized lending schemes introduced by the CBN in response to COVID-19 and the improved payment terms on existing CBN schemes (lowering of interest rates and moratorium on repayments). Rather than reflecting increased willingness by banks to lend to the private sector, lending on highly subsidized terms could have reduced/crowded out banks' willingness to lend with their own funds. Moreover, the CBN's policy of applying CRR penalties to encourage banks to increase their lending may have led to increased credit provision but at the possible cost of deterioration in the quality of the banks' loan portfolios. This is likely as the CBN's LDR penalties when combined with loan forbearance introduced in March 2020 encouraged banks to expand their lending to riskier borrowers (e.g., MSMEs) at the height of the COVID-19 crisis (Figure 3. ***12***).

While loan forbearance was adopted by many countries as a COVID-19 response, the high level of utilization among Nigerian banks may be a harbinger of asset quality pressures in the period ahead as support measures are phased out. Within only three months of the CBN's sanctioning of loan forbearance, banks responded by restructuring the loans of about 35,640 borrowers amounting to N7.8 trillion, equivalent to 42 percent of total bank lending[54]. To avoid a situation where forbearance results in the accumulation of non-performing loans, both banks and the CBN need to apply increased vigilance in assessing the viability of bank credit exposures. This needs to be undertaken on an ongoing basis, and not only at the time when loans are restructured. Such viability assessments are often not clear cut – a factor that is amplified by fundamental uncertainty of the trajectory of the post-COVID economic recovery.

[54]https://www.thisdaylive.com/index.php/2020/07/23/emefiele-loan-forbearance-will-enable-companies-survive-covid-19/

Policy recommendations

Re-aligning roles and responsibilities in the conduct of monetary and financial sector policies

The primary roles and responsibilities of the CBN need to be clearly focused on ensuring the primacy of price stability among its objectives. Enshrined in the statutory mandate of the CBN is a dual responsibility for price stability and development of the Nigerian economy, and the CBN is at times inevitably conflicted in exercising this dual mandate. This is illustrated by the CBN's use of intervention funds which, while potentially providing important sources of funding to specific sectors and programs, simultaneously serve to potentially undermine the banks' appetite for extending their lending and compromise the thrust of monetary policy. The pursuit of price stability is to be complemented by sustainable fiscal consolidation[55], thus credibly removing the specter of fiscal dominance and repeated recourse to material central bank financing of the Federal government deficit.

There is room to improve the transparency and accountability in the funding of subsidies in CBN's development finance programs. At present, subsidies are funded out of CBN's seignorage income, the income that CBN receives as a central bank from the issuance of local currency and from managing foreign exchange reserves. CBN establishes development finance programs and priorities, and provides their funding thus avoiding the scrutiny of outside parties, particularly of parliament, in the use of CBN's income. The best practice could be for CBN's net income to be included as contributing to the Government's revenues and deployment of this income would then be subject to parliamentary approval as part of the Government's budget. Further, enhancement in the deployment of such subsidized programs could be achieved through systematic use of impact evaluations, the scope of which may include assessing the impact and adequacy of the use of interest rate subsidies.

Strengthening institutions for financial intermediation

To reduce the risks associated with financing MSMEs, strengthen credit information sharing, loan foreclosure processes, and property registries. As noted above the role of MSMEs is fundamental to the future growth of the Nigerian economy and every effort needs to be made to enhance MSME access to finance. In terms of MSME access to finance the potential benefits from establishing reliable financial infrastructure are considerable, as the assembled information base will significantly reduce the costs of loan processing and allow the banks to rely to a greater degree on more sophisticated techniques, such as credit-scoring, to more accurately price credit risk to the advantage of both the banks and their MSME clients.

Stability relating to the policy-framework for financial intermediation is essential in justifying the significant investment required to improve financial sector infrastructure. Strengthening financial infrastructure is a medium-term, structural endeavor, and to make such investment worthwhile private and public sector stakeholders need assurance that the authorities are committed to promoting a market-based financial system. This speaks against measures that undermine the functioning of markets, such as provision of subsidized credit to specific market-segments. Such interventions give favorable treatment to certain borrowers without due consideration to their credit standing, the value of the security they can provide, the processes and delays associated

[55] As a high percentage of fiscal revenues are already devoted to paying interest on government securities, the government is constrained in funding government expenditures through sale sof greater volumes of government securities to the private sector.

with foreclosure on collateral, etc. Thus, effectively achieving outcomes in terms of strengthening financial infrastructure is closely linked to the agenda regarding re-defining the mandate of the central bank as outlined above.

Enhancing the role of banks in lending to MSMEs

Banks have an important role to play in supporting the post-COVID recovery. Given how important the MSME sector is to the Nigerian economy, every effort needs to be made to sustainably augment funding provided by the banking system to this market segment. Banks will need to build financial buffers to allow them to take on riskier lending and, while the medium-term structural issues outlined above are being addressed, support will need to be provided to banks to mitigate their risks and encourage them to engage in this relatively underdeveloped segment of the financial market.

i. **Building financial resiliency: managing loan forbearance***:* Banks need to focus on strengthening their capacity to assess their borrowers' ability to repay their original loans or the agreed modified amount of principal and interest on the restructured loans. This is particularly important given the difficulties that many borrowers are experiencing in servicing their loans and the extent of loan restructuring being undertaken by banks. The purpose of loan forbearance measures is to return the banks' exposure to a situation of sustainable repayment and prevent otherwise viable borrowers from reaching a non-performing status. The CBN needs to play an active role in supervising the process of building such resiliency – not only by issuing policy guidelines, but also by requiring reporting and overseeing how the banks implement these measures.

ii. **Providing banks with access to long-term funding to finance lending to MSMEs:** There is a role for development finance provided it is made available on terms that are market-conform. In 2017 the Government, with support from the World Bank and other donors, established the Development Bank of Nigeria (DBN), a wholesale development finance institution, which contrary to the schemes financed by the CBN, is mandated to provide term-funding for on-lending to MSMEs on a financial fully self-sustainable basis, thereby supporting the sustainable expansion of the MSME finance market. The emphasis on market-conformity reflects the dual policy-objectives of the DBN of: (i) reaching scale which will – once limited donor resources are exhausted – necessitate access to commercial funding through the issuance of longer-term naira-denominated securities; and (ii) acting as a catalyst to encourage Participating Financial Intermediaries (PFIs) to adopt lending practices and procedures on their own account that are well-suited to the MSME market-segment. Thus, the DBN is equipped with the capacity to facilitate longer-term lending to MSMEs at scale and thereby substantially impact their cash flows by increasing the maturity of their borrowing and lowering their monthly debt service payments.

iii. **Scaling up existing—properly designed—partial credit guarantee targeting MSMEs:** Partial credit guarantees (PCGs) can act as catalyst in supporting banks to enter new markets. PCGs have become a prominent policy

response worldwide to help banks meet firms' financing needs in the context of the COVID crisis.[56] Given the banks' reluctance to assume credit risk associated with lending to MSMEs, the DBN – in parallel with establishing its on-lending facility – has set up a wholly-owned subsidiary, IMPACT, responsible for the development of partial credit guarantees (PCG). IMPACT[57], which has recently become operational, is a market-oriented credit guarantee facility with a mandate to provide PCGs to participating financial institutions to de-risk and thereby stimulate new MSME lending. Without undoing or disturbing the structure or design of the recently operationalized PCG, the intention is to temporarily adjust the terms of the guarantees issued by regulated PCGs operating in Nigeria—including IMPACT—to respond to the challenging circumstances of the post-COVID economic environment and thereby stimulate the recovery of the Nigerian economy. Due to the COVID crisis, firms have experienced a collapse in their cash flows, and commercial banks are refraining from extending new loans, thereby amplifying pro-cyclical behavior. As the riskiness of lending to MSMEs is higher than in normal times, a higher coverage ratio may be needed to motivate participating financial intermediaries to draw on the guarantee scheme. Further, acute uncertainty and credit risk could lead to unaffordable pricing of the guarantee, it may be appropriate to subsidize the fees charged on an interim basis, i.e., for a well-defined time period. In this context, IMPACT supported by interim government funding could provide a cost-effective means to incentivize lenders to strengthen their financing of MSMEs.

The regulatory treatment of partial credit guarantees is crucial for FIs' MSMEs lending operations. By recognizing the PCG offered by IMPACT as a risk-mitigation tool the CBN would make an important contribution towards incentivizing banks to lend to MSMEs: (a) by using a lower percentage in calculating risk-weighted assets regarding those loans covered by regulated PCGs operating in Nigeria - including IMPACT - experience from other countries suggests that it would be appropriate to apply a risk-weighting of between zero and 20 percent on the banks' guaranteed exposures; (b) by regarding the proportion of bank loans covered by PCGs as being supported by collateral; and (c) by accepting guarantee coverage in lieu of provisioning should bank loans become impaired for the portion of the loan that is covered by the guarantee (i.e., guaranteed loans are regarded as performing regardless of their past-due status)[58].

[56] Please see https://www.bis.org/fsi/fsibriefs5.pdf

[57] Detailed design features can be important to success of scale up of PCGs as reflected in the design of IMPACT's PCG is built on international good practices. IMPACT provides up to 60 percent guarantee of the MSME loans made by eligible FIs. FIs are required to pay risk-adjusted fees to ensure the PCG's financial self-sustainability. To reduce moral hazard, final beneficiaries are not informed of the presence of the guarantee. As part of the PCG design implemented by IMPACT, claims can be filed and will be processed after loans are 180 days overdue and before PFIs have exhausted all legal means to recover the debt or have finalized the realization of available collateral. Claims are to be efficiently processed with a commitment to make pay-outs within 45 days after a claim is submitted.

[58] These matters are currently being considered by the CBN in developing the regulatory framework for PCGs. An exposure draft of the PCG regulation was issued on August 4th, 2021.

iv. **Leveraging Private Capital Mobilization to Support MSMEs and Create Sustainable Jobs:** MSMEs financing in Nigeria is focused on debt instruments, and it can be scaled up through complementary equity-based financing instruments. This will require concerted efforts to identify possible investors who are willing to take this risk and mobilize private capital to cater for the needs of viable MSMEs that has a promising growth potential. Concomitant to this is the need to consider possible de-risking instruments that can crowd in private capital into this segment. The Bank of Industry's Growth Platform is one good example of a platforms that can lead innovation efforts to develop a sustainable and scalable framework for equity-based financing of viable MSMEs to contribute to building back Nigeria better. The Development Bank of Nigeria is also currently assessing the possibility to provide support to MSMEs through engaging with private equity funds that invest in MSMEs.

Why Reforms Are Needed	Which Reforms Are Critical	What Impact these Reforms Could Have
Re-aligning roles and responsibilities in the conduct of monetary and financial sector policies		
• Realigning the roles and responsibilities of the CBN is important to strengthen accountability, as CBN's schemes are funded from seignorage income that CBN receives as a central bank from the issuance of local currency and from managing foreign exchange reserves. The CBN directs a part of its income to the development agenda it defines which avoids the scrutiny of outside parties, particularly of parliament.	• Good practice would be for the central bank to surrender the CBN's net income to the Government—i.e., after covering the cost of operating the central bank, including monetary policy implementation. • CBN's net income would normally be included in full as contributing to the Government's revenues, and deployment of this income would then be subject to parliamentary approval as part of the Government's budget.	• Realignment of the primary roles and responsibility of the CBN is needed to clearly focus the mandate of the CBN on ensuring price stability. • Re-channeling of the CBN's income, including income currently redirected to schemes that subsidized lending on priority programs to the Government will lessen accountability, transparency, and additionality concerns.
Strengthening the institutional infrastructure for financial intermediation		
• Efforts need to focus on strengthening credit information sharing, loan foreclosure processes, and property registries to facilitate financial institution in making well-founded and robust credit decisions in lending to MSMEs.	• Reduce costs associated with assessing and monitoring of loans to smaller enterprises that hamper financial intermediaries in expanding their lending to the MSME segment.	• Reduce the risks associated with financing MSMEs: strengthening the financial infrastructure will significantly reduce the costs of loan processing and allow financial institutions to price credit risk more accurately relying to a greater degree on more sophisticated techniques, such as credit-scoring.
Building financial resiliency: managing loan forbearance		
• Building financial resilience and strengthening financial buffers is particularly important given the difficulties that many borrowers are experiencing in servicing their loans and the	• CBN needs to play an active role in supervising the process of building such resiliency–not only by issuing policy guidelines, but also by requiring reporting and overseeing how the banks implement these measures.	• Support banks to mitigate credit risks and encourage them to engage in this relatively underdeveloped segment of the financial market.

extent of loan restructuring being undertaken by banks.		
Providing banks with access to long-term funding to finance lending to MSMEs		
• There is a role for development finance to support sustainable expansion of the MSME finance market, provided it is made available on terms that are market-conform, such as currently being supported by Federal Ministry of Finance, the World Bank and other donors, through the Development Bank of Nigeria (DBN).	• DBN is equipped with the capacity to facilitate longer-term lending to MSMEs at scale through leveraging international and bilateral development partners support to finance MSMEs and to draw on domestic capital markets–when the right fundamentals are in place–to channel long term capital to MSMEs.	• Acting as a catalyst to encourage Financial Intermediaries (FIs) to adopt lending practices and procedures on their own account that are well-suited to the MSME market-segment. • Substantially impact MSMEs cash flows by increasing the maturity of their borrowing and lowering their monthly debt service payments.
Scaling up existing—properly designed—partial credit guarantee targeting MSMEs		
• Regulatory treatment and recognition of PCGs is crucial to banks when assessing MSMEs credit risk with international experience suggesting that specific regulatory accommodations are appropriate: recognizing PCGs as a substitute for collateral and applying a risk-weighting of between zero and 20 percent on the banks' guaranteed exposures for capital adequacy purposes.	• Recognizing the PCG offered by IMPACT and other operational and market-oriented credit guarantee schemes in Nigeria as a risk-mitigation tool the CBN would make an important contribution towards incentivizing banks to lend to MSMEs.	• Partial credit guarantees will support banks in increasing MSME finance in the post COVID context–where credit growth has slowed down despite loan forbearance–by encouraging financial intermediaries to enter new markets and/or maintain their presence in servicing risker market segments.
Leveraging Private Capital Mobilization to Support MSMEs and Create Sustainable Jobs		
• While MSMEs financing in Nigeria is focused on debt instruments, it will be critical to supplement this through developing and scaling up complementary equity-based financing instruments.	• Identify possible investors who are willing to take this risk and mobilize private capital to cater for the needs of viable MSMEs. • Identify possible de-risking instruments that can crowd in private capital into this segment.	• Reduce debt burden on MSMEs, support viable entrepreneurial business opportunities especially to youth and women, and strengthen resilience of startups and young MSMEs.

Nigeria: Key Economic Indicators

Economy	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f
Real GDP Growth (% yoy)	**2.7**	**-1.6**	**0.8**	**1.9**	**2.2**	**-1.8**	**2.7**	**2.8**	**2.8**
Nominal GDP (Naira tr)	95	103	115	129	146	154	179	203	230
Oil Production (mb/d)	2.1	1.8	1.9	1.9	2.0	1.9	1.6	1.8	1.9
Oil Price (Bonny light, US$/bbl)	54	45	55	72	65	42	70	74	68
Inflation (%, average)	9.0	15.6	16.5	12.1	11.4	13.2	17.0	13.5	11.0
Real sectoral growth (%, yoy)	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021f**	**2022f**	**2023f**
Real GDP Growth	2.7	-1.6	0.8	1.9	2.2	-1.8	2.7	2.8	2.8
Agriculture	3.7	4.1	3.4	2.1	2.4	2.2	1.4	2.2	2.5
Industries	-2.2	-8.9	2.1	1.9	2.3	-5.8	-0.5	5.1	3.9
Industry-Oil	-5.4	-14.4	4.7	1.0	4.6	-8.9	-7.7	9.4	6.4
Industry-NonOil	0.1	-5.0	0.6	2.4	0.9	-3.9	3.9	2.7	2.5
Services	4.8	-0.8	-0.9	1.8	2.2	-2.2	4.6	2.1	2.5
Oil GDP	-5.4	-14.4	4.7	1.0	4.6	-8.9	-7.7	9.4	6.4
Non-Oil GDP	3.7	-0.2	0.5	2.0	2.1	-1.3	3.1	2.1	2.5

Source: National authorities and World Bank estimates

Nigeria: General Government Fiscal Summary - preliminary

Actual (%GDP)	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f
Total revenues	**7.5**	**5.9**	**6.8**	**8.2**	**7.4**	**6.5**	**7.1**	**6.7**	**6.3**
Federally collected	6.4	4.8	5.4	6.6	5.9	5.2	5.6	5.2	4.9
Oil and gas revenues	3.2	1.6	2.3	3.6	3.0	2.0	2.9	2.5	2.2
Non-oil revenues and other revenues	3.2	3.1	3.1	3.0	2.9	3.1	2.7	2.8	2.7
Independent and other revenues	1.1	1.2	1.4	1.6	1.5	1.4	1.2	1.2	2.2
Total expenditure	**10.7**	**9.7**	**10.8**	**11.9**	**12.0**	**11.9**	**12.7**	**11.9**	**11.8**
Overall balance (general government)	**-3.2**	**-3.8**	**-4.1**	**-3.6**	**-4.6**	**-5.4**	**-5.7**	**-5.3**	**-5.5**
Public Debt (net)	**14**	**19**	**22**	**26**	**28**	**33**	**36**	**38**	**39**
Domestic debt	12	16	17	20	22	25	26	28	29
External debt	2	3	5	6	6	8	9	10	10

Nigeria: Federal Government Fiscal Accounts - preliminary

Actual (%GDP)	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f
Total Revenue	**2.7**	**2.0**	**2.4**	**3.0**	**2.8**	**2.2**	**2.4**	**2.3**	**2.1**
Share of federally collected revenues	2.3	1.5	1.8	2.4	2.3	1.7	2.3	2.1	1.9
Oil, Gas and Mineral Revenue (incl. signature bonus)	1.5	0.7	1.0	1.5	1.4	0.9	1.2	1.0	0.9
Non-Oil Revenue	0.9	0.8	0.8	0.9	0.9	0.8	1.1	1.1	1.0
FG Independent revenues and grants	0.4	0.5	0.6	0.6	0.5	0.5	0.1	0.1	0.2
Total Expenditure	**5.0**	**4.7**	**5.7**	**6.1**	**6.9**	**6.6**	**7.5**	**6.7**	**6.5**
Recurrent Expenditure	4.4	3.9	4.4	4.7	5.2	5.4	5.0	5.0	5.0
Personnel Cost (including Pensions)	2.2	1.8	1.8	1.8	1.8	2.1	2.0	1.9	1.7
Overhead Cost	0.1	0.1	0.2	0.1	0.2	0.2	0.2	0.2	0.1
Other recurrent (incl. COVID-19 intervention and power sector)	1.0	0.7	1.1	1.0	1.5	1.0	0.8	0.8	0.6
Interest payments	1.1	1.2	1.4	1.7	1.7	2.2	2.0	2.2	2.5
Capital Expenditure (incl. COVID-19 intervention)	0.6	0.7	1.2	1.5	1.7	1.2	2.5	1.7	1.5
Overall Fiscal Balance	**-2.2**	**-2.7**	**-3.3**	**-3.1**	**-4.1**	**-4.4**	**-5.0**	**-4.4**	**-4.4**

Source: National authorities and World Bank estimates.
Notes: The reported revenue and fiscal balance figures differ from the published FGN budget figures as the World Bank excludes the non-revenue items under international classification. Figures exclude GOEs.

External Sector	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f
Exchange rate - official (N/US$, end of period)	197	305	306	307	307	380	410*	-	-
Exchange rate - parallel (N/US$, end of period)	267	490	363	363	362	465	540*	-	-
Real effective exchange rate index (end of period)	67	86	99	87	79	79	-	-	-
Current Account Balance (%GDP)	-3.2	1.3	3.4	1.6	-3.3	-3.9	-1.6	-1.0	-1.3
Current Account Balance (US$ bn)	-15.4	5.1	12.7	6.3	-14.6	-17.0	-6.9	-4.8	-7.2
Exports of Goods and Services (US$ bn)	49.0	38.4	50.8	66.0	69.9	39.9	57.6	62.1	63.7
o/w oil and gas exports (US$ bn)	42.4	32.0	42.3	56.6	54.5	31.4	47.8	51.5	52.4
Imports of Goods and Services (US$ bn)	71.9	47.0	50.9	71.6	100.8	72.2	81.6	86.4	93.7
Net Income (US$ bn)	-12.7	-6.3	-9.2	-12.3	-10.1	-5.8	-5.7	-5.7	-5.7
Net transfers (incl. remittances) (US$ bn)	20.2	19.9	22.0	24.1	26.4	21.0	22.8	25.2	28.5
Net Direct Investment (US$ bn)	1.6	3.1	2.1	0.2	2.0	2.7	2.0	2.1	2.5
Net Portfolio Investment (US$ bn)	0.9	1.9	10.3	0.0	3.1	-3.6	7.2	3.6	4.5
Net Other Investment (US$ bn)	-13.7	4.3	5.1	3.0	11.8	4.3	5.9	3.9	2.8
External Reserves (US$ bn, end of period)	29	26	39	43	39	35	44	48	51
Equivalent months of imports of G&S	5	7	9	7	5	6	5	5	5

Source: National authorities and World Bank estimates
Note: *= latest available as of November 19, 2021.

Monetary and Financial Sector (% change yoy, end of period, unless indicated otherwise)	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f
Money Supply (M2)	5.9	17.8	2.3	12.1	6.3	31.0	15.6	-	-
Narrow Money	24.1	31.5	-0.9	5.2	-10.4	51.7	17.6	-	-
Net Foreign Assets	-18.7	61.8	69.6	18.5	-68.5	26.4	-22.9	-	-
Net Domestic Credit	12.1	24.3	-3.5	6.3	31.2	17.6	18.9	-	-
Credit to Government	152.0	68.6	-25.4	33.7	94.9	30.8	34.6	-	-
Credit to Private Sector	3.3	17.4	1.4	1.9	17.6	12.9	13.8	-	-
Monetary policy parameters:						...			
Monetary Policy Rate (absolute rate, end of period)	11.0	14.0	14.0	14.0	13.5	11.5	11.5	-	-
Liquidity Ratio (absolute rate, end of period)	30.0	30.0	30.0	30.0	30.0	30.0	30.0	-	-
Cash Reserve Requirement (absolute rate, end of period)	20.0	22.5	22.5	22.5	22.5	27.5	27.5	-	-
Financial Market Indicators (end of period)									
Stock Market (NSE) Index	28,642	26,875	38,243	31,431	26,842	40,271	41,815	-	-
Fitch Sovereign Long Term Foreign Debt Rating	BB-	B+	B+	B+	B+	B	B	-	-
Moody's Sovereign Long Term Foreign Debt Rating	Ba3	B1	B2	B2	B2	B2	B2	-	-
S&P Sovereign Long Term Foreign Debt Rating	B+	B	B	B	B	B-	B-	-	-

Source: National authorities and World Bank estimates

Nigeria Development Update
November 2021

View this report online:
www.worldbank.org/en/country/nigeria

Procastination 1
by Yusuff Abogunde

Yusuff Aina Abogunde was born in 1997 in Lagos, Nigeria. He studied Fine and Applied Arts at the Federal College of Education (Technical) in Akoka, Lagos. He is a multidisciplinary artist reflecting stories and experiences inspired by people around him. Yusuff has participated in various exhibitions, both within and outside Nigeria. Some of these include: "Unusual Suspect" group exhibition at African Artists Foundation in Lagos (2021); "Real Life Is Fragile" group exhibition at Thinkspace Project in Los Angeles, California (2021); "Life In Color" group exhibition at the Mitochondria Gallery in Houston, Texas (2021); and "Where We Dey Go Now?", a virtual solo exhibition hosted on yusuffaina.com (2020). He has also been featured in several publications and in media such as Reuters, HypeBeast, ContemporaryAnd, and Artnet. Yusuff's work examines oneness in human identity, Pan-Africanism, and sociopolitical issues. His work "Procrastination 1" depicts the period of mental isolation that precedes human decisions—arriving at a decision, when faced with multiple choices, involves a period of contemplation, drowning in thoughts.

People forge ideas, people mold dreams, and people create art. To connect local artists to a broader audience, the cover of this report and following editions will feature art from Nigeria.