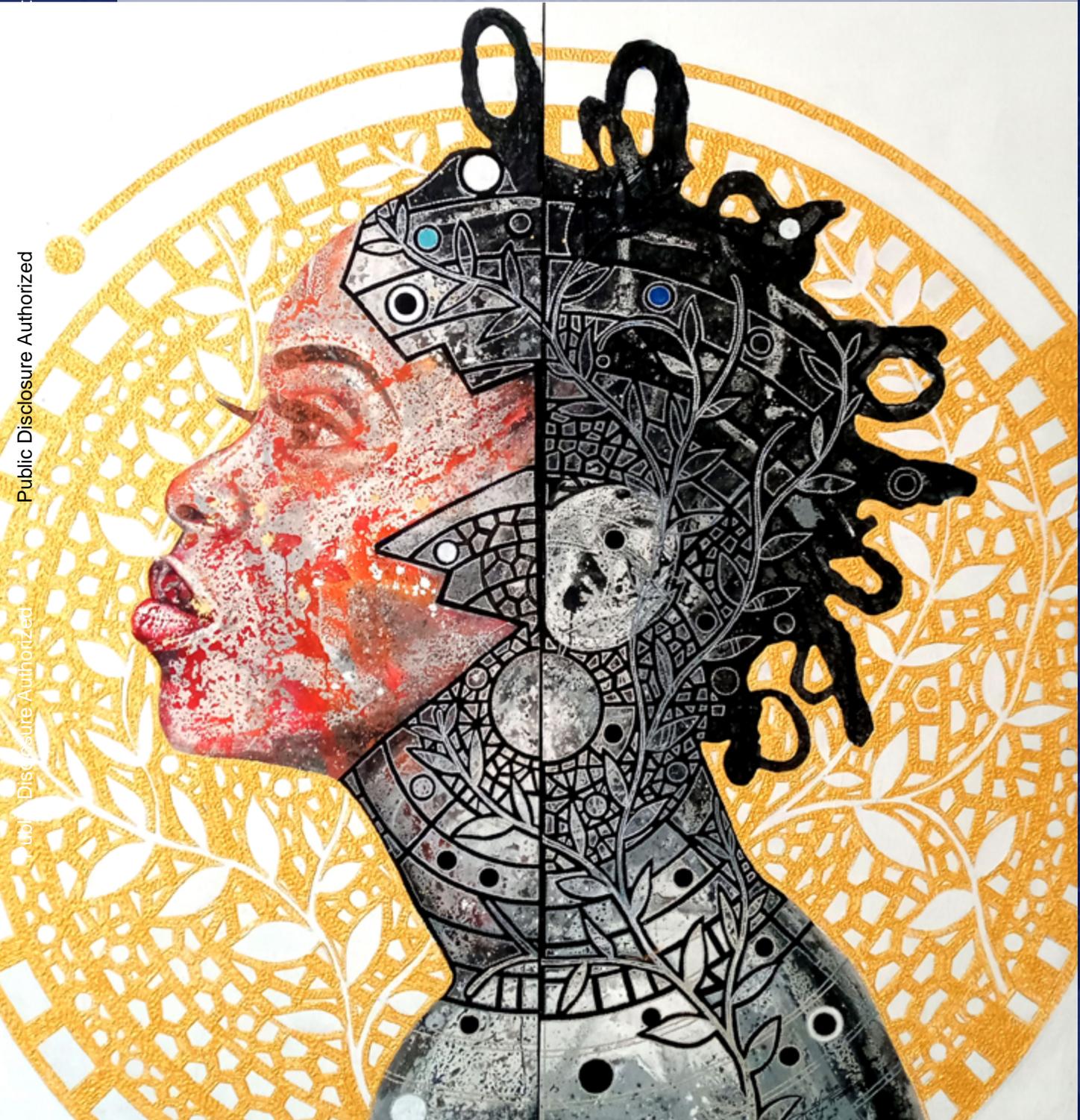


Jumpstarting Inclusive Growth: Unlocking the Productive Potential of Nigeria's People and Resource Endowments



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Nigeria Economic Update
Fall 2019

Jumpstarting Inclusive Growth: Unlocking the Productive Potential of Nigeria's People and Resource Endowments

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Abbreviations and Acronyms

AfCFTA	African Continental Free Trade Area
bbbl	Barrels
BDC	Bureau De Change
bn	Billion
BOF	Budget Office of the Federation
BoP	Balance of Payments
CBN	Central Bank of Nigeria
DMO	Debt Management Office
ECA	Excess Crude Account
ERGP	Economic Recovery and Growth Plan
FDI	Foreign Direct Investment
FGN	Federal Government of Nigeria
FMDQ	Financial Markets Dealers Quotations
Forex	Foreign Exchange
FPI	Foreign Portfolio Investment
GDP	Gross Domestic Product
H1	First Half of the Calendar Year
H2	Second Half of the Calendar Year
HCI	Human Capital Index
IEFX	Investors & Exporters Foreign Exchange
mbd	Million Barrels per Day
MPR	Monetary Policy Rate
MSME	Micro, Small and Medium Enterprise
NBS	National Bureau of Statistics
NNPC	Nigerian National Petroleum Corporation
OAGF	Office of the Accountant-General of the Federation
SME	Small and Medium Enterprise
SSA	Sub-Saharan Africa
TFP	Total Factor Productivity
TSA	Treasury Single Account
VAT	Value Added Tax
WDI	World Development Indicators
WEO	World Economic Outlook
WEF	World Economic Forum

Overview

Nigeria continues its recovery from the 2016 recession, sustaining an estimated 2 percent growth rate in 2019. The collapse of global oil prices during 2014–16, combined with lower domestic oil production, led to a sudden slowdown in economic activity. Nigeria's annual real GDP growth rate, which averaged 7 percent from 2000 to 2014, fell to 2.7 percent in 2015 and to -1.6 percent in 2016. Growth rebounded to 0.8 percent in 2017, 1.9 percent in 2018, and then plateaued at 2 percent in the first half of 2019, where it is expected to remain for the rest of the year. Services, particularly telecoms, remained the main driver of growth in 2019, although trade started contracting amidst increasing use of policy measures aimed at import substitution. Agricultural growth picked up slightly but remains affected by insurgency in the Northeast region and ongoing farmer-herder conflicts. Industrial performance was mixed: growth in the oil sector remained stable, but manufacturing production slowed in a context of weaker power sector supply. Overall, the slow pace of recovery in 2019 is attributable to weak consumer demand and lower public and private investment. The annual headline inflation rate fell from a peak of 15.7 percent in 2016 to a projected 11.6 percent in 2019 but remains high and above the central bank's target of 6–9 percent.

In the absence of structural reforms, growth is projected to remain stable, averaging 2.1 percent during 2020–21. In agriculture, the outlook remains below potential due to continued insurgencies, which in the recent past have displaced people and destroyed crops. Oil production is projected to remain levelled at around 2 million barrels per day (mb/d), below the 2.3 mb/d target outlined in the government's medium-term fiscal strategy. Growth in the nonoil industry and services would remain stable in a context of low investment levels, high unemployment, and high financing costs.

Nigeria's growth outlook is vulnerable to external and domestic risks. Externally, Nigeria is confronted with a sharper-than-expected slowdown in the global economy, and geopolitical and trade tensions. Domestically, the main risks are associated with the degree of predictability of macroeconomic policies, the pace of structural reforms, and the country's security situation. The economy's sensitivity to volatile oil markets is a major cause of uncertainty and a disincentive to long-term investment. For instance, a decline in oil prices to the levels seen in 2016 would significantly reduce growth, potentially leading to another recession. This time, however, Nigeria's fiscal and external positions are more fragile because the fiscal buffers in the excess crude account are depleted, and international reserves mask considerable amounts of foreign-held short-term government and central bank securities. In this context, a negative shift in investor confidence could lead to a drop in international reserves and put pressure on the exchange rate and the public debt stock. Conversely, growth could be accelerated through reforms that boost tax revenues to allow for higher investment in human and physical capital, as well as efforts to improve the quality of spending and reduce barriers to trade and private sector development. For example, gradually eliminating the use of monetary policies that crowd out credit to the private sector would accelerate growth.

The recession spurred a rise in unemployment, but some states have recently begun creating enough jobs to keep pace with their growing labor force. In 2018, Nigeria created about 450,000 new (net) jobs, partially offsetting the loss of 700,000 jobs in the previous year. However, Nigeria's labor force is growing rapidly. In 2018, about 5 million Nigerians entered the labor market, resulting in an additional 4.9 million unemployed people in the last year. In percentage terms, the national unemployment rate rose from 18.8 percent in the third quarter (Q3) of 2017 (the year following the recession) to 23.1 percent in Q3 2018. Positive news are

emerging from a subset of states that are now creating more jobs than the entrants to the labor market. In 2017, none of the 36 states in Nigeria and its Federal Capital Territory created enough jobs to absorb new labor market entrants. The situation improved in 2018, with four states—Lagos, Rivers, Enugu, and Ondo—generating more jobs than labor-market entrants, leading to a decline in unemployment in these states.

Economic and demographic projections highlight the urgent need for reform. With population growth (estimated at 2.6 percent) outpacing economic growth in a context of weak job creation, per capita incomes are falling. Today an estimated 100 million Nigerians live on less than US\$1.90 per day. Close to 80 percent of poor household are in northern Nigeria, while employment creation and income gains have been concentrated in central and southern Nigeria. The “cost of inaction” is significant. Under a business-as-usual scenario, where Nigeria maintains the current pace of growth and employment levels, by 2030 the number of Nigerians living in extreme poverty could increase by more than 30 million, and Nigeria could account for 25 percent of world’s extremely poor population.

Building reform momentum is essential to mitigate risks and promote faster, more inclusive, and sustainable growth that improves living standards and reduces poverty. Robust growth and job creation will require strengthening macroeconomic management while increasing fiscal revenues to attenuate the impact of oil-sector fluctuations and advance much-needed investments in human capital and infrastructure. This edition of the Nigeria Economic Update (NEU) discusses selected reform areas, including: (i) leveraging trade integration to harness the benefits of the Africa Continental Free Trade Area; (ii) improving basic education financing to improve human capital outcomes; (iii) monitoring the impact of conflict on household’s welfare to protect the poor and vulnerable; and (iv) leveraging digital technologies to diversify the economy and create jobs for young workers. Reforms in these and other areas would enable Nigeria to strengthen its macroeconomic resilience, promote private sector

development, and improve the efficiency of public service delivery.

Increasing productivity will be vital to support robust growth and job creation in Nigeria. Nigeria’s economic productivity is low by international standards. Productivity has grown slowly, and since the recession, it has been declining, affecting growth. The productivity gap between Nigeria and comparator countries reflects both its lower relative stocks of physical and human capital and the inefficiency with which inputs (capital and labor) are transformed into outputs. The vulnerability of Nigeria’s economy to volatile oil prices has also inhibited sustained productivity gains: labor has repeatedly shifted from agriculture to services when oil prices were high, then shifted back when oil prices were low, thereby limiting the economic transformation that is needed to produce more and better-paid jobs.

The focus section of this report analyzes the evolution of productivity in Nigeria and identifies policies and institutions that can leverage productivity growth to accelerate Nigeria’s economic expansion and create new job opportunities. The analysis highlights four key priorities. First, ensuring policy transparency and predictability will be critical to reduce investment risk and promote growth outside the extractive industry. Second, investing in infrastructure, strengthening land-tenure security, improving educational outcomes, and liberalizing the trade regime and enhancing trade and transport facilitation would help develop value chains and facilitate the efficient reallocation of factors of production, making Nigeria more cost-competitive. Third, reducing regulatory discretion would help attract foreign and domestic investment to the nonoil sector, encourage competition, and promote formalization. And fourth, improving access to finance could enable new firms to compete with incumbents and allow more-productive firms to scale up their operations. Actions in these areas would lay the groundwork for Nigeria’s transition to a new economic model that more effectively utilizes its large, young population and abundant natural resources to support sustainable growth and poverty reduction.

Figure O.1. Nigeria continues to recover from the 2016 recession, though growth is projected to be below peers

Real GDP growth (percent): Nigeria and comparators

	2016	2017	2018	2019	2020	2021
Nigeria	-1.6	0.8	1.9	2.0	2.1	2.1
Commodity-exporting EMDE	1.5	2.1	2.2	2.1	3.1	3.0
Other EMDE	6.0	6.1	5.8	5.2	5.5	5.5
Sub-Saharan Africa	1.3	2.6	2.5	2.9	3.3	3.5
Advanced economies	1.7	2.3	2.1	1.7	1.5	1.5

Source: For Nigeria: National authorities and World Bank calculations. For remaining region: World Bank Global Economic Prospects (June 2019). Note: EMDE = Emerging Markets and Developing Economies.

Figure O.2. More Nigerians are looking for jobs, but few find them

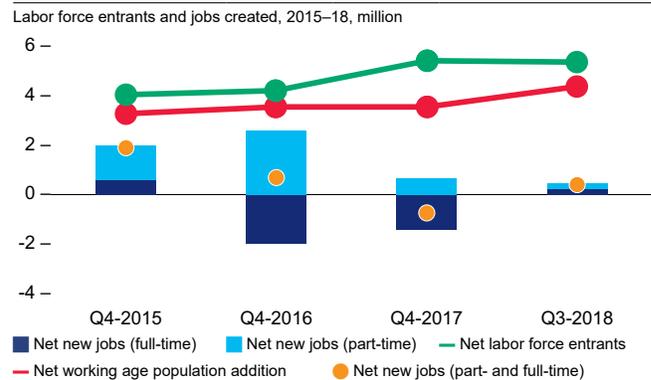


Figure O.3. Raising revenues would allow Nigeria to invest in much-needed human capital and infrastructure

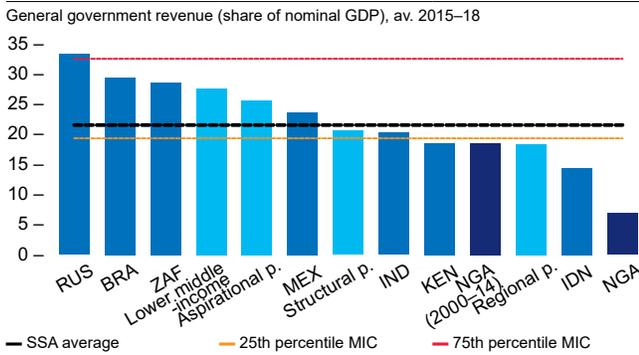


Figure O.4. Nonoil exports increased but overall the external balance deteriorated

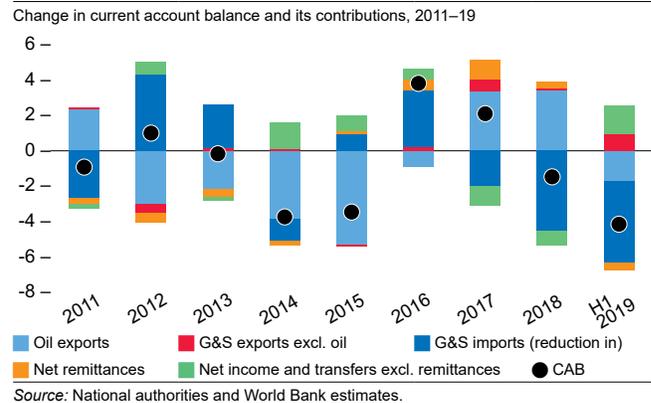


Figure O.5. Under a business-as-usual scenario, the number of people living in poverty could increase dramatically

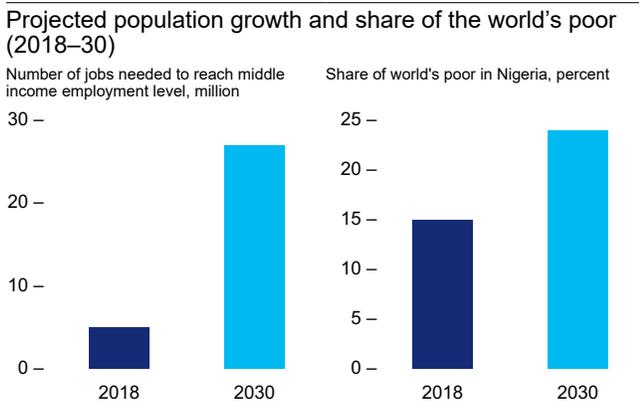
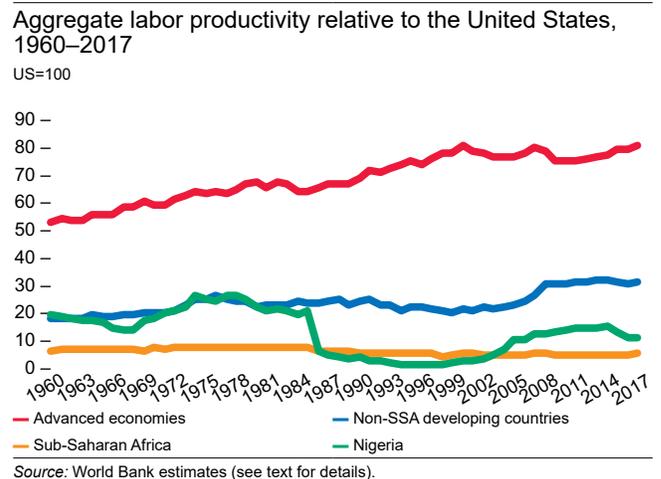


Figure O.6. Boosting the productivity of the Nigerian economy will help promote growth and job creation



Chapter 1: Recent Economic Developments

Economic Growth: A slow recovery limits progress in improving living standards

Nigeria's economy continues to recover from the 2016 recession, with GDP growth remaining broadly stable at 2 percent in the first half (H1) of 2019. The real GDP growth rate accelerated from 1.7 percent in H1 2018 to 2.1 percent in H2 2018, then eased slightly to 2 percent in H1 2019. However, Nigeria's recovery following the 2014–15 oil shock has been slower than those of most comparator economies (Figure 1.1). Until 2015, Nigeria's real GDP growth compared favorably with that of peer countries, including structural peers (i.e., commodity exporters with large populations) and aspirational peers (i.e., upper-middle-income countries with growth rates that Nigeria could match). Between 2000 and 2014, Nigeria's GDP growth rate averaged 7.2 percent, but the oil shock caused it to plunge to

2.7 percent in 2015 and -1.6 percent in 2016. Despite its modest recovery since 2017, Nigeria's growth rate remains below those of peer countries (Figure 1.1).

Nigeria's recent economic performance reflects a combination of slow growth in private consumption and private investment combined with contracting net exports. Though positive, the growth of private consumption (accounting for about 60 percent of GDP) remains constrained by high inflation (averaging 11 percent during H1 2019) and stagnating real incomes. While an uptick in public capital spending in the beginning of the year has helped boost investment, the contribution of investment to growth remains limited due its small share in the economy.² Net exports of goods and services contracted, as import growth (especially capital goods and services) outpaced oil-dominated exports.

Figure 1.1. Nigeria's real GDP growth has trailed growth in peer¹ countries since 2015

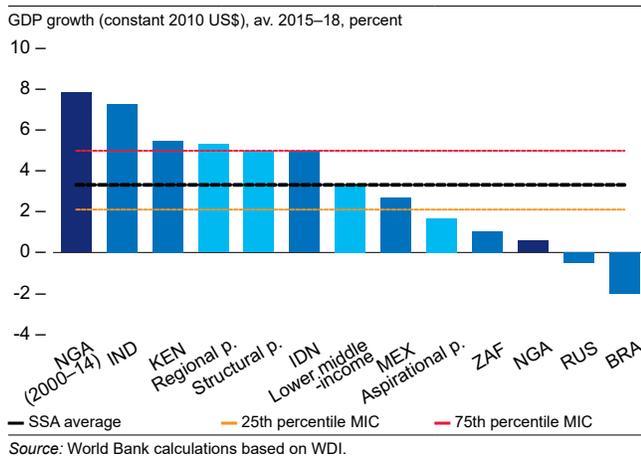
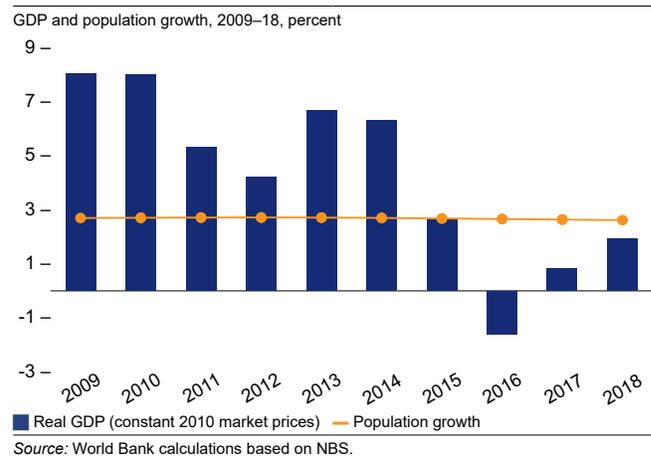


Figure 1.2. GDP growth remains below the rate of population growth



1 *Structural peers* include countries that resemble Nigeria in terms of their economic structure and performance indicators. These include lower-middle-income countries with large populations and natural-resource exports exceeding 20 percent of total exports. *Aspirational peers* are countries that Nigeria could match in terms of their economic performance. These include upper-middle-income countries with nominal income per capita at least double that of Nigeria, populations of over 30 million, and natural resources exceeding 20 percent of total exports. *Regional comparators* are geographically proximate countries that exhibit similar economic characteristics.

2 The latest expenditure-side GDP estimates released by Nigeria's National Bureau of Statistics (NBS) date from the first quarter of 2019.

Services drove growth in the first half of 2019, supported by agriculture and industry. Representing 53 percent of the economy and growing at a rate of 2.2 percent, services contributed 1.2 percentage points (pp) to GDP growth, with telecommunications and information services contributing the most (Figure 1.3). Agriculture grew by 2.5 percent and contributed 0.5 pp to GDP growth. Industry growth was dominated by the oil sector, which contributed 0.2 pp to growth, with nonoil industry (manufacturing, construction, and utilities) growing by 1 percent year-on-year and contributing about 0.1 pp to growth.

The growth of services accelerated from 0.8 percent in H1 2018 to 2.2 percent in H1 2019. Expanding at a rate of 9 percent year-on-year, information technology and telecommunications drove the overall growth of services, bolstered by gains in road transportation. Wholesale and retail trade (which provides employment opportunities to about 10 million Nigerians)³, recovered through H2 2018, but then slowed and started contracting in early 2019 in a context of tight foreign-exchange (forex) restrictions. The finance and real estate subsectors showed similar patterns.

Agriculture, which constitutes a quarter of the country's GDP and employs about half of the labor force, picked up slightly, but remains below its potential. In H1 2019, crop production, which is responsible for 90 percent of agricultural output,⁴ was affected by the ongoing insurgency in the northeast region and by farmer-herder conflicts in the north-central region. Together, those regions produce a significant share of the country's main crops, particularly grains (sorghum, millet, maize, and rice), beans, yams, cassava, potatoes, groundnuts, sesame, and soybeans. Agriculture grew by 2.5 percent in H1 2019, marginally up from 2.1 percent in H1 2018. The government's Economic Recovery and Growth Plan targets agriculture as a key sector to support economic diversification

and promote import substitution. The strategy aims to achieve production self-sufficiency in certain partly imported commodities, including rice, wheat, sugar, and palm oil. Consequently, agriculture has received ample direct support from the government and, in recent years, from the Central Bank of Nigeria (CBN). In H1 2019, the CBN continued to support agriculture through concessionary financing and risk-sharing programs such as the Commercial Agricultural Credit Scheme (CACs), the Nigerian Incentive-Based Risk Sharing in Agricultural Lending (NIRSAL) program, and the Anchor Borrowers Program. Since 2015, importers are not eligible to source foreign exchange from Nigerian forex windows for staples such as rice, vegetables, poultry, meat, and tomatoes.

Rising oil production accelerated the growth of the oil sector despite lower oil prices (Figure 1.4). Nigeria's oil output in H1 2019 (2.0 mbd) was marginally higher than in H1 2018 (1.9 mbd) but remained below the government's budget benchmark of 2.3 mbd (Figure 1.4). Meanwhile, the average price of Bonny Light, Nigeria's premium-grade crude oil, declined by about 7 percent from US\$72 in H1 2018 to US\$67 in H1 2019. Oil output is limited by a lack of significant new investments, which are deterred by regulatory uncertainty. Nigeria also continued to suffer episodes of crude oil theft in H1 2019.⁵ Oil and gas, which make up only 10 percent of GDP and employ less than 1 percent of the labor force, remain the country's main export commodities (accounting for 90 percent of total goods exports) and contribute about 50 percent of total government revenues. The sector therefore remains central to Nigeria's economy.

The growth of the nonoil industrial sector slowed from 2.7 percent in H1 2018 to 1 percent in H1 2019. Manufacturing growth slowed from 2 percent in H1 2018 to less than 1 percent, as lower real incomes, electricity shortages, the high cost of bank financing, and

³ National Bureau of Statistics data; includes those working 1–19 hours and treated as unemployed for the unemployment statistics.

⁴ The other components are livestock production, fishing, and forestry.

⁵ The Nigerian National Petroleum Corporation (NNPC) reported that Nigeria lost about 22 million barrels of its crude oil production to theft in the first half of 2019. This is equivalent to about 120,000 b/d—about 6 percent of Nigeria's daily production.

restrictions on access to forex for some imported inputs eroded private demand.⁶ The early-June adjustment of the exchange rate used to compute customs duties from ₦305/US\$ to ₦326/US\$ added to the challenges faced by manufacturers. After a prolonged period of slow growth, coal mining grew by 20 percent in H1 2019, but metal ore mining contracted. The production of solid minerals, which Nigeria has in abundance, constitutes about 2 percent of GDP, and the government is seeking to encourage exploitation of solid minerals. Supported by higher public investment and private megaprojects, the construction subsector grew in H1 2019, albeit at a lower rate than in the previous year.

Figure 1.3. Services contributed most to growth in H1 2019

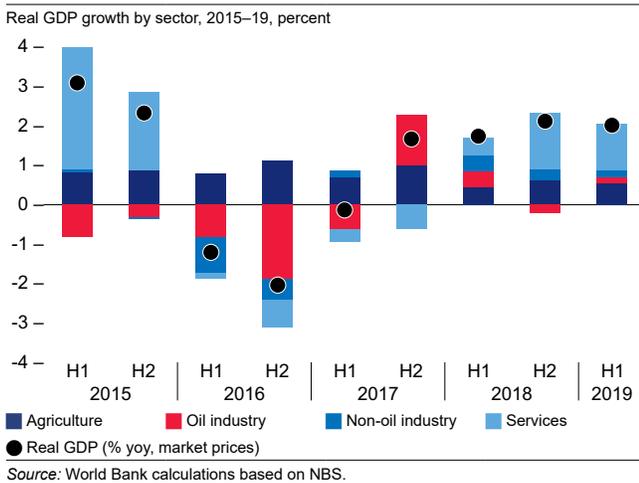
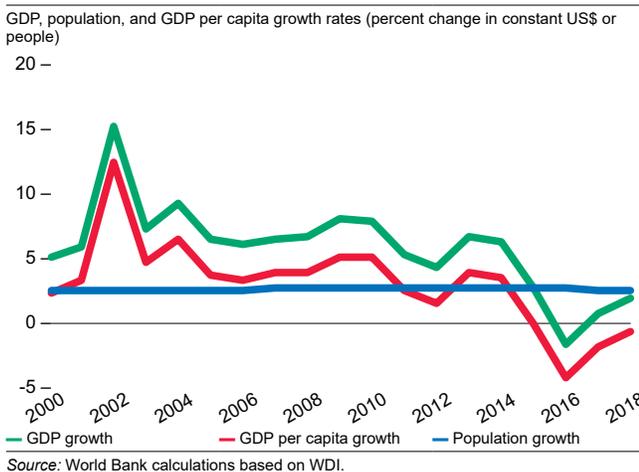


Figure 1.5. Nigeria's GDP per capita is contracting



GDP growth remains below the estimated population growth rate of 2.6 percent, resulting in declining real per capita incomes. In the aftermath of the recent oil shock, Nigeria's living standards began to decline as sustained high population growth rates exceed the growth rate of the economy (Figure 1.5). In 2018, about half of all Nigerians were estimated to be living in extreme poverty. The vulnerability of those living below the poverty line is worsened by the adverse security situation in the north, which has displaced a large population that has amplified the high incidence of poverty in the north-east.

Figure 1.4. Oil prices declined slightly; production recovered

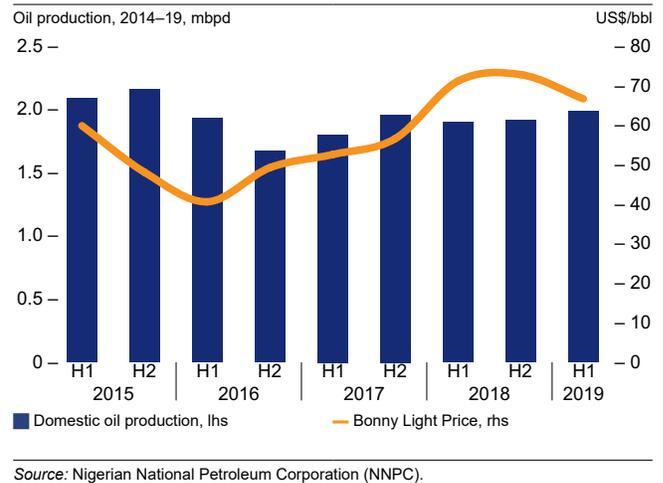
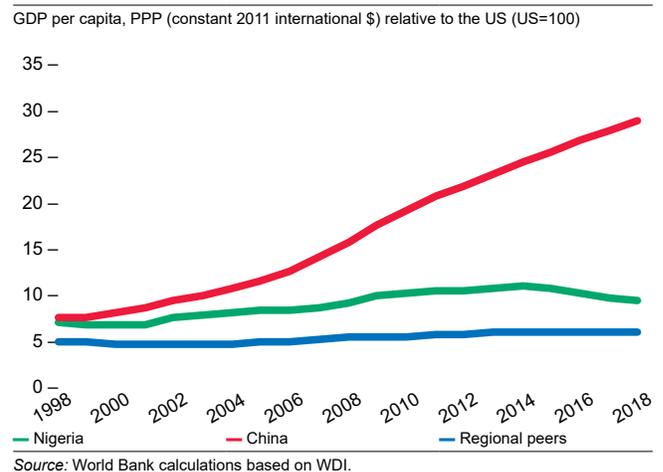


Figure 1.6. Nigeria's per capita income is not catching up



⁶ Since 2015 (at the height of the oil price shock and reduction in foreign exchange inflows from oil exports), the CBN designated some imported products as ineligible for foreign exchange in a bid to manage forex demand. Some of these products (now 42 of them) are inputs into manufacturing.

While Nigeria has achieved considerable progress in boosting income levels and living standards, it has not yet managed to reach a convergence path with advanced economies. Nigeria's performance relative to China illustrates the missed opportunities of the past five decades (Figure 1.6). In 1970, Nigeria's per capita GDP was roughly double that of China in purchasing-power-parity terms. By 1998, China had caught up with Nigeria, and both countries had per capita income levels equal to about 7 percent of that of the United States at the time. However, the Chinese economy continued to accelerate, and by 2018 China's GDP per capita was almost five times that of Nigeria.

High levels of income inequality weaken the impact of growth on poverty reduction. Nigeria's Gini coefficient was 43 in 2009, the latest year for which data are available. Though not exceptionally high by the standards of Sub-Saharan Africa (SSA), national-level inequality indicators obscure profound regional and rural/urban disparities. Central and southern Nigeria are wealthier than the northern regions, and urban areas dramatically outperform rural areas on indicators of both monetary poverty and nonmonetary wellbeing. The country's poorest areas are also highly vulnerable to conflict (see Box 1.3), and the ongoing Boko Haram insurgency has displaced millions of people in the areas bordering Niger, Chad, and Cameroon.

The Labor Market: More jobs are needed to employ a fast-growing labor force

The differential between high rates of population growth and low rates of job creation has led to an increase in unemployment and underemployment. Nigeria's labor force is large: according to the National Bureau of Statistics,⁷ out of 115 million working-age

Nigerians in 2018, 90 million were active in the labor force. Of these, about 70 million were employed full- or part-time, while another 21 million were unemployed but actively looking for a job. Nigeria's labor force is also growing rapidly: in the last five years, 19 million Nigerians entered the labor force (Figure 1.7).⁸ During the same period (which spans the recent recession) 3.5 million jobs were created. Consequently, 80 percent of new labor market entrants ended up unemployed, adding 15 million to the number of unemployed. Between 2015 and 2018, the number of unemployed nearly quadrupled (Figure 1.8), and the unemployment rate reached 23 percent. Nationally, in the year after the recession (Q3 2017–Q3 2018, latest available), more than 5 million Nigerians entered the labor force (Figure 1.7). Joining the 16 million already unemployed, they competed for just 450,000 net new jobs. Given the high population growth rates, nearly 30 million new jobs would be needed by 2030 just to keep the current employment rate constant.

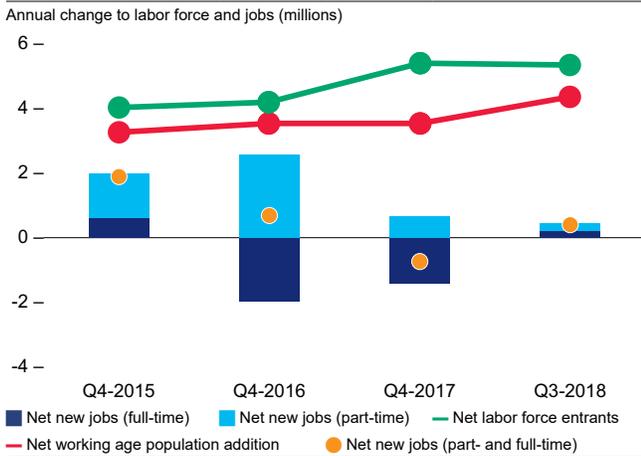
Unemployment is particularly acute among youth and women. In 2018, 37 percent of 15–24-year-olds were unemployed, compared to 16–24 percent in the other age groups. Of those employed, only one-third have a full-time job, compared to two-thirds of the workforce as a whole. Gender disparities in full-time employment are also considerable: 48 percent of active women are employed full-time, compared to 64 percent of men. Women hold only about 30 percent of civil-service and college-lecturer jobs and constitute just 6 percent of national parliamentarians. Women's economic empowerment is vital to growth and job creation in Nigeria, particularly in the context of a large young population with higher expectations for quality employment. The October 2019 edition of the World Bank's *Africa's Pulse* discusses policies that can improve women's economic opportunities and narrow gender gaps.⁹

⁷ This section references the Nigeria's National Bureau of Statistics labor force data according to the Nigerian definitions of employment and unemployment. Total number of the employed includes those employed full time (at least 40 hours a week) and part-time employees (working 20–39 hours a week). The unemployment numbers include those in the labor force unable to find any employment (0 hours) and those under-employed (0–19 hours).

⁸ The national fertility rate is 5.5 children per woman, well above the rates of regional and structural peers.

⁹ See World Bank (2019), *Africa's Pulse*, October 2019, Volume 20. Washington, D.C.: The World Bank.

Figure 1.7. As more people look for jobs, few find them; new jobs tend to be part-time and informal



Source: World Bank calculations based on NBS data.

Notes: Figure 1.7 plots the difference in the level of variables over the course of one year (e.g. for 2017, the net labor force entrants present difference between the total labor force in Q4 2017 compared to Q4 2016). Figure 1.8 the labor force variables as index (where Q4 2014 value is equal to 100). Due to data availability, annual estimates for 2018, are based on data for Q3 2017–Q3 2018.

Figure 1.8. Unemployment is rising as more Nigerians compete for fewer jobs

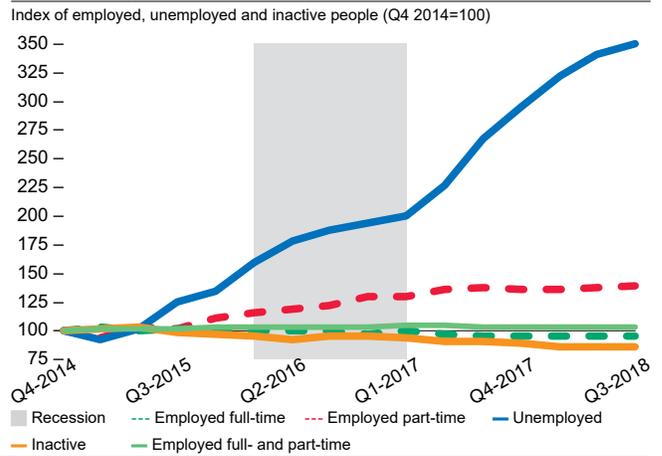


Figure 1.9. In the year following the recession (Q1 2017–Q1 2018) no Nigerian state created enough jobs to accommodate its growing labor force...

Annual change in number of people in the labor force, employed, and unemployed

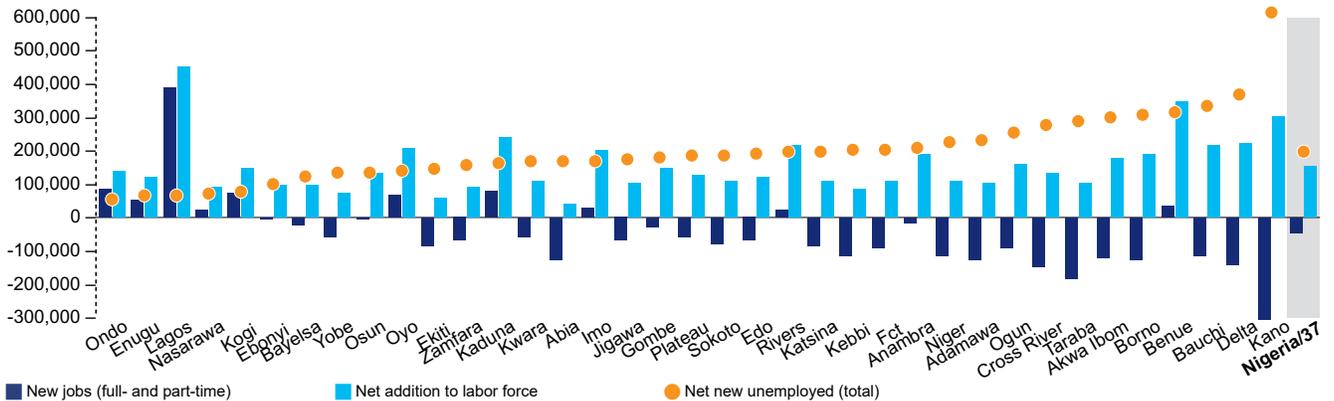
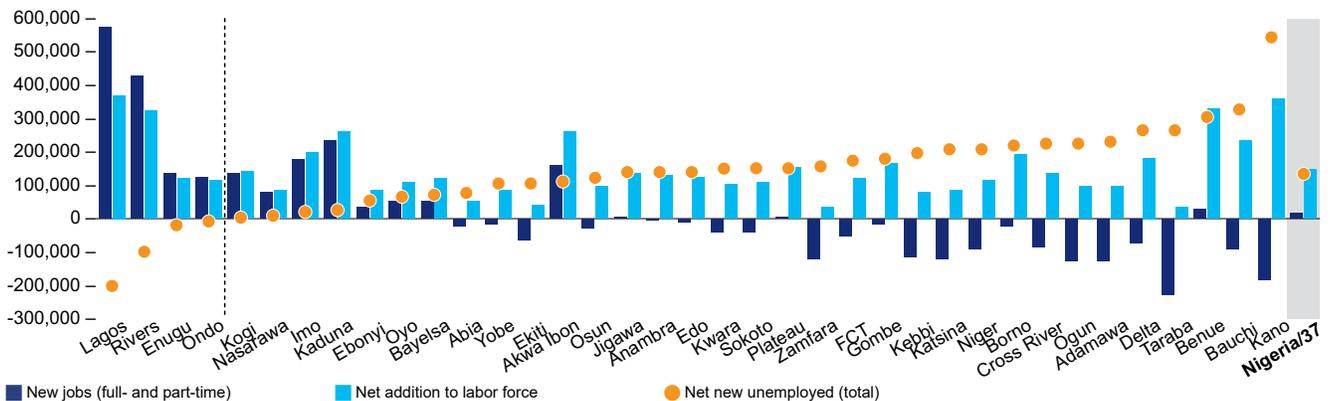


Figure 1.10. ...but the situation improved, and by Q3 2018, four states were creating enough jobs to reduce the number of unemployed workers.

Annual change in number of people in the labor force, employed, and unemployed



Source: World Bank calculations based on NBS data.

Notes: The graphs plot the absolute number of: net new part- and full-time jobs created in each state (upper panel: Q1 2017–Q1 2018; lower panel: Q3 2017–Q3 2018).

Some states are creating enough jobs to keep up with the growth of their labor forces. In the year following the recession (between the first quarter of 2017 and the first quarter of 2018), 10 states saw some positive job creation (Figure 1.9), but the number of new jobs was not sufficient to absorb the new entrants into the labor force. Meanwhile, 26 of 36 states and the Federal Capital Territory (FCT) were still losing jobs, and unemployment has been rising across all Nigerian states. By the third quarter of 2018, (latest available), in four states—Lagos, Rivers, Enugu, and Ondo—in 2018 growth of full- and part-time jobs significantly outpaced the growth of the labor force, reducing unemployed, and the number of job-losing states declined to 21 plus the FCT (Figure 1.10). The remaining 11 states created new jobs, but not enough to employ all new labor-force entrants. Average unemployment rates are higher in oil-abundant southern states and in the north, where they are also rising more rapidly. In 2018, nine northern states experienced increases in unemployment rates of over 10 pp.

However, the quality of the available jobs has declined. Most new jobs created in the last five years were part-time, and the likelihood of getting a full-time job is now lower than it was before the oil shock (Figure 1.7). In 2014, 81 percent of new jobs were full-time. As the economy entered recession in 2016, fewer full-time jobs became available, though there were more part-time jobs (Figure 1.7). In 2017, there were not enough part-time jobs to balance the sustained decline in full-time jobs, and total jobs fell by more than 700,000. In 2018, both full- and part-time jobs grew positively but at a low rate. By the end of the year, 3 million fewer full-time jobs were available than had been before the crisis.

High rates of unemployment and underemployment have contributed to the growth of the informal economy. Nigeria now has an estimated 54.6 million informal workers, representing 53 percent of the labor force.¹⁰ The size of Nigeria's informal economy has been estimated at 50 percent, among the highest on the continent. An estimated 75 percent of all new jobs are

informal. Informal jobs tend to offer less employment and income security, especially since employers have little access to financial services. Many low-income households depend on subsistence agriculture or low-productivity self-employment in services and industry, and a significant share of the population moves in and out of poverty. Nigeria has the largest installed manufacturing base in West Africa, yet wage employment in industry is rare. Just 10 percent of the working-age population is employed in formal wage labor, and over half these jobs are in the public sector. Informal enterprises have low growth potential, limited access to the formal legal system, and few opportunities to leverage the economies of scale and agglomeration associated with urban centers. Informality also narrows the tax base, which is already distorted by an overreliance on oil revenues and limits the resources available for public investment.

Higher investments in the current and future workforce skills would help Nigeria harness some of the demographic dividend. Most of Nigeria's labor force are low-skilled: about 50 percent of workers have only a primary education or less; 30 percent never attended school. Just 20 percent of Nigerian adults aged 18–37 years who completed primary school can read. Among workers aged 15–24, only 59 percent of women are literate compared to 71 percent of men; less than half completed secondary school. Meanwhile, 9 million Nigerian children are out of school, especially in the northeast, where families were displaced by the Boko Haram insurgency.¹¹

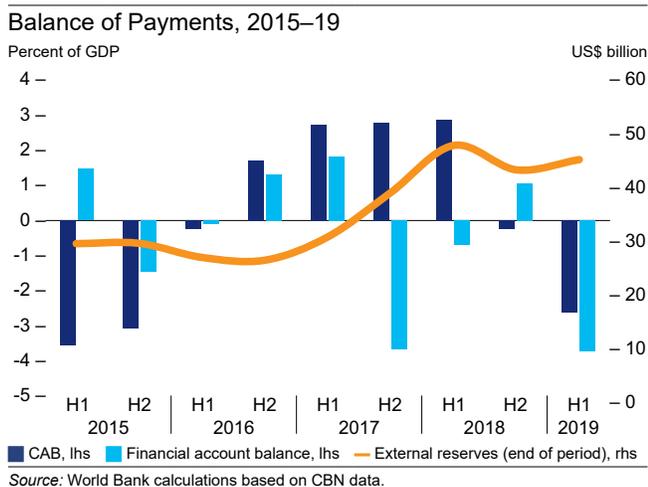
The External Sector: Exports have increased, but the external balance has deteriorated

Despite a modest increase in the dollar value of goods and services exports, Nigeria's current-account balance turned negative in H1 2019. Nigeria's current-account balance declined from 3.0 percent of GDP

10 According to National Bureau of Statistics data, there is slightly more than one informal worker for every formal sector worker.

11 See the Fall 2018 edition of the NEU: "Investing in Human Capital for Nigeria's Future."

Figure 1.11. The current account balance turned negative in H1 2019



in H1 2018 to -2.6 percent in H1 2019 as higher capital and services imports increase, in part related to construction of a private petroleum refinery in Lagos State (Figure 1.11 and Figure 1.13). Other nonoil imports have been subdued by weak demand and forex restrictions on 42 groups of products. The value of oil and gasoline imports fell, partly due to the lower oil prices. The services and income components of the current account are in negative territory, as has typically been the case, though service imports, particularly travel and transportation, have been rising. Current transfers, mainly diaspora worker remittances, steadied in H1 2019 at US\$13.5 billion—more than half the US\$22.7 billion value of net oil exports in the first half of the year. Over time, the steady flow of remittances into Nigeria has been a solid support for the current account, which would have often been negative without it.¹²

Oil and gas continue to dominate Nigeria’s export portfolio, contributing an estimated 86 percent of total exports in 2019 (see Figure B1.1.2 in Box 1.1). The slight increase of the value of total goods exports in H1 2019 (US\$31.3, compared to US\$30.2 billion in H1 2018) was driven by the small uptick in nonoil exports, which rose from US\$2.7 billion to US\$4.3 billion. Oil exports declined slightly from US\$27.5 billion to US\$27 billion due to lower prices (Figure 1.4). The

Figure 1.12. Foreign portfolio investments are by far the largest share of capital inflows into Nigeria

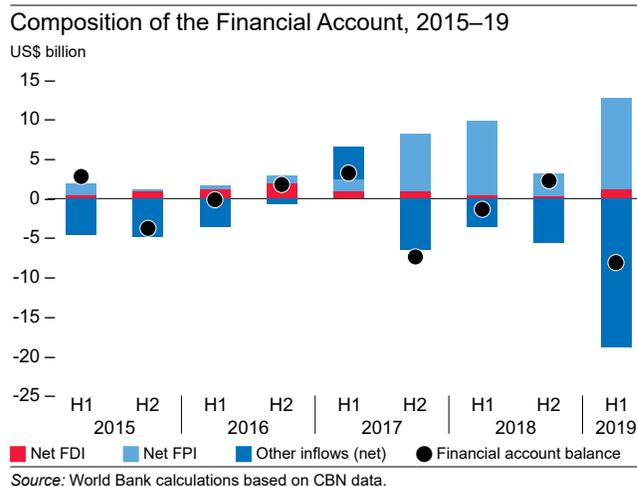
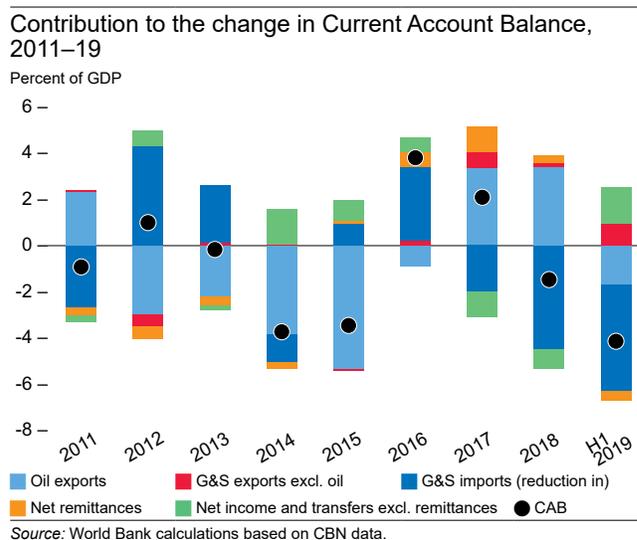


Figure 1.13. An upsurge in imports had the most impact on the current account balance in H1 2019



first pillar of the government’s Economic Recovery and Growth Plan 2017–20, drafted after the 2014/2015 commodity price crash, calls for improving the external balance of trade by broadening the export base; however, as yet progress has been slow to make a dent in the trade account.

On July 7, 2019, Nigeria signed the Africa Continental Free Trade Area (AfCFTA) agreement. The goal of AfCFTA is to increase trade between African countries. As one of the most closed economies in Africa

¹² The section refers to the CBN Balance of Payments data.

with a concentrated export-base, Nigeria can gain from increased regional integration. Box 1.1 provides a brief overview of the potential welfare gains that the AfCFTA can have for the country.

The financial account balance is also estimated to have deteriorated despite sustained Foreign Portfolio Investment (FPI) flows (Figure 1.12). FPI inflows rose in 2017, after exchange rate stabilization, and were further spurred by accelerated issuance of CBN bills and after the 2019 national election, supported by the stability of the Investors & Exporters Foreign Exchange (IEFX) window exchange rate and by high short-term domestic money market rates (rates on Nigerian Treasury and CBN bills), which currently range from 11 to 17 percent. Foreign direct investment (FDI) picked up slightly but at 0.6 percent of GDP remained low. Uncertainties about Nigeria's macroeconomic fundamentals may limit FDI inflows to small investments in domestic production. Although in recent years the federal government and some state governments have made significant efforts to improve

business regulation, long-term investors continue to find Nigeria unattractive because of such fundamental structural deficiencies as prolonged insecurity and a significant infrastructure deficit. The increased outflows of “other investment” in H1 2019, and large and volatile errors and omissions in the balance of payments highlight the need to improve Nigeria's external sector statistics.

Sources of external financing for Nigeria require close monitoring. Highly concentrated in monetary instruments, FPI flows tend to be responsive to domestic monetary policy decisions, oil price movements, and unpredictable policy adjustments globally. For Nigeria, sudden outflows would eat into already slipping external reserves and could destabilize the current exchange rate solution decision to hold the IEFX rate at about ₦360/US\$. External reserves rose from US\$43.1 billion in January to US\$45.1 billion at the end of June, equivalent to 6 months of goods and services imports.¹³ However, the gross figure masks a considerable amounts of forex swaps, and foreign holdings of short-term government

Box 1.1. Harnessing the Benefits of the African Continental Free Trade Area (AfCFTA)

Nigeria can gain from the AfCFTA. It is among the most closed countries in Africa (Figure B1.1.1) and its exports are the least diversified (Figures B1.1.2-3). Because its exports are highly concentrated in oil, they fluctuate with oil prices. Nigeria trades little with other African countries and has few nonoil exports beyond relatively basic agricultural goods. Accelerating diversification and becoming more integrated into the regional and global economy could help Nigeria achieve its potential as an African economic powerhouse.

Nigeria has yet to take a leading role in the Economic Community of West African States (ECOWAS), or beyond the region in the African Union (AU). The good news is that Nigeria's signing of the AfCFTA in July 2019 and proactive stakeholder consultation efforts beforehand could signal that it is now more willing to become a driver of continental growth and integration. Today, Nigeria has an opportunity to capitalize on the potential gains of doing so.

Nigeria could leverage integration into the regional market to achieve economies of scale and lower costs for manufacturers and exporters. That would make it possible for its competitive services firms to expand into other countries. Working through AfCFTA, Nigeria could leverage regional market integration to achieve economies of scale, lower costs, build regional value chains, and take a larger role worldwide—e.g., regional value chains can provide a stepping stone into global value chains.

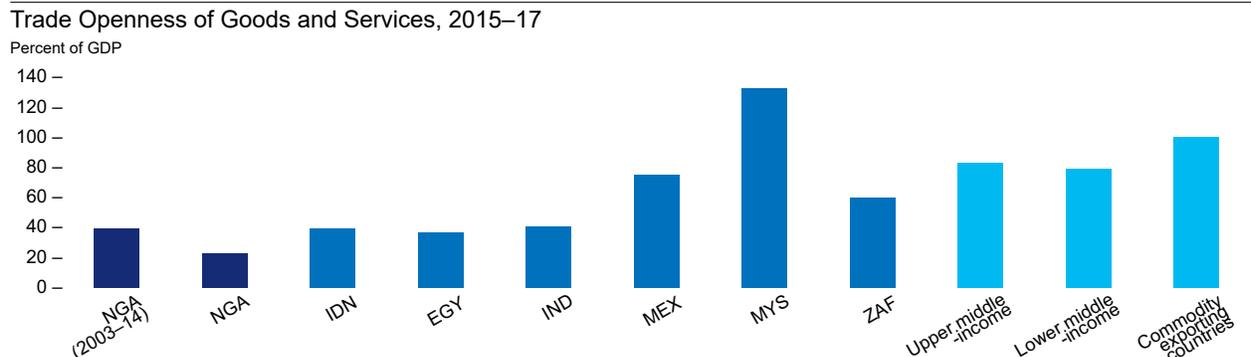
¹³ This is the 12-month moving average; the CBN has not published day-to-day external reserves data since November 2011.

Box 1.1 continued

There will be losers and winners. The International Monetary Fund estimates that trade reforms foreseen in the AfCFTA would lead to welfare gains of 1–1.2 percent, with most gains driven by the reduction of nontariff barriers (NTBs), e.g., reducing the widespread use of import bans and addressing inefficiencies at borders (Abrego et al. 2019). Nigeria’s short-term revenue losses from AfCFTA’s tariff liberalization would be small and distributed over 10 years (Arenas and Vnukova 2019); the result would be only a 0.2 annual percentage change in tariff revenues (0.1 percent of tax revenues). In the long run, trade and welfare gains are estimated to increase substantially in response to such other aspects of trade agreements as trade facilitation, elimination of NTBs, and liberalization of services (Vanzetti et al. 2018).

Nigeria’s proactive stance in AfCFTA negotiations would ensure that its private sector can take advantage of new opportunities. At the same time, the federal government needs to address concerns that greater integration could hurt Nigerian manufacturers. To support those who might lose from increased openness, the government has options, among them a new Africa Union facility to support countries that experience revenue declines from the AfCFTA. The African Export-Import Bank has also agreed to provide a credit line of up to \$1.5 bn to help members meet shortfalls.

Figure B1.1.1. Nigeria is among the most closed economies

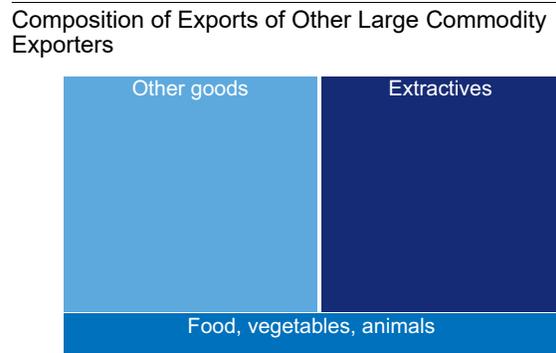


Source: World Bank calculations based on data from WDI and CBN.

Figure B1.1.2. Nigeria’s exports are highly concentrated...



Figure B1.1.3. ...more than those of other large commodity exporters.



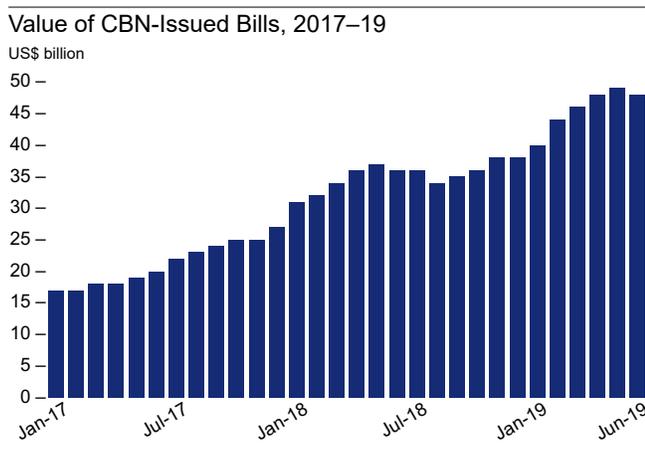
Source: World Bank calculations based on data from World Integrated Trade Solution (WITS).
 Note: Other commodity exporters include Nigeria’s structural and aspirational peers (Brazil, Colombia, Algeria, Egypt, Indonesia, India, Mexico, Malaysia, Peru, Russian Federation and South Africa).

and CBN securities; a sudden reversal of capital inflows into Nigeria could swing the financial account position very quickly, putting pressure not only on international reserves but also on exchange rates and domestic yields. International reserves fell to US\$42 billion at the end of August 2019 following a reduction in foreign holdings of short-term securities.

Monetary and Financial-Sector Policy: Conflicting objectives limit the effectiveness of macroeconomic management

The headline inflation rate remained stable in H1 2019. Inflation settled between 11.0 and 11.4 percent in H1 2019, driven by higher food prices, and remains above the CBN’s target range of 6–9 percent. While core inflation trended down from 9.9 percent in January to 8.8 percent in June, food inflation, which has a weighting of over 50 percent in the Consumer Price Index (CPI) basket, has been affected by persistent conflict in the major food-producing regions of northeast and north-central Nigeria (Box 1.3). In H1 2019, the food-inflation rate ranged from 13.2 to 13.8 percent.

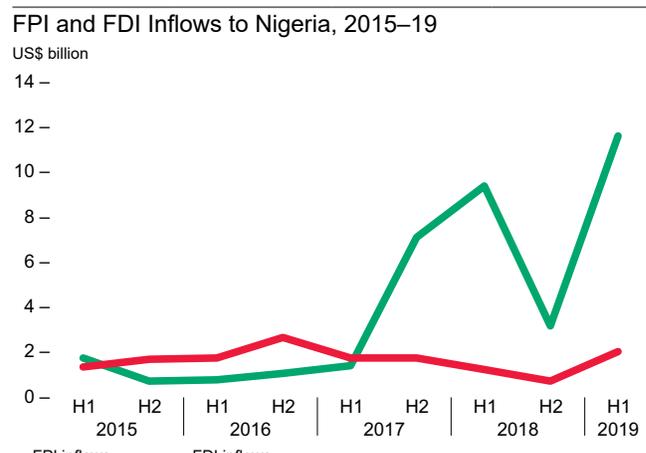
Figure 1.14. The CBN issued more securities in 2019



Source: CBN.

Actions to keep exchange rate and foreign reserves stable slowed the growth of credit to the private sector. The main monetary policy instrument deployed in 2019 was the issuance of liquidity management bills (“CBN bills”) through open-market operations. While these bills are often issued to control monetary growth, in H1 2019 they were used more often and at higher yields to attract foreign investors and thus keep foreign reserves and the exchange rate stable. The stock of CBN bills grew markedly between June 2018 and June 2019, hitting US\$48 billion in June 2019 (Figure 1.14), with yields of 16–17 percent. Their issuance also included maturities that compete with federal Treasury bills (T-bills). The attractive yields on both CBN and government securities supported sizable foreign inflows into Nigeria in H1 2019 (Figure 1.15), and over one-third of CBN securities are currently held by foreigners. However, they also reduce incentives for commercial banks to lend to the private sector, because banks would rather invest in high-yielding, income-tax-exempt, and bank risk-capital-free exposures than in more risky private assets. Bank exposures to the private sector have continued to fall in relation to total bank assets and in real terms (by about 8 percent in Q1 2019). Meanwhile, the combined exposure of commercial bank balance sheets to government and CBN securities increased from about 40 percent of private sector credit as of 2017 to about 56 percent as of March 2019.

Figure 1.15. Foreign portfolio investment grew significantly in 2019



Source: CBN.

As commercial banks' access to CBN bills and government securities increased, the CBN introduced measures aimed to encourage banks lending. The growth of commercial bank credit to the private sector has been negative since 2017, and in June 2019 it reached -0.2 percent, year-on-year. Via a circular issued on July 3rd, the CBN instructed banks to ensure a minimum loan-to-deposit ratio (LDR) of 60 percent by September 30, 2019. Adherence to the LDR was to be reviewed quarterly, and failure to meet the requirement would result in the imposition of additional cash reserve requirements on the shortfall. By September 30th, the CBN had debited 12 defaulting banks a cumulative ₦499 billion, and the CBN raised the LDR target to 65 percent by December 31, 2019. Furthermore, a July 10 circular informed banks of a maximum ₦2 billion remunerable deposit in the CBN's Standing Lending Facility (SLF). The CBN had previously abolished the symmetric corridor of the Standing Deposit Facility (SDF),¹⁴ and the SLF rates varied around the monetary policy rate (MPR). The CBN resorted to an asymmetric corridor in which the SDF rate would be 5 pp below the MPR, while the SLF rate remained at 2 pp above the MPR—thereby reducing the incentive for commercial banks to accumulate deposits at the CBN. In October,

the CBN refunded some of the additional cash reserves which it had debited from the 12 penalized banks as they began to meet the LDR.

It is possible that policy and regulatory efforts to stimulate commercial bank lending to selected private credit segments, while well-intentioned, could entail unintended negative consequences. For example, the minimum LDR requirement could lead banks to approve loans that expose them to more-risky credits, undermining the quality of their loan portfolios. It could also lead banks to shift funding modalities away from mobilizing deposits, which would undermine financial inclusion initiatives. Dropping the level of deposits for which the CBN would remunerate banks when using the SDF could undermine the CBN's ability to control liquidity conditions in the banking system, and additional, potentially costlier open market operations would be required to drain liquidity.

Previous measures to incentivize increased commercial bank credit to the private sector have met with limited success. Under a 2018 differentiated cash reserve requirement (DCRR), banks interested in utilizing additional resources to finance new and

Figure 1.16. Banking system credit to the Federal Government has soared, while credit to the private sector remains low

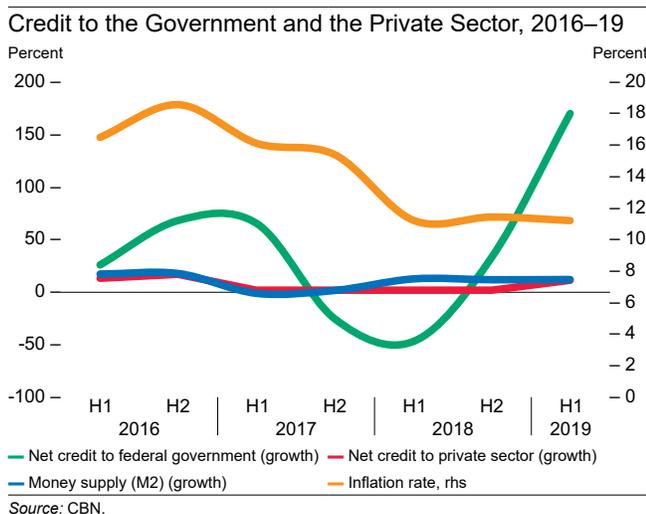
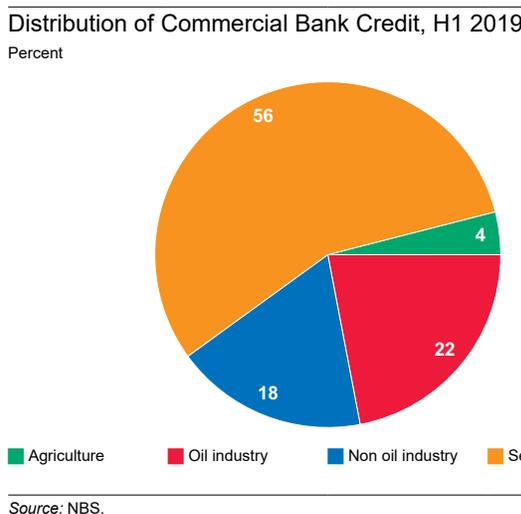


Figure 1.17. Commercial bank credit in H1 2019 was concentrated in industry and services



¹⁴ The SDF is a remunerated facility of the CBN where banks can deposit their excess funds. The SLF is a facility, also of the CBN from which banks that are short of funds can borrow for the short-term. The CBN lends to commercial banks from its SLF at the given SLF rate, while it accepts deposits from them in its SDF at the SDF rate. The MPR is only an indicative rate somewhere in between these two rates; the SLF rate being above the MPR and the SDF rate being below. The gap ("corridor") between the MPR and both rates has usually been even ("symmetric") but was recently made uneven ("asymmetric").

expansion projects in agriculture and manufacturing could request the release of funds from their cash reserve requirement (CRR) deposits with the CBN. However, this measure did not yield the desired growth in credit to the private sector, as lending is influenced more by a bank's assessment of credit risk than by regulatory measures.

The CBN continued to support credit growth through directed lending. In recent years, the growth of commercial bank credit to the private sector has been limited overall and concentrated in the oil industry, large-borrower segments of nonoil industry, and services (Figure 1.17). Since 2014, the CBN has ramped up its own directed and subsidized financing to firms in agriculture and manufacturing, especially micro, small, and medium-scale enterprises (MSMEs).¹⁵ It has also provided subsidies to the power sector. Though well-intentioned, these practices could have adverse consequences. For example, CBN interventions could: (i) undermine the effectiveness of the credit transmission channel of monetary policy and the signaling role of changes in the MPR; (ii) crowd out private-sector funding by discouraging banks from venturing into underserved markets without subsidies when the schemes are not properly targeted, as well as creating expectations for borrowing at single-digit rates; (iii) create a potential conflict of interest for the CBN between its oversight role in the banking sector, its objectives as an operator of development financing schemes (whether directly or through the on-lending relationships with banks), and its interests as a shareholder in development finance institutions; (iv) reduce the CBN's operational surpluses, a share of which is normally transferred to the federal government as part of its independent revenue; and (v) undermine transparency and accountability in the allocation of public resources by circumventing the government's standard budgetary process.

Exchange-rate convergence is improving. There are, however, still several foreign-exchange windows. While the IEFX window accounts for at least 50 percent of

Nigeria's total forex transactions, the interbank-retail, and the interbank-wholesale market windows are still open, though the exchange rates in these windows have been relatively stable in the ₦335–₦365/US\$ range. The Bureau-de-Change (BDC) window exists for retail transactions. The CBN has a window for selected imports, such as refined petroleum products, and its rate of ₦305–307/US\$ could imply a potential arbitrage premium of about 10–20 percent. International experience suggests that multiple exchange rates create implicit public subsidies that can distort the allocation of resources in the economy (see Chapter 3).

Banks are performing better, but asset quality needs to be monitored closely. Nonperforming loans (NPLs) as a percentage of total loans—mostly in the oil, gas, and power sectors—declined from 12.4 percent in June 2018 to 9.4 percent in June 2019 (the prudential limit is 5 percent). The recent reduction in NPLs was driven by write-offs and clearance of oil-sector-related arrears that improved the cash flow of bank borrowers so they could repay banks, and sales to asset management companies. Meanwhile, driven by healthy profitability, the aggregate capital adequacy ratio (CAR) also improved, from 12.1 to 15.3 percent, slightly better than the prudential requirement of 15 percent. Going forward, asset quality needs to be closely monitored because it may deteriorate if the CBN continues to exercise regulatory forbearance for undercapitalized banks. The CBN gave liquidity support to four medium-sized banks that were severely undercapitalized, without requiring hard time-bound recapitalization plans.

Fiscal Policy: Limited buffers and oil dependence leave Nigeria vulnerable to shocks

Nigeria remains heavily dependent on the oil sector as a source of federal revenue. In H1 2019, oil-related

15 Among the CBN schemes are the Agricultural Credit Guarantee Scheme (ACGS), the Commercial Agriculture Credit Scheme (CACs), and the Anchor Borrowers Program (ABP). In February 2019, CBN announced the Nigeria Incentive-Based Risk-Sharing System for Agricultural Lending (NIRSAL) Micro Finance Bank (MFB) to empower about 400,000 small enterprises and small-holder farmers.

taxes provided over half of gross federal revenue. Given Nigeria's low revenue levels (Figure 1.19), the Economic Recovery and Growth Plan (ERGP) emphasizes increasing nonoil revenue, and in 2016 the government embarked on a series of actions to boost tax revenues, starting with the review and revision of its National Tax Policy in 2016–17, which was followed by a one-year tax amnesty program, the Voluntary Assets and Income Declaration Scheme, from July 1, 2017, to June 30, 2018, and by a variety of other tax administration reforms and some tax policy adjustments, notably a minor increase in excises on tobacco and alcohol in 2017. However, nonoil revenues have been stagnant at around 4 percent of GDP—not enough to buffer against the volatility of oil revenues. Mobilizing nonoil revenues would require action on several fronts, including enhancing the VAT system; rationalizing tax incentives that narrow the corporate tax base; and further strengthening tax administration to reduce compliance costs for taxpayers. Furthermore, recent studies have shown that tax morale is low among Nigerians because the tax system is complex, taxpayers' experience with tax officials is generally negative, and taxpayers perceive the use of public resources to be relatively opaque and inefficient.¹⁶ Recent efforts to mobilize nonoil revenues, including the Ministry of Finance's Strategic Revenue Growth Initiative (SRGI) and the re-establishment of the National Tax Policy Implementation Committee to drive tax policy reforms, starting with drafting of a new Finance Bill, are positive developments.

Federally collected revenues fell by 16 percent relative to GDP between H1 2018 and H1 2019.¹⁷ Total revenue in H1 2019 reached 2.4 percent of annual GDP, down from 2.9 percent a year earlier. Oil revenues drove the decline, falling by 26 percent year-on-year. Meanwhile, nonoil revenues grew by 2 percent, year-on-year, due in part to rising customs revenue, as capital imports increased and higher exchange rates boosted the real value of customs duties. While the average oil price

from October 2018 to March 2019 (US\$67) exceeded the average budget benchmark price (US\$51.5), the average output of 1.9 mbd fell short of the budgeted 2.3 mbd.¹⁸ Furthermore, the various deductions by the Nigerian National Petroleum Corporation (NNPC) from payments for crude oil purchased from the federal government (including “cost under-recovery” for unbudgeted petrol subsidies which mostly benefit non-poor households) caused the realized net oil revenues to come in much lower than budgeted. Though growing largely in line with inflation in nominal terms, nonoil revenues continue to stagnate in real terms, with no significant yields from tax administration reforms and no significant tax policy reforms.

NNPC deductions of petrol subsidies from crude oil sales revenue amounted to ₦294 billion (almost US\$1 billion, or 0.2 percent of annual GDP)¹⁹ in H1 2019. In addition to this nominal price subsidy, imports of the product are subsidized with a preferential exchange rate valued at about 18 percent above the prevailing exchange rate. Steadily rising petrol consumption contributes to this quantum of subsidies. The Petroleum Product Pricing and Regulatory Agency (PPPRA) reports that Nigeria's daily petrol consumption has been rising steadily, reaching 56 million liters in April 2019. However, there are also widely reported cases of petrol smuggling from Nigeria into neighboring countries where pump prices are higher than the Nigerian subsidized price.

Fiscal buffers in the Excess Crude Account (ECA) have been exhausted, rendering Nigeria more vulnerable to shocks (Figure 1.18). The account balance on June 30th was US\$0.1 billion, down from US\$0.6 billion at the end of 2018 and US\$2.5 billion at the end of 2017. The ECA has rarely operated as envisaged; when it was established in 2004, it was to be drawn on only when the actual crude oil price falls below the budget benchmark price for three consecutive

16 See for example: Kouame, Wilfried (2019), “Trust to Pay? Tax Morale and Trust in Africa”, World Bank Policy Research Paper 8968. Washington, D.C.: The World Bank.

17 This refers to the net measure of federation and VAT accounts revenues (i.e. gross revenues net of revenue-collection agencies' costs of collection, cost recoveries on oil and gas sales (including petrol subsidy deductions), government's contribution to cost of oil production and costs of other federally-funded upstream projects). It is the net revenue that is distributed to the three tiers of government, in line with the existing revenue-sharing formulae.

18 October 2018–March 2019 price and output are used to reference oil revenues of January–June 2019 because there is usually a three-month lag between oil export sales and realized oil export revenues.

19 According to the NNPC monthly report data.

months. However, the state governments contended that the federal Fiscal Responsibility Act (FRA) of 2007 creating the ECA was not binding on state and local governments. In 2011 the Nigeria Sovereign Investment Authority (NSIA) Act was therefore passed, establishing the Nigeria Sovereign Wealth Fund (NSWF) as the oil savings fund for the country; it has three ring-fenced funds (future generations, infrastructure, and stabilization funds), jointly owned by the three tiers of government. The stabilization fund, much like the ECA, was to support federation revenue in times of economic stress, and it was envisaged that the balance in the ECA in 2011 would be transferred to this fund. Instead, in 2012 seed capital of only US\$1.5 billion was transferred, plus another US\$0.5 billion in 2017. The stabilization and future generations funds have, however, earned some investment income and the infrastructure fund has been deployed for certain projects like the Second Niger Bridge.

The Federal Government’s (FGN) fiscal position deteriorated in H1 2019 as realized revenues fell behind H1 2018. The 2019 budget law was not enacted until the end of May, five months into the year—similar delay compared to the recent years. As the constitution provides, the federal government began

to execute its recurrent spending budget in January (subject to the previous year’s budget for each spending category) but execution of the 2019 capital budget did not begin until May 29; although the implementation of the carry-over of 2018 capital budget continued.²⁰ The federal government’s realized revenues in H1 2019 were 19 percent lower (in real terms) than H1 2018 receipts, reflecting both contracting federation account revenues and its independent revenues, which comprise elements like operational surpluses of government-owned enterprises, and personal income taxes of federal government employees. Nevertheless, federal government spending accelerated slightly, particularly for capital projects.

In H1 2019 the fiscal deficit of the FGN increased, from -1.8 percent of GDP in H1 2018 to -2.1 percent and is increasingly financed by the CBN. This higher deficit was the result of both lower oil and independent revenues and higher capital spending around the elections. The deficit was financed domestically by FGN bonds, Treasury bills, and overdrafts at the CBN. Having speeded up issuance of Eurobonds in 2017–18, and with the November 2018 issue yielding up to 9.25 percent for the 30-year series, the FGN did not signify any intention to access the Eurobond market to finance its 2019

Figure 1.18. Fiscal buffers are depleted even though the average crude price mostly exceeds the budget benchmark

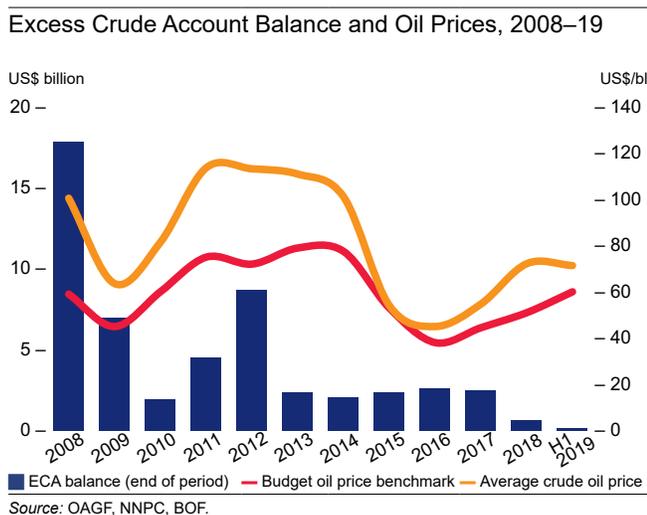
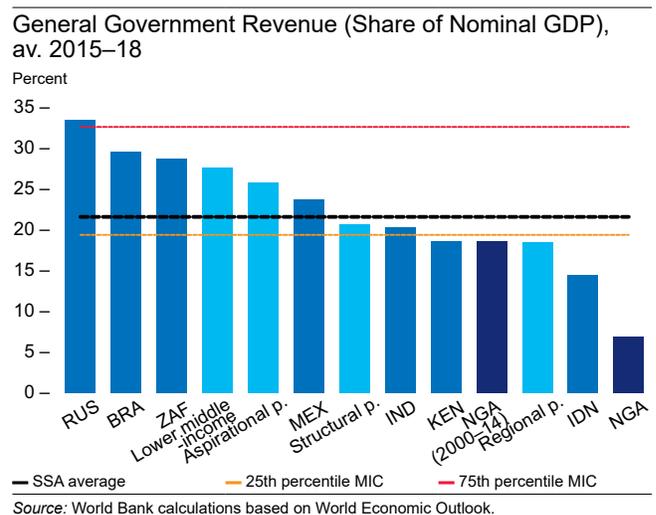


Figure 1.19. Compared to peers, Nigeria’s consolidated government revenues are strikingly low



²⁰ The mismatch between the recurrent and the capital budget cycles has been the practice for a number of years and it makes fiscal accounting at the FGN level rather complicated. The FGN is keen to revert to a regular budget calendar of January to December.

deficit. It increasingly used domestic financing; and by June 2019, overdrafts at the CBN had grown by over 300 percent year-on-year.

The revenue shortfalls affected the share of federally collected revenues accruing to the state governments.

State governments received only half of what was projected in the federation revenue framework. While several states are working to boost internally generated revenue, the states' share of federation account revenues still financed the bulk of most state budgets. Consequently, many states suffered from significant

fiscal constraints in H1 2019. Moreover, the federal government recently announced that it would begin to deduct at source payments due from 35 states that benefitted from the ₦614 billion state budget support facility, set up in the 2016–17 Fiscal Sustainability Plan (FSP), which had a grace period of two years. For states that had not factored it into their budgeting, this would worsen the fiscal stress.

Nigeria's consolidated government revenue are very low by the standards of comparable countries. During the commodity boom Nigeria's consolidated government

Box 1.2. Financing Human Capital Development in Nigeria: Basic Education

Although Nigeria has a longstanding commitment to universal basic education, the number of out-of-school Nigerian children is among the highest in the world. The Universal Basic Education (UBE) Act of 2004 stipulates free, compulsory, and universal basic education for grades 1–9; six years of primary school followed by three years of junior secondary school. Yet in recent years enrollment in basic education has gone up only slightly; in 2017–18 the gross enrollment ratio (GER) was 76.6 percent in primary and 40.0 in junior secondary.

As for education quality, the 2013 Service Delivery Indicator (SDI) survey in four Nigerian states found that only one-third of grade 4 pupils had acquired minimum numeracy and literacy skills. Inadequate learning has contributed to Nigeria's low rank on the Human Capital Index (HCI) of 0.34, placing the country at 152 out of 157. Children in Nigeria are expected to complete 8.2 years of education by age 18, slightly above the regional average of 8.1. However, because they learn relatively little, their years in school are equivalent to just 3.4 years of learning; 4.7 years are lost because the quality of Nigeria's education system is poor. Consequently, a Nigerian child born today will be only 34 percent as productive when she grows up as she could be if she enjoyed complete education and full health. Nigeria's HCI places the country lower than the average for Sub-Saharan Africa (SSA), its region, and for lower-middle-income countries, its peers.

Financing of public education in Nigeria is complex, and there is no clear division of responsibilities: both the federal government and the states finance secondary and tertiary schools; local governments, in theory, finance most primary education but in practice have ceded all management responsibilities to the states. In addition, arrangements vary from state to state, and there is no requirement for states to report their education spending to the federal level, which makes it difficult to obtain a complete picture of public education spending.

According to the last comprehensive analysis available,¹ in 2013 total public spending on education by all levels was 1.7 percent of GDP. As a share of total public spending, it increased marginally from 10.2 to

¹ World Bank. 2015. *Governance and Finance Analysis of the Basic Education Sector in Nigeria*.

Box 1.2 continued

12.5 percent over 2009–13. Nigeria’s spending on education is thus lower than the SSA average of 4.6 percent of GDP and 16 percent of total public spending.

Based the current development trend in education is simply “business as usual”, by 2030 enrollment in basic education will go up by 18.5 million (53 percent).² At the same time, the GER will remain far from universal, increasing to 79.5 percent in primary and 41.9 in junior secondary education as high birth rates exceed growth in enrollments (Figure B1.3.1).

Fulfilling the Government of Nigeria’s commitment to UBE by 2030 will require a more efficient system in which more children complete the primary cycle and transition to junior secondary. A scenario in which system efficiency gradually improves through 2030 calls for rising intake, promotion, and transition rates, falling repetition rates, and absorption of out-of-school children. As a result, the number of students in basic education would increase on average by 11 percent a year in 2020–30, culminating in about 80 million students enrolled in basic education.

Absorbing all these students will likely cost on average an additional US\$7.2 billion annually for 2020–30—an increase in public basic education spending of 1–5 percent of GDP. Though this is a substantial increase, it must be kept in mind that Nigeria’s current spending on public education is very low. Moreover, the cost of universalizing basic education can be reduced through savings in both capital and recurrent spending. To curb recurrent spending, better allocation and deployment of teachers are crucial. For capital spending, savings in the cost of constructing new classrooms and specialized facilities can be very important. Simulating the fiscal impact of common-sense reforms on the input model of primary and junior secondary schooling, including classroom libraries and better utilization of classrooms and teachers, leads to projections that by 2030 could cut the annual cost of basic education by at least 27 percent (Figure B1.2.1).

Figure B1.2.1. Gross enrollment in basic education will rise between 2018 and 2030

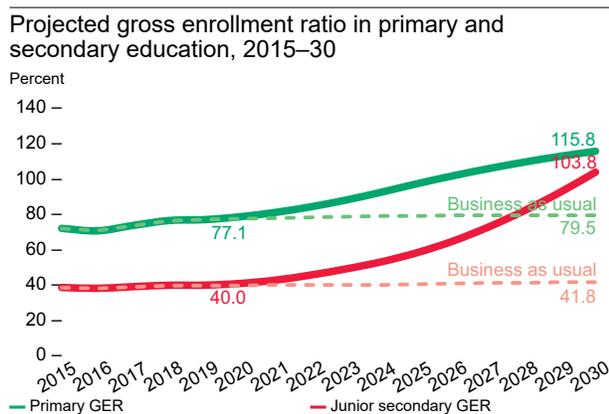
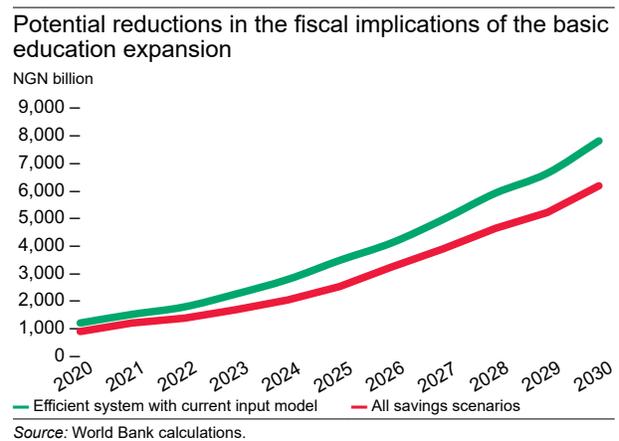


Figure B1.2.2. The cost of universalizing basic education can be reduced through savings in both capital and recurrent spending



² Enrollment projections and associated costs are derived from an Excel-based simulation model, which employs UN population projections and recent trends in student promotion and retention. The tool allows users to easily adjust a range of policy and service parameters in order to estimate the impact on public costs.

revenue reached 12 percent of GDP, among the lowest ratios for structural, aspirational, and regional peers (Figure 1.19). After oil price and production shocks and Nigeria's first recession in over two decades, in 2016 general government revenue plunged to 6 percent of GDP—second lowest of 115 countries for which data are available. Recovering to 8 percent of GDP in 2018, government revenues are projected to plateau there unless there are significant tax policy and administration reforms. This will continue to constrain the budget envelope and limit fiscal space for investing in physical and human capital (Box 1.2).

The ratio of public debt to GDP is relatively modest at around 20 percent, but debt sustainability is challenged by low revenues. The interest payments on public debt are high and rising, due to growing debt stock and because of high interest rates in the domestic debt market and the high proportion of domestic debt. Government domestic debt constitutes 77 percent of total domestic debt, which itself is almost 70 percent of total debt (Figure 1.20 and Figure 1.21). Yields on FGN T-bills and FGN bonds are in the region of 11–15 percent. Interest payments are particularly high relative to the low revenue collection, with the FGN interest-to-revenue ratio at about 60 percent since 2016.

Figure 1.20. Nigeria's public debt portfolio is largely domestic

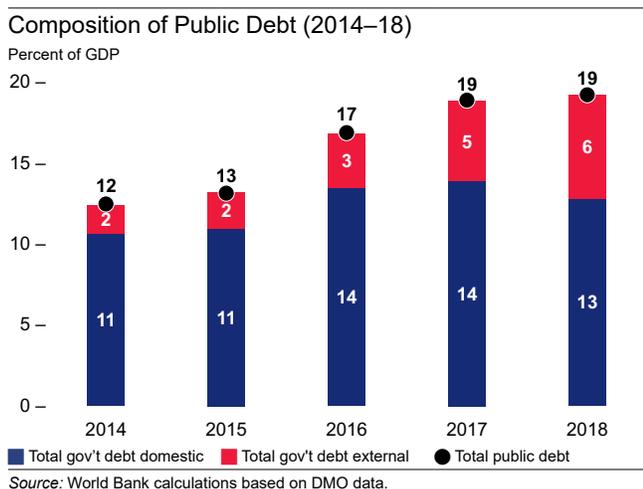
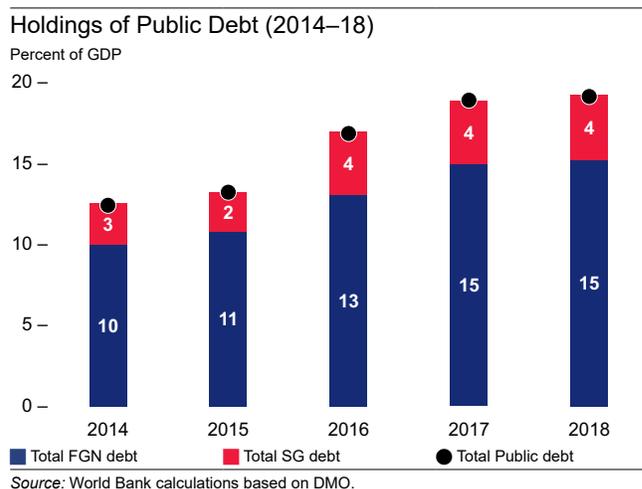


Figure 1.21. The Federal Government's debt is by far the largest



Box 1.3. The Impact of Conflict on Households and Welfare in Nigeria

The rise in conflict in Nigeria is affecting many households: Between 2010 and 2017, 22 percent of households in the Niger Delta (South-South), reported at least one event, with bandits and criminals responsible for 42 percent of the events; 49 percent of households in the North-East had similarly been victims of a conflict event, more than 66 percent of which were reportedly caused by Boko Haram; and 25 percent of households in the North-Central region experienced at least one such event, usually perpetrated by pastoralists or nomads (45 percent) and insurgents (21 percent).¹

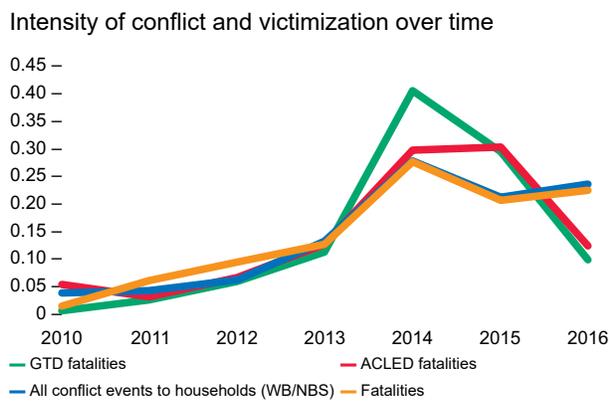
¹ The data is showing only one side of the farmer herder conflict as the sample of interviewed households does not include nomadic households. The data does not capture information on attacks perpetrated by farmers.

Box 1.3 continued

These conflict events have severe consequences for household welfare. It is estimated that one additional such event leads to a 3–4 percent decrease in total consumption (food and nonfood). Based on the US\$1.90 per capita per day poverty threshold, the study also finds that that poor households are more likely to stay poor after being victimized, whereas nonpoor households manage to prevent themselves from falling into poverty. An additional conflict event is estimated to increase food insecurity by about 4.4–5.2 percent. Generally, property events are more detrimental to consumption and food insecurity than are violent events.

Victimization is related to more symptoms of depression, especially after violent attacks and those perpetrated by insurgents. On average, conflict events are not found to have an impact on household spending on health and education, but farmer herder clashes are related to increased health spending and decreased education spending. These findings highlight the importance of collecting nuanced information on household conflict exposure.

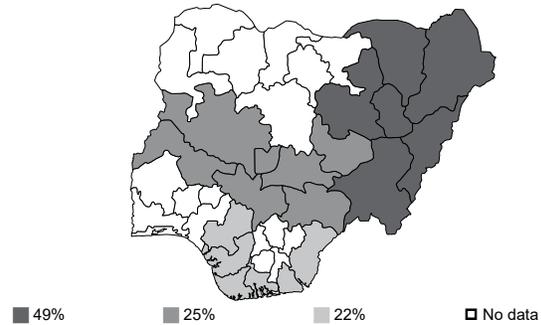
Figure B1.3.1. Conflict events have risen since 2010



Source: Kaila and Azad (2019).
 Note: Vertical axes represent fatality distribution over time.

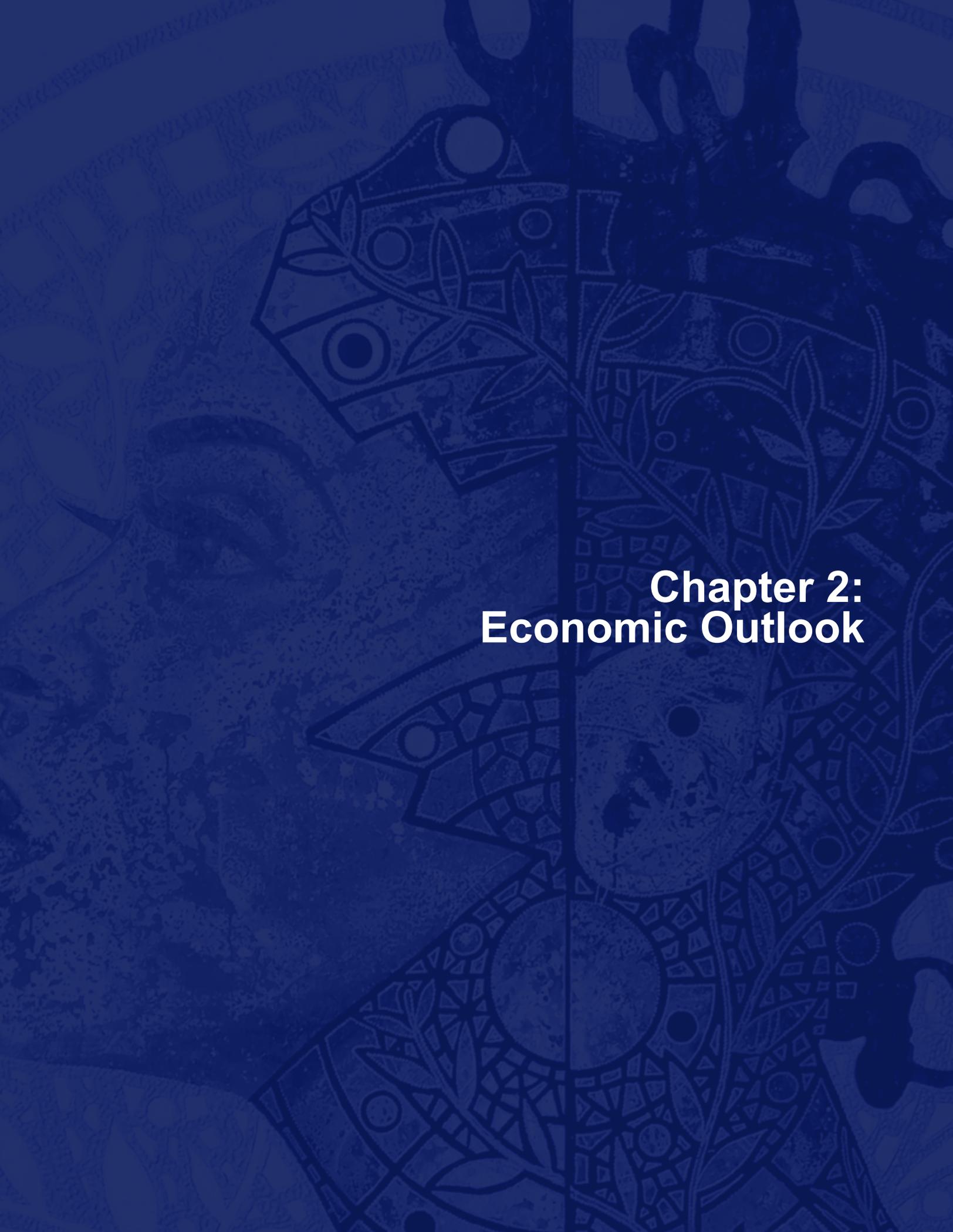
Figure B1.3.2. The North-east of Nigeria is affected most by conflict

Household conflict exposure in the North-East, the North-Central, and the South-South



Source: Kaila and Azad (2019).

Reference: Kaila and Azad (2019), “Conflict, Household Victimization, and Welfare: Does the Perpetrator Matter?”. World Bank Policy Research Paper 9019. Washington, D.C.: The World Bank.



Chapter 2: Economic Outlook

Chapter 2: Economic Outlook

Global Economic Prospects: Global economic growth is slowing in a context of policy uncertainty and trade tensions

Global growth projections have been revised down as policy uncertainty and an escalation of trade tensions between major economies undermine global confidence, and therefore investment. Growth in global GDP is expected to slow from 3 percent in 2018 to 2.6 percent; in 2020 and 2021 activity is projected to firm somewhat with growth rising to 2.8 percent. This modest rise assumes that global financing conditions will stay benign, and that activity will recover in major commodity exporters and in emerging market and developing economies previously affected by financial market stress. In the Euro Area—the main destination for Nigeria’s exports—growth is expected to decelerate in 2019 with weakness in manufacturing because of slowing exports. Although global growth is projected to edge up in 2020–21, it is not likely that more accommodative fiscal and monetary policy support can fully offset the weak economic activity. In the United States, growth is projected to slow in 2019 and decelerate into 2021 as the effects of fiscal stimulus wane and as escalating trade tensions discourage activity. Similarly, growth in China is expected to moderate as manufacturing and trade soften as trade tensions with the United States continue. However, it is assumed that policy actions in China will move to mitigate the headwinds to activity.

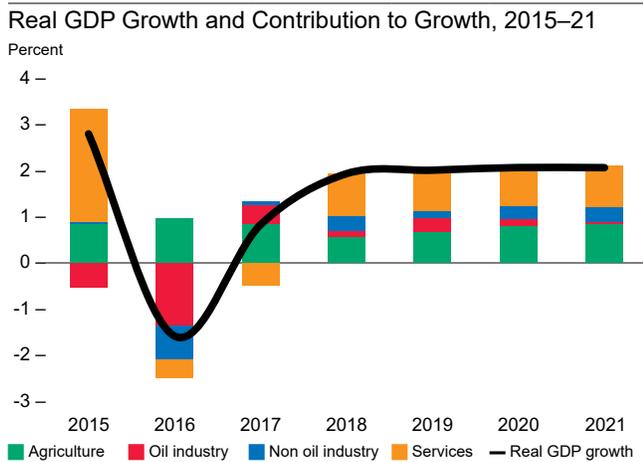
Though oil prices in 2019 have been buffeted by both supply and demand factors, prices are expected to moderate. On the supply side, prices have been supported by production quotas set by Organization of the Petroleum Exporting Countries (OPEC) and its partners first half of this year and now extended into March 2020. Prices were also buoyed when the United

States terminated the waivers it had granted for its sanctions on the Islamic Republic of Iran and by rising geopolitical tensions in the Middle East. More recently, however, concerns about slowing global demand amid heightened trade tensions have been weighing heavily. Yet a major disruption to supply from Saudi Arabia in mid-September exerted renewed, though probably temporary, upward pressure on prices, underscoring the uncertainty of the oil outlook. Nonetheless, oil prices in 2019 are expected to moderate from 2018 levels and in 2020 decline to an average of US\$63–64 per barrel of Nigeria’s Bonny Light crude, as softening global activity continues to reduce oil demand. While the current heightened geopolitical concerns present a key upside risk to the price outlook, further weakening in global growth poses a significant downside risk. With exports of oil-related products accounting for more than 90 percent of Nigeria’s total goods exports, a decline in oil prices more than is forecast will damage the country’s terms of trade.

Nigeria’s Economic Outlook: Stable growth but vulnerable to risks

The growth outlook is stable, but population growth is expected to continue exceeding economic growth, undermining Nigeria’s prospects for poverty reduction. Nigeria’s real GDP is projected to grow by 2.0 percent in 2019 and hold at about 2.1 percent through 2021, below the average for SSA (3 percent), and considerably below rates expected in East and South Asia (6–7 percent). With economic growth expected to remain below the estimated population growth of 2.6 percent through 2021, per capita real GDP will

Figure 2.1. Growth is forecast to stagnate; any shocks would lower it further



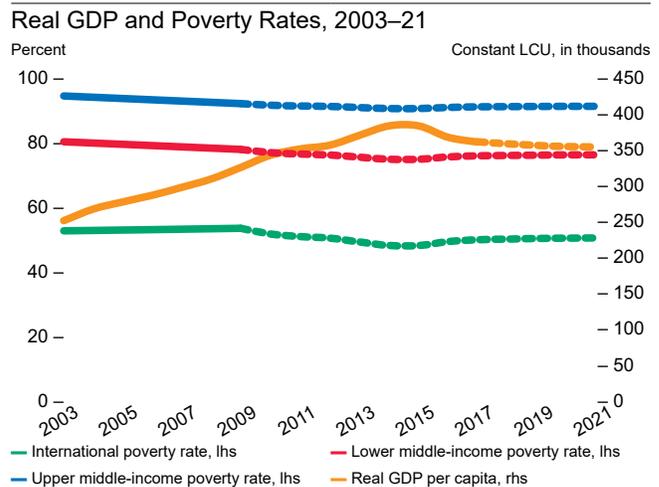
Source: World Bank calculations based on data from Nigerian authorities.

decline from US\$2,485 in 2018 to US\$2,460 by 2021, pushing more Nigerians into poverty.

Medium term growth could be boosted by implementing core structural reforms. Rethinking agriculture finance may increase efficiency of public sector support to the sector. Agricultural output will continue to be affected by the insurgencies that have displaced people, destroyed crops, and prevented cultivation. With agriculture mostly rainfed, the weather will also have sporadic impact on crops. CBN financing schemes for the sector and forex restrictions designed to reduce imports of staple foods will continue to support the sector but will affect the quality and increase the price of agricultural products. With little growth in agriculture and few opportunities elsewhere, agricultural labor productivity is expected to stagnate, failing to improve the living standards of the 40 million Nigerians it employs.²¹

Reducing the crowding out of private sector credit could help boost domestic demand and spur growth in nonoil industry and services. Consumer demand will remain depressed by stagnating incomes, persistent unemployment, and the high cost of financing. Global and domestic policy uncertainties limit private investment in Nigeria, with domestic investment

Figure 2.2. With per capita incomes contracting, poverty will continue to rise



crowded out by the public sector. Manufacturing growth outlook remains positive as the food and beverage sector slowly expands in response to the policy drive to develop domestic industries, but lack of access to reliable power will continue to hold the sector back. Supported by current mega-projects, construction will continue expanding, but growth is likely to stagnate as public investment slows. While large industry players are partially shielded from international competition through forex and import restrictions, growth among MSMEs is restricted by minimal access to financing and its high cost, which deters job creation. Growth in the services sector, which accounts for over 50 percent of the economy, will remain dominated by sustained expansion of telecommunications. The trade sector, the second largest employer after agriculture and providing incomes to 14 percent of those employed and underemployed (about 11 million people) will likely be impacted by the increased use of measures intended to spur the growth of domestic industry. A reduction in trade-restricting measures and a phasing out of monetary policy measures which currently add to the crowding out credit to the private sector would improve the competitiveness of the nonoil industry and services.

The outlook for the oil sector is stable. Oil production is projected to remain around 2 mbd in the medium

21 National Bureau of Statistics estimate; includes those underemployed.

term, below the 2.3 mbd target outlined in the medium-term fiscal strategy. Among the numerous problems weighing on production growth are the lack of certainty about and the possible content of the petroleum sector legislation, attacks on oil and gas infrastructure and theft, more financially attractive lower-cost projects elsewhere, currency restrictions, and uncertainty about

prices. Without sustained investment, given the high levels of natural decline, oil production may slip below current levels.

The external balances will be sensitive to both external shocks and domestic policy decisions. By 2021, the external balance is expected to improve gradually,

Table 2.1. Medium-Term Macro-Fiscal Projections

<i>Macroeconomic Indicators</i>	2015	2016	2017	2018	2019	2020	2021
<i>(Annual percent change, unless indicated otherwise)</i>							
Real GDP growth at constant market prices	2.7	-1.6	0.8	1.9	2.0	2.1	2.1
Private consumption	1.5	-5.7	-1.0	0.1	0.1	0.3	0.5
Government consumption	-11.9	-15.1	-8.0	9.5	3.8	-2.7	-1.4
Gross fixed capital formation	-1.3	-4.8	-3.0	24.5	-4.8	2.3	6.3
Exports of goods and services	0.1	11.5	8.7	0.5	13.5	3.7	2.6
Imports of goods and services	-25.7	-10.4	4.8	28.8	13.4	-4.7	0.1
Real GDP growth at constant factor prices	2.8	-1.6	0.8	1.9	2.0	2.1	2.1
Agriculture	3.7	4.1	3.4	2.1	2.6	3.1	3.3
Industry (oil)	-5.4	-14.4	4.7	1.1	3.3	1.7	0.0
Industry (nonoil)	0.1	-5.0	0.6	2.4	1.1	2.0	2.4
Services	4.8	-0.8	-0.9	1.8	1.7	1.6	1.7
Inflation (Consumer Price Index)	9.0	15.7	16.5	12.1	11.6	12.2	11.4
Current account balance (% of GDP)	-3.2	0.7	2.8	1.3	-0.7	0.0	0.2
Goods & services exports (% GDP)	10.1	9.5	13.5	17.1	15.0	13.2	12.0
of which: oil and gas exports (% GDP)	8.7	7.9	11.3	14.7	12.8	11.2	10.2
Goods & services imports (% GDP)	14.8	11.6	13.6	18.0	18.2	15.5	13.9
Net income and transfers (% GDP)	1.5	2.8	2.8	2.3	2.6	2.3	2.1
of which: remittances (% GDP)	4.2	4.8	5.8	6.1	5.5	5.0	4.5
GDP per capita (annual percent change, real LCU)	0.0	-4.1	-1.8	-0.7	-0.6	-0.5	-0.5
Oil price (Bonny light, US\$)	54	45	55	72	65	63	64
Oil production (mb/d)	2.1	1.8	1.9	1.9	2.1	2.1	2.1
<i>Fiscal and Debt Indicators</i>							
<i>(Percent of GDP, unless indicated otherwise)</i>							
Federal government							
Revenue	2.7	2.0	2.4	2.8	2.5	2.5	2.3
Expenditure	5.0	4.7	5.6	6.1	6.4	6.1	6.0
Fiscal balance	-2.2	-2.7	-3.2	-3.3	-3.9	-3.6	-3.7
Debt	10.8	13.1	14.7	15.2	17.7	19.6	21.4
<i>Interest (% of GDP)</i>	1.1	1.2	1.4	1.7	1.8	1.9	2.0
<i>Interest (% of revenue)</i>	39	61	57	60	72	75	88
<i>Debt (% of revenue)</i>	395	654	622	545	713	788	924
General government							
Revenue	7.5	5.9	6.7	7.8	7.5	7.0	6.6
Spending	10.7	9.7	10.6	12.2	12.4	11.6	11.2
Fiscal balance	-3.2	-3.8	-3.9	-4.4	-4.9	-4.6	-4.6
Debt	14.2	17.3	19.0	19.2	22.3	24.6	26.9

Source: World Bank calculations based on data from Nigerian authorities.

but the improvement will mask a contraction in both exports and imports relative to GDP. In 2019, with capital imports rising, the current account is expected to be in deficit, recovering in the medium term to a small surplus. Exports, which remain dominated by oil, are expected to moderate in line with the lower prices and stable production outlook, but oil will continue to be vulnerable to shocks, theft, and attacks. Imports, after increasing in H1 2019 because of the capital imports, are expected to decline, returning to more subdued levels observed in 2018, with possible further policy measures aiming to spur domestic industrialization. The food import bill, which is equivalent to about 10 percent of goods imports, is likely to decline due to tighter forex restrictions on a widening range of imports, including meat, rice, vegetables, oils, and tomato paste. Fuel imports, which account for about 30 percent of all goods imports, are expected to remain high and to exceed domestic consumption, as the fuel subsidy will continue to encourage smuggling to neighboring countries. Capital imports are expected to exceed 2017–18 levels, as the growth of import-substitution industries boosts imports of machinery and other capital goods. Remittances, which are equivalent to about 50 percent of oil and gas export earnings,²² are expected to keep growing as Nigerians seek jobs abroad.

Measures that increase the effectiveness of monetary policy would strengthen macroeconomic management. A review of policies and programs aimed at encouraging commercial banks to lend to the private sector through regulations on minimum loan-to-deposit ratios or directed lending by the CBN or supporting import-substitution through forex restrictions and import bans would help assess the efficiency and efficacy, and potential unintended effects, on credit, inflation, reserves, and exchange rate stability. Inflation is expected to remain high in 2020 around 12 percent in a context of import-substitution policies and border closures that are expected to increase the prices of some tradable goods.

Further efforts to increase domestic revenues and improve expenditure and debt management would help strengthen Nigeria's fiscal position. If domestic revenues do not rise, the general government's fiscal deficit will remain high at over 4 percent of GDP during 2020–21, and rising debt service will eat into the fiscal space needed to build human and physical capital. If passed, the law raising the VAT rate would mark a positive step in tax policy reform. However, bolder measures to mobilize domestic revenue, such as eliminating the fuel subsidy or rationalizing tax incentives, are needed to push revenue above its current level of 8 percent of GDP. Oil revenues continue to be undermined by discretionary deductions and by the CBN's below-market exchange rate. With oil prices and production expected to remain flat in a context of sustained inflation, oil and gas revenues will shrink as a share of GDP, and without nonoil tax policy reforms, that share will continue to stagnate in real terms. The resulting sustained revenue shortfalls will continue to limit government spending to about 12 percent of GDP, which is not enough to fund desperately needed investments in infrastructure and social development.

The FGN deficit, which constitutes about half of general government spending, is projected to widen to nearly 4 percent of GDP, above the 3 percent limit stipulated in the 2007 Fiscal Responsibility Act. Although the new minimum wage is not expected to have a strong impact, soaring interest payments on the growing public debt and subsidies to the power sector will worsen the deficit. The growth in capital spending seen in H1 2019 is not likely to be sustained in H2, particularly as Nigeria plans to issue no Eurobonds, its usual choice for boosting infrastructure investment. With revenue likely to stagnate in 2019 and to contract relative to the economy in the medium term, FGN capital spending is expected to hold at about 1 percent of GDP—less than its interest payments, which consume 60 percent of its retained revenues. The minimum wage law is expected to have more impact on recurrent spending by the states. Because their borrowing

²² This was the average for 2015–18, when oil prices were relatively low. In 2010–14, when oil prices were high, remittances were equivalent to about 25 percent of oil and gas export earnings.

constraints are higher, however, the cumulative deficits are not expected to exceed 1 percent of national GDP.

Nigeria's stock of public debt and the related interest payments are projected to rise. Although Nigeria's debt, about 20 percent of GDP, may seem low by international standards, its low domestic revenue raises questions about debt sustainability. Nigeria's public debt is growing rapidly with sustained fiscal deficits. The FGN holds more than 75 percent of public debt stock,²³ with the share of external commercial debt rising steadily; cumulative state debt is equivalent to 4 percent of GDP. With no Eurobonds, which constitute external deficit financing, expected in 2019, deficits will be domestically financed, adding pressure to already high domestic interest rates. Mobilizing domestic revenues would help ease debt sustainability constraints arising from high debt servicing cost as a share of low revenues and make more space for productive investments.

Externally, geopolitical risks are contributing to an increasingly volatile environment, highlighting the need to build fiscal and external buffers to mitigate shocks. The World Bank's 2019 edition of *Global Economic Prospects* revised down its 2019 projections by 0.3 pp for global growth and 0.5 pp for growth in SSA; any further slowing would have serious negative spillovers on Nigeria because of both lower external demand for its exports and lower remittances and FDI. The prolonged trade dispute between the United States and China and the ongoing uncertainty surrounding Brexit are generating anxiety about resurgent protectionism, which may adversely affect growth prospects both in Nigeria and worldwide. Moreover, Nigeria's crude oil faces heightened competition from rising US production of light crude, which could cut into demand for Nigeria's key export. The underdevelopment of the Nigerian domestic sovereign bond market amplifies its exposure to hikes in global interest rates.

Risk Scenario: A moderate decline in oil prices could lead to a recession in Nigeria

Due to its dependence on oil, the Nigerian economy is highly vulnerable to a drop in oil prices. The oil sector remains the dominant source of risk for growth of Nigeria's economy, with sustained suboptimal policy decisions aggravating the size of the potential impact on the economy. For example, a sudden decline in oil prices to 2016 levels, sustained for a year, would undermine growth and fiscal balances. And the lack of monetary and fiscal buffers would magnify the impact of any shock to the economy. If oil prices dropped again by about 25 percent in oil prices, down to about US\$50/bbl, the country swing into a recession, with a more difficult recovery path:

- **Impact of a temporary decline in oil price shock on growth:** A direct hit on oil sector value-added could subtract up to 0.5 pp from growth. Yet, the indirect (spillover) effects on external and fiscal balances and the financial sector would be significant, similar to, if not worse, than what happened during the 2016 recession. For some companies an oil price shock would not only reduce their earnings but might even make some high-cost fields unprofitable, which would threaten their ability to service debts to commercial banks. If so, NPLs would rise, causing banks to lend less to other sectors and raising the cost of lending for all. Firms in nonoil industries and services would find it even harder to access finance and would stagnate; those servicing the oil sector would start contracting.
- **Impact on exports and reserves:** The value of oil exports would fall, widening the current account deficit and nibbling away at external reserves. Export earnings would decline by more than 25 percent as less demand for Nigerian crude reduces the volume as well as the unit value of oil exports. A small corresponding decline in the cost of oil imports, which constitute only 20 percent of export value,

²³ Federal government debt as recorded excludes arrears to domestic contractor, which are being recognized through gradual issuance of promissory notes.

would make little impression on the import bill. The current account deficit would widen to about 2 percent of GDP, pushing external reserves below US\$40 billion.

- **Impact on financial flows:** The slippage in external reserves would put pressure on the nominal exchange rate. External portfolio investors could become nervous enough to flee; cashing out their holdings of short-term paper before a likely devaluation would slash external reserves below 2016 levels and intensify devaluation pressure. The banking sector would stiffen, and development of local supply chains would have to be put on hold as financing and import costs spike.
- **Impact on public finances and inflation:** Since the FGN deficit is already twice the size of Nigeria's revenues, the fall in fiscal revenues proportionate to the 25 percent fall in oil prices would virtually eliminate space for infrastructure spending, with obvious long-term repercussions for growth. With no fiscal buffers available—the Excess Crude Account balance is less than US\$0.5 billion—and no likelihood of external borrowing as investor confidence drops because of uncertainty over Nigeria's policy response (steep devaluation or introduction of capital controls), deficits would have to be financed domestically, sending the cost of borrowing soaring.
- **Overall impact of the shock:** Given the small size of the sector (10% GDP), the direct impact of oil sector contraction would be relatively small, about 0.5 percentage points. But because there are no buffers, the nonoil economy could contract by more than in 2016, with the economy as a whole shrinking by more than 2 percent. Inflation would shoot up. The monetary and fiscal authorities would have little room to maneuver in making policy decisions.
- **Recovery** would be slow in the absence of structural reforms, even if the oil price rebounded by about 15 percent as the global economy recovers.

The articulation and bold implementation of structural reforms would boost the growth of the economy. Reforms that could have a significant impact on the economy's trajectory in the short-term are the removal of subsidies with adequate social protection for the most vulnerable, review of the measures aiming to spur industrialization and through which institutions they are channeled, greater transparency and predictability of monetary policy, and increased domestic revenue mobilization. Such reforms would help improve investor confidence and raise living standards of low-income groups while increasing spending on much needed public services. The special chapter of this report on boosting productivity for growth and jobs articulates the priority reforms in more detail. The Box 1.4 provides an overview of the potential growth-catalyzing effects of the digital economy reforms.

Box 1.4. Digital Economy Reforms for Nigeria's Economic Transformation

By leveraging ICT, Nigeria has the potential to diversify its economy and create jobs for its youth. Digital financial services alone could be transformative, creating more than 3 million new jobs in the next few years.

The country currently uses only 4 percent of its Internet capacity. At the end of 2018 fixed broadband had a household penetration rate of 0.04 percent, below the Sub-Saharan African (SSA) average of 0.6 percent and far below the world average of 13.6 percent (ITU 2018). According to ITU, mobile broadband (3G) coverage reaches 54 percent of the population, against the SSA average of 62.7 percent (ITU, 2018); 4G coverage is also very low and concentrated in urban areas. According to *The State of ICT in Nigeria 2018* there is a serious digital gap in mobile broadband, with just over 20 percent of Nigerians owning a smartphone, 45 percent a feature phone, and 32 percent a basic phone. The gender gap in mobile phone ownership is also significant, with a higher probability of mobile phone ownership among men than women. In 2018, 19.9 percent of Nigerians used their cellphone to connect to the Internet. Overall Internet usage in Nigeria stands at 27.7 percent—above the 22.1 percent average for Africa (ITU 2018).

Nigeria lacks digital skills, ranking 121st out of 139 countries in the Global Competitiveness Report's assessment. Thus, the poorest are excluded from the benefits of the digital world. Of the total population of around 200 million, the labor force is estimated to be about 90 million, with a literacy rate of 51 percent. Although Nigeria does not participate in international or regional student assessments, after completing grade 4 only 66 percent of public-school students can read at least one of three words and only 78 percent can add single digits; Nigeria trails Ghana, Kenya, and Senegal in the quality of its math and science education. Such shortages of foundational skills will make it difficult for Nigeria to heighten digital literacy and will lower the chances it can take advantage of the opportunities the digital economy offers.

Nigeria's Economic Recovery and Growth Plan (ERGP) demonstrates the Government's intent to support development of the digital economy. It adopted the *Nigeria ICT Roadmap 2017–20*, and the *Nigeria ICT Innovation and Entrepreneurship Vision* (NIIEV) was released in 2018. NIIEV sets up three ambitious goals to be achieved by 2025: (1) access to broadband Internet available to 95 percent of the population; (2) 75 percent digital literacy nationally; and (3) ICT contributing 25 percent of GDP.

Through reforms in the digital economy, Nigeria can catalyze private investment and job creation. Such reforms would include deployment of wholesale, carrier-neutral, shared infrastructure to increase 4G deployment, creation of a Wholesale Open Access Network (WOAN), simplification of digital rights of way, digitalization of all government payments, formal teacher training in the use of technology to enhance learning, seeking global partners to gain global standard certification for local ICT, and better regulation of mobile money.

Reference: World Bank (2019). *Digital Economy for Africa (DE4A) Diagnostic*. Washington, D.C.: The World Bank.

Figure 2.3. A moderate and temporary decline in international oil prices...

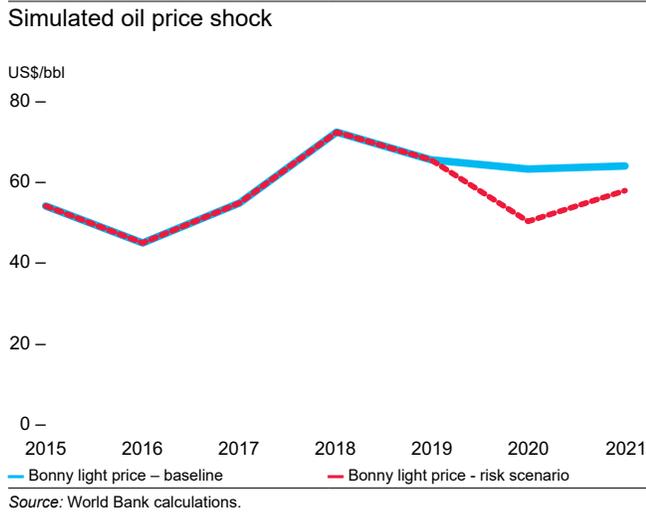
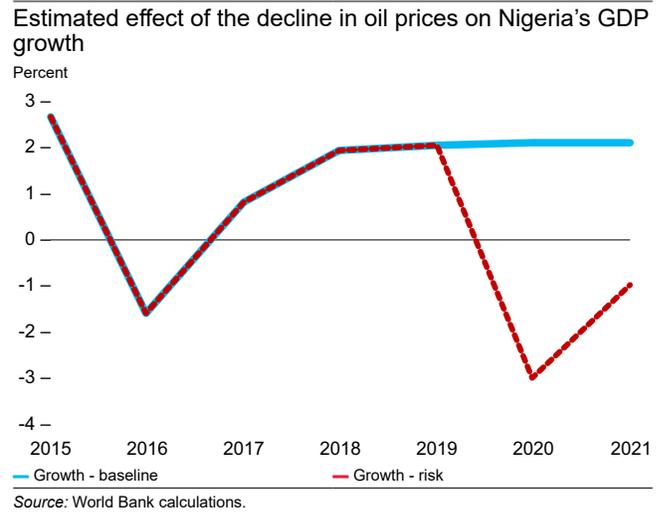


Figure 2.4. ...would have a significant negative impact on GDP growth in Nigeria



Chapter 3: Boosting Productivity to Accelerate Growth and Job Creation

“Productivity isn't everything, but, in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.”

—Paul Krugman, Nobel Laureate, Professor of Economics at the City University of New York and columnist for The New York Times

Introduction

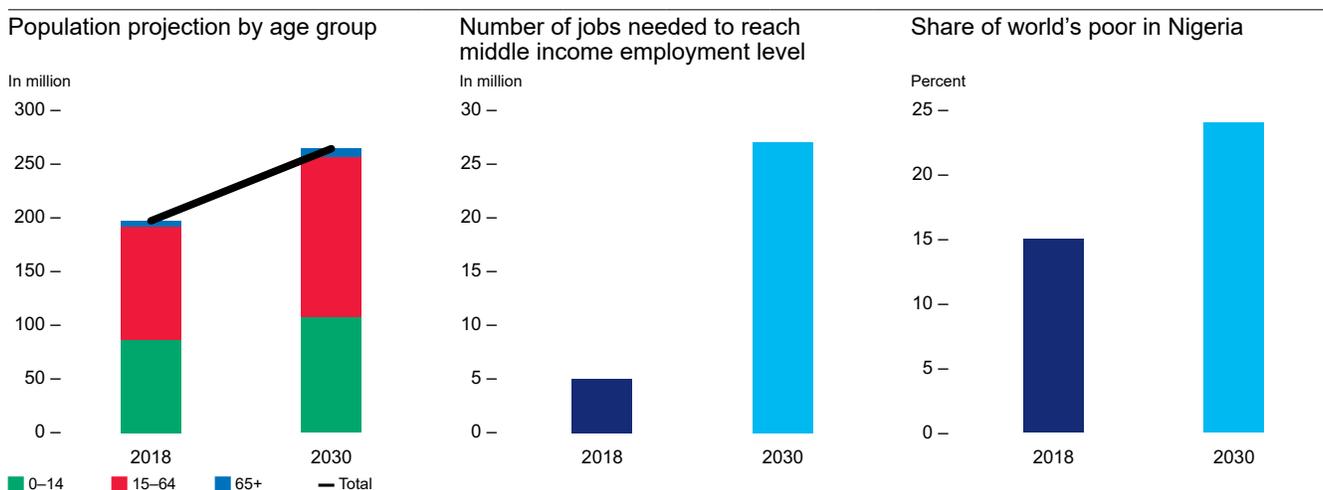
The Nigerian government aspires to enable 100 million people to escape poverty over the next decade; achieving this ambitious goal will require bold reforms designed to boost economic productivity.

Nigeria's growth and jobs challenges stem from its low levels of productivity. Productivity reflects the relative efficiency and intensity with which inputs are used in the production process. In other words, it measures how successfully the economy transforms land, labor, capital, and other inputs into goods and services. Policymakers and analysts focus on productivity because a country's

productivity growth rate can have major implications for economic growth, job creation, and living standards. Nigeria's productivity indicators are low compared to those of peer countries, and slow or negative productivity growth rates in recent years have hindered overall economic growth.

The returns to recent growth have been concentrated among wealthier households in urban areas and have done little to reduce poverty. Half of Nigeria's population (or about 100 million people), lives in extreme poverty. Unless the pace of growth and job creation accelerates, by 2030 the number of Nigerians living in extreme poverty could increase by more than

Figure 3.1. Nigeria's Business-as-Usual Scenario: Projected Population Growth, Required Job Creation, and Share of the World's Poor, 2018–30



Source: World Bank calculations based on data from NBS, UN Population Division, and World Poverty Clock.

30 million, and Nigeria would account for a quarter of all people living in extreme poverty worldwide (Figure 3.1).

Creating opportunities for Nigeria's rapidly expanding labor force will require a new economic model based on productivity growth. The country's working-age population is projected to grow by 35 million over the next decade. Demographic pressures and rapid urbanization are intensifying competition for scarce fiscal, economic, and environmental resources. If too few jobs are created, the risk of social instability could rise, especially in urban areas and in the conflict-affected north. The World Bank's 2019 Nigeria Systematic Country Diagnostic highlights that achieving income convergence with advanced economies will require that Nigeria maintain macroeconomic stability while shifting its growth drivers from consumption and public spending to investment and nonoil exports. A strong private sector will be crucial to support productivity gains and job creation.

Without robust productivity growth, poverty in Nigeria will continue to rise, and living standards will continue to deteriorate. Given the current levels and trajectory of human and physical capital investment, increasing the efficiency with which the economy transforms inputs into outputs will be vital to ensure sustainable economic growth underpinned by robust job creation. If labor productivity remains on its current path, workers will not be able to earn enough to reduce the number of Nigerians living below the poverty line.

This chapter analyzes the evolution and determinants of productivity in Nigeria.²⁴ It begins by describing labor and multifactor productivity trends in Nigeria and comparator countries, examines differences in the intensity with which different inputs are used, and explores patterns of growth in total factor productivity (TFP) across countries (see Box 3.1 for definitions of

productivity).²⁵ The analysis uses both development accounting exercises and a growth decomposition to find the sources of Nigeria's economic growth per worker over the past 50 years. The decomposition quantifies the shares of growth attributable to physical and to human capital and illuminates the influence of public investment and natural resources. The analysis assesses trends in labor productivity by sector and distinguishes between manufacturing and nonmanufacturing activities in the industrial sector, and between market and nonmarket services in the tertiary sector. Using data on labor productivity and labor shares, the analysis examines changes in resource allocation by sector over the past several decades. After identifying the institutions and policies that affect productivity growth and those that drive misallocation of resources, it concludes with recommendations for improving labor productivity and increasing the efficiency of the economy.

The analysis highlights four priority areas for policy action. Sustainably accelerating productivity growth will require comprehensive reforms to fiscal, monetary, and trade policy, plus measures to improve the business and investment climate and strengthen Nigeria's public institutions. Given the country's limited institutional capacity, effective prioritization is critical to the success of any reform agenda. Actions in the following areas will lay the groundwork for Nigeria's transition to a new economic model based on efficiency improvements and diversification beyond the extractive industries:

1. **Promoting policy transparency and predictability** will create the certainty necessary to make effective long-term economic decisions, reduce investment risk, and promote sustainable growth outside the extractive industries.
2. **Enhancing factor quality** by investing in infrastructure, making land tenure more secure, improving educational outcomes and building skills, and liberalizing the trade regime will facilitate the

²⁴ The emphasis of the analysis is on resource misallocation. In seminal work, Restuccia and Rogerson (2008) and Hsieh and Klenow (2009) have argued that the microstructure of firms in different sectors of the economy can help to explain the development gap between rich and poor countries. Aggregate total factor productivity is influenced by (1) how productivity is distributed across production units and how those units allocate resources (e.g., how manufacturers allocate capital and labor), and (2) the number of firms per capita (Hopenhayn 2014). In this context, institutions and policies that impede the systematic redistribution of resources from less to more productive agents will worsen TFP. Restuccia and Rogerson classify these types of policies and institutions into two groups: (1) regulation that affect such discretionary choices as firing costs, size-dependent policies (e.g., subsidies to SMEs), labor and product market regulations, state-owned enterprises, and restrictions on land markets; and (2) market imperfections, such as trade policies, mark-ups, credit constraints, imperfect information, and insurance.

²⁵ The analysis presented in this section draws on a forthcoming World Bank report, "Boosting Productivity in Sub-Saharan Africa," by Cesar Calderon.

Box 3.1. Defining Productivity

This analysis focuses on two aspects of productivity: labor productivity and total factor productivity (TFP).

Labor productivity measures the value of the output generated by a single worker and allows for simple cross-country comparisons. For example, if the United States (US) and Nigeria produce the same good, and Nigeria's labor productivity is 10 percent that of the US, then a worker in the US would produce ten units of the good in the same time it takes a Nigerian worker to produce one. The growth of marginal labor productivity is defined as the percentage change in real output per worker from one year to the next.

TFP measures the efficiency with which inputs are transformed into outputs. TFP is the difference between the aggregate value of the labor and capital used in production and the aggregate value of the goods and services produced. In cross-country comparisons, TFP indicates differences in economic output that are not accounted for by differences in the supply of human, physical, and natural capital.

efficient reallocation of factors and make Nigeria more cost-competitive.

3. **Reducing regulatory discretion** will alleviate constraints on market entry and formalization, promote competition, and sharpen incentives to improve productivity.
4. **Improving access to finance** will help establish a competitive playing field that enables new firms to compete with incumbents and allows more-productive firms to scale up their operations.

The Evolution of Productivity in Nigeria

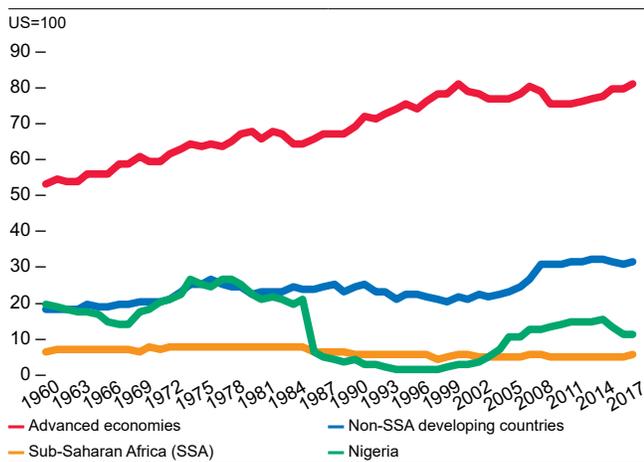
Low productivity growth combined with rapid population growth are causing Nigeria's per capita GDP to contract. As ever-larger cohorts of new workers enter a private sector marked by slow-growing capital stock, persistent allocative inefficiencies, and inadequate infrastructure, Nigeria's labor productivity is falling further below the levels of both advanced economies and developing countries outside Sub-Saharan Africa (SSA).²⁶ Despite the robust GDP growth rates recorded

between 2000 and 2014, the output of the average Nigerian worker fell from 26 percent of the average US worker in the 1970s to just 15 percent in 2010–14; one of the worst declines in a region where labor productivity has been slipping steadily in relative terms (Figure 3.3). Meanwhile, most non-SSA developing countries narrowed the gap with advanced economies, underscoring Nigeria's competitiveness challenges (Figure 3.2 and Figure 3.3).

The accumulation of physical capital during oil-revenue booms has not generated substantial gains in Nigeria's TFP or labor productivity; instead, it has led to structural economic changes that have exacerbated inefficiency and driven a decline in capacity utilization. Whereas in advanced economies and non-SSA developing countries, growth over 1961–2017 was at least partly driven by improvements in TFP, in Nigeria growth relied almost entirely on capital accumulation (Figure 3.4 and Table 3.1). Instead of enhancing growth, the contribution of TFP in Nigeria has been negative for much of the last 60 years, indicating a decrease in the efficiency with which productive resources are utilized, and undermining the positive impact of capital accumulation.

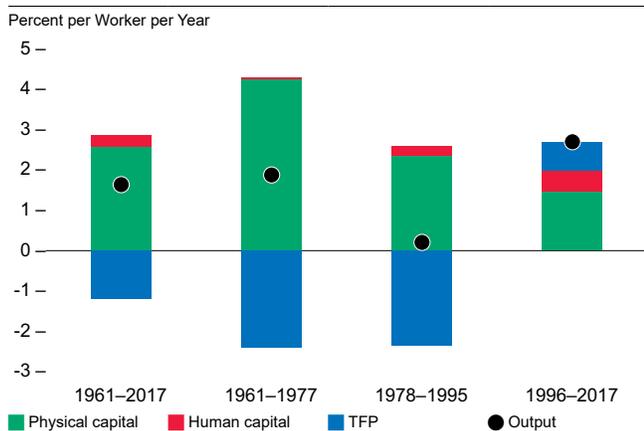
²⁶ The frontier is proxied by the United States. Figure 3.2 plots the labor productivity (that is, real output per worker, PPP) of Nigeria and other country groups as a share of US labor of productivity (output per worker).

Figure 3.2. Aggregate Labor Productivity Relative to the United States, 1960–2017



Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1 data.
 Note: Relative output per worker uses real GDP at 2011 US dollars (PPP). Regional averages are employment-weighted.

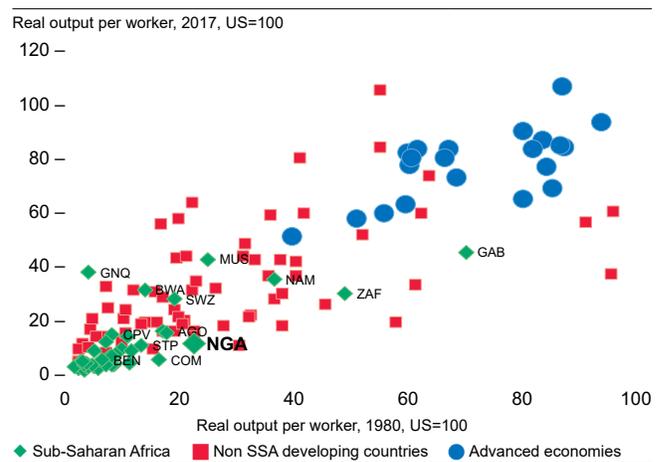
Figure 3.4. Traditional Solow Growth Decomposition, 1961–2017



Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1.
 Note: Growth = growth in real GDP per capita per worker.

From 2001 to 2011, Nigeria, breaking with the previous trend, enjoyed a decade of consistently positive TFP growth, but this period ended in 2012, and in the recent recession TFP contracted abruptly (Figure 3.5). Since 1960, Nigeria has experienced four periods of negative TFP growth (1960–69, 1976–84, 1991–2000, and 2012–18) and three periods of positive growth (1970–75, 1985–90, and 2001–11). The most recent period of positive TFP growth, 2001–11, was supported by stable macroeconomic policies and major economic and governance reforms, among them privatization of SOEs, civil-service reforms, enhanced

Figure 3.3. Output per Worker, Nigeria and Comparators Relative to the United States, 1980 vs. 2017



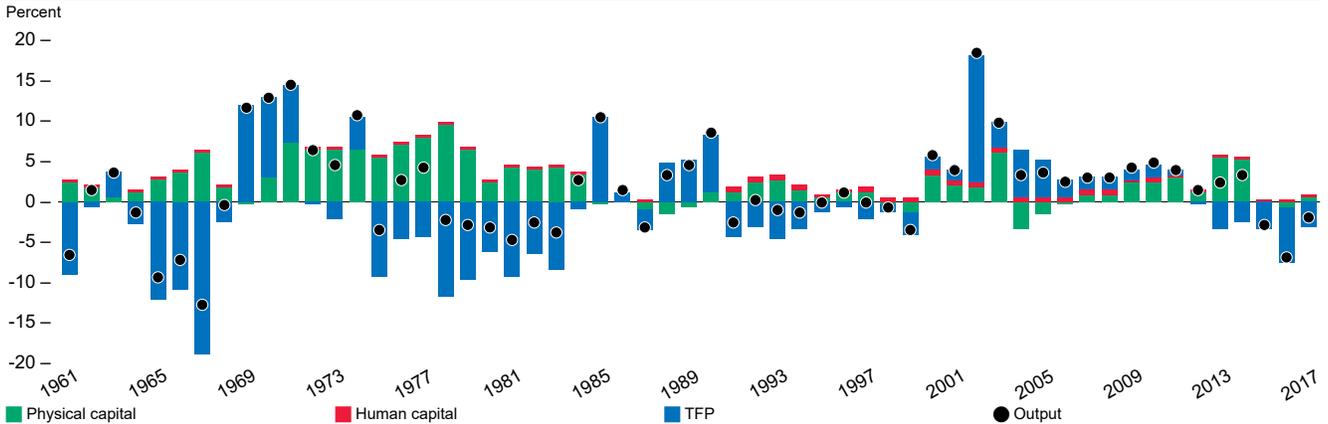
Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1 data.
 Note: Relative output per worker uses real GDP at constant 2011 US dollars.

Table 3.1. Traditional Solow Growth Decomposition, 1961–2017

Percent per Worker per Year	GDP Growth	Human Capital	Physical Capital	TFP
1961–2017	1.7	0.3	2.6	-1.2
1961–1977	1.9	0.0	4.2	-2.4
1978–1995	0.2	0.2	2.3	-2.4
1996–2017	2.7	0.5	1.5	0.7

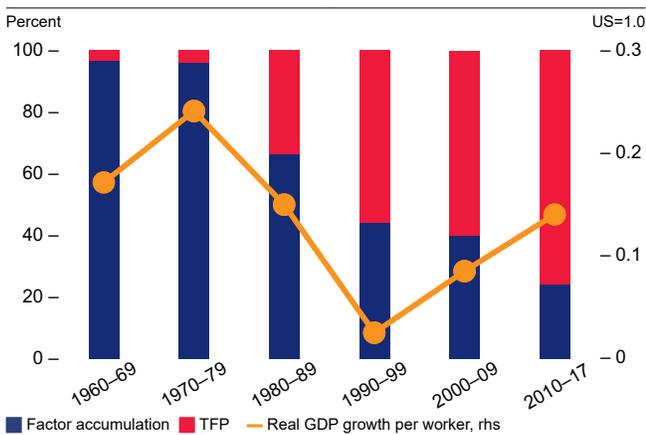
banking-sector supervision, and trade reforms. Nigeria experienced its greatest surge in productivity growth during this period, when there were efforts to build up political institutions and expand economic inclusion as the country moved from military rule to democracy. Most governance indicators improved moderately, demonstrating the importance of institutional quality. However, after the collapse of global oil prices in 2014, compounded by an inadequate macrofinancial policy response, productivity again began to contract; and after the 2016 recession TFP deteriorated dramatically, underscoring the fragility of Nigeria’s growth model.

Figure 3.5. Growth Decomposition in Nigeria, 1961–2017



Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1.
 Note: Growth in real GDP per worker is decomposed into contributions from physical capital, human capital and total factor productivity (dtfp).

Figure 3.6. Contributions to the Output per Worker Growth from Factor Accumulation and TFP, relative to the US, Nigeria, 1960–2017

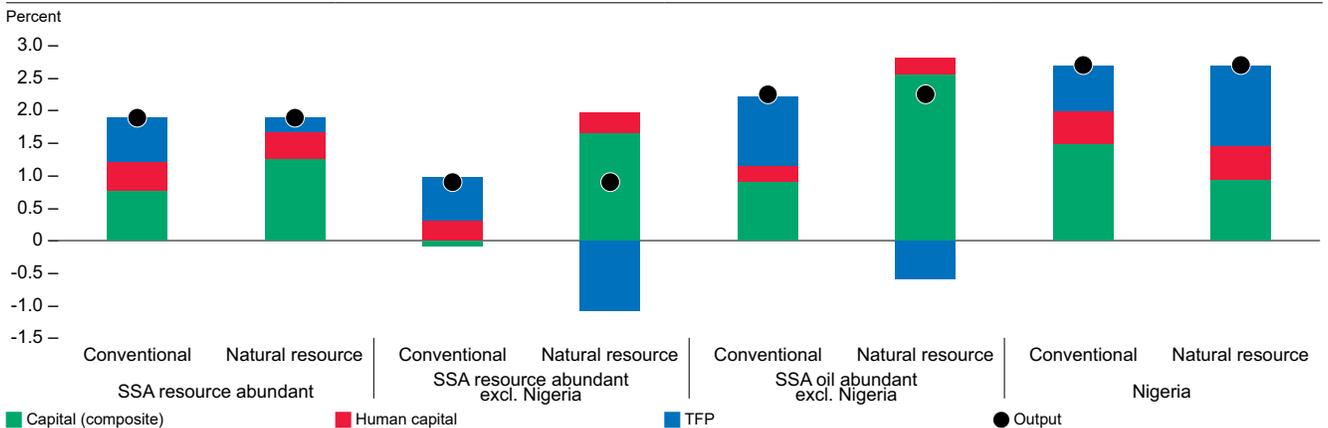


Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1.

Low growth of TFP is driving Nigeria’s continued divergence from advanced economies (Figure 3.6).

From the 1960s through the 1980s, the gap in output per worker between Nigeria and advanced economies primarily reflected Nigeria’s lower base levels of physical and human capital and the slow process of capital formation. Since the 1980s, however, that gap in labor productivity has been primarily attributable to Nigeria’s slow rate of TFP growth: Nigerian workers are now less productive primarily because the Nigerian economy is becoming less efficient at transforming labor, capital, and other productive factors into goods and services. The differences seen in TFP likely reflect greater inefficiencies in the use of production inputs by firms—a hypothesis widely supported by the international literature on

Figure 3.7. Growth Decomposition: Conventional and Natural Resource-Reflective Methodologies, Nigeria and Comparators, 1996–2017



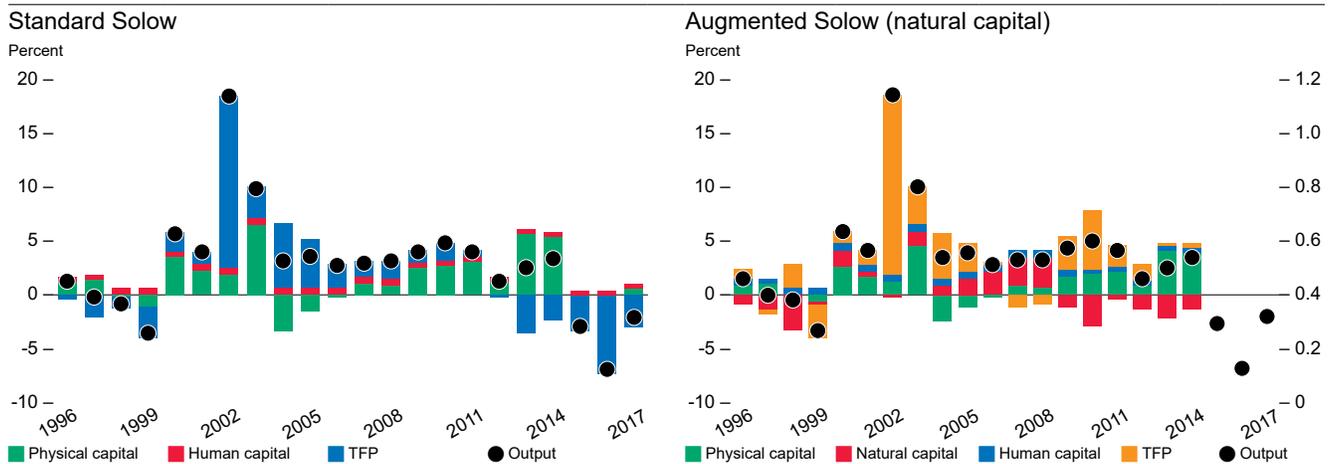
Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1, and Lange et al. (2018).
 Note: Growth in real GDP per worker is decomposed into contributions from physical capital, natural capital, human capital and total factor productivity. Data on natural resource wealth is available until 2014 only.

misallocation of resources. In other words, low levels of TFP suggest that inefficient allocations of labor and capital are inhibiting the transformation of the Nigerian economy.

By conventional measures, since 1990s TFP has been a positive contributor to growth in Nigeria, and its influence increases when natural capital is accounted for (Figure 3.7). This finding is counterintuitive; it suggests that natural resources detract from growth. Accounting for natural resources typically boosts the contribution of total capital stock to growth, and since TFP is calculated as the residual, an increase in the contribution of capital is offset by a

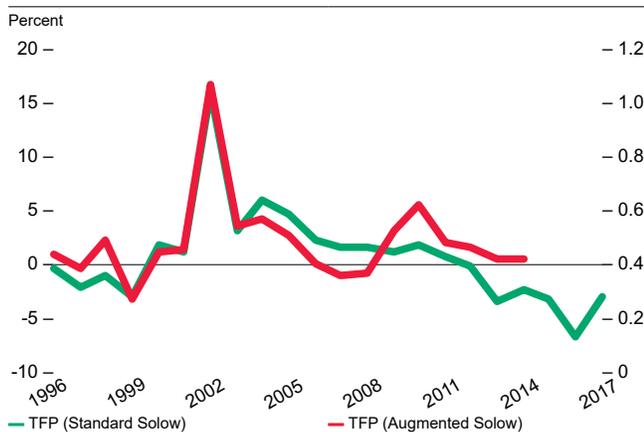
corresponding decrease in TFP. In Nigeria, however, including natural resources shrinks the capital stock and causes a commensurate increase in TFP. This might be attributed to a combination of greater sensitivity of the valuation of natural resource wealth in Nigeria to oil price fluctuations and depletion or reduction of resources in times of declining prices. (Figure 3.10). Since 1996, steep drops in oil prices have repeatedly dragged the contribution of the resource sector to total physical capital into negative territory. The opposite pattern prevails among comparator groups because their aggregate resource sectors are much more diverse and far less vulnerable to a single, highly volatile commodity market.

Figure 3.8. Growth Decompositions, Traditional and Accounting for Natural Capital, 1996–2017



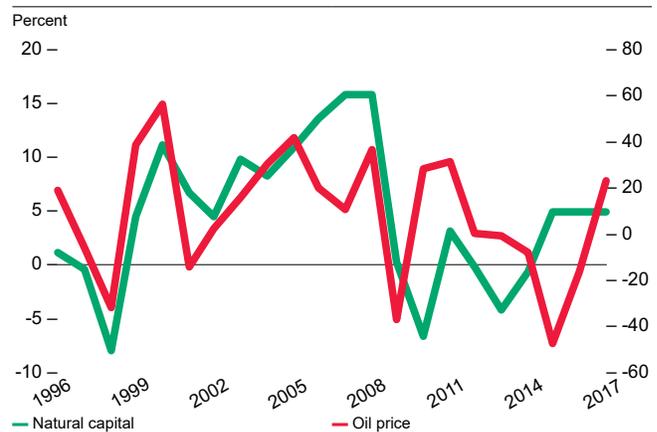
Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1, and Lange et al. (2018). Note: Growth in real GDP per worker is decomposed into contributions from physical capital, natural capital, human capital and total factor productivity. Data on natural resource wealth is available until 2014 only.

Figure 3.9. Changes in TFP, Natural Capital and Standard Solow Models, Nigeria



Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1. Notes: Figure 3.9 plots the TFP from Standard Solow decompositions and the model augmented with natural capital. Figure 3.10 plots the annual changes in the measure of natural wealth (dt) and nominal oil price.

Figure 3.10. Changes in Natural Capital stock and Oil Prices, Nigeria

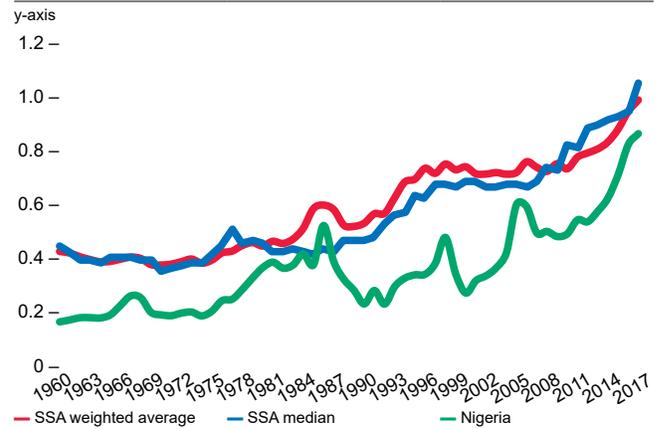


Drivers of Productivity in Nigeria

As well as reflecting the progressive accumulation of human and physical capital or improvements in the efficiency with which those factors are used (productivity), changes in Nigeria's per capita income are driven by fluctuations in oil prices. The capital-output ratio is often used to highlight the relationship between the value of capital invested in the economy and the consequent increase in GDP because it shows the amount of capital used to produce one unit of output. In Nigeria, the productive capacity of the economy varies with oil-price movements, and the oil sector's influence on the capital-output ratio contributes to a vicious cycle of underinvestment and volatility (Figure 3.11). The oil boom drove a steep increase in economic inefficiency as the capacity utilization rate fell from about 80 percent in the mid-1970s to 40 percent by 1984 (Sala-i-Martin et al. 2012). In the early 1960s, Nigeria's capital-output ratio was much lower than the SSA average, indicating that productive efficiency was relatively high. Over time, however, that ratio has steadily converged with the regional average, illustrating the erosion of Nigeria's competitiveness against comparable economies.

Nigeria's stock of natural capital—specifically its oil and gas reserves—has influenced the evolution of both its economy and government institutions. While at first the extractive industries seem to have made a positive contribution to growth, the effect vanishes when their impact on institutional quality is accounted for. Natural resource rents are a valuable income stream, but without adequate institutional checks and balances, competition between interest groups can promote patronage and clientelism, encouraging corruption and even violence. The corrosive effects of the “resource curse” on public institutions can discourage productive investment and inhibit long-term growth of nonresource sectors, intensifying the economy's dependence on natural resources (Badinger and Nindl 2014; Beck et al. 2000; Holder 2006; Lane and Tornell 1996; Mehlum et al. 2006; Raggl 2017). Nigeria experienced its

Figure 3.11. Capital-Output Ratios, Nigeria and SSA Averages, 1960–2017



Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1.

greatest surge in productivity between 2000 and 2011, a period marked not only by increasing (if volatile) oil prices, but also by economic reforms and efforts to create more inclusive political institutions as the country moved from military rule to democracy. At that time, most governance indicators improved moderately, demonstrating the importance of institutional quality for productivity growth.

Policy measures have exacerbated the misallocation of capital and labor by sector, accelerating the decline in economic efficiency. As detailed below, inefficient distribution of productive factors affects aggregate output and productivity through three channels: technology, selection, and misallocation. The institutions and policies driving misallocation can generate additional inefficiency through both the selection and technology channels. Meanwhile, discretionary subsidy policies, deficiencies in taxation and regulation, and imperfections in credit and land markets also contribute to misallocation of resources.

The government's dependence on volatile oil revenues and limited institutional capacity make the public sector less effective. In the absence of fiscal buffers, macroeconomic policy is not capable of mitigating oil-price volatility, which is transmitted directly to government spending and household consumption.

Revenue volatility undermines the efficiency of public spending through project delays and cost overruns. Erratic public spending destabilizes employment and undermines private investment, inhibiting the accumulation of private capital and slowing growth of the nonoil economy. The government’s approach to macroeconomic management obstructs economic diversification, narrows the revenue base, and intensifies dependence of the public sector on oil, which further undermines the quality of public policies and erodes the capacity of institutions.

The decline in labor productivity reflects persistent underinvestment in both physical and human capital. Among oil-rich countries in SSA, for the past half century accumulation of physical capital has overwhelmingly driven economic growth, with public investment making a much larger contribution than private. Yet in Nigeria, this pattern has been inverted: capital accumulation has made a smaller contribution to growth than in comparable countries, with both private investment and public investment levels and stocks below comparative averages (Figure 3.12 and Figure 3.13). Among resource-rich countries in SSA, for the past three decades public capital has contributed an average of 36 percent to the growth of labor productivity, compared to 21 percent attributable to growth in private capital; in Nigeria, public capital has contributed only

10 percent, and private investment has driven 39 percent of growth per worker. Investment needs are increasing as many young Nigerians enter the labor force.

Low rates of public investment have contributed to a vast infrastructure deficit, which slows growth and exacerbates the misallocation of productive resources.

For instance, Nigeria’s road network is extensive, but its condition is generally poor, especially in rural areas. Deficiencies in transportation infrastructure increase logistical and transaction costs, restrict factor mobility, and slow the process of economic transformation. In both rural and urban areas, deficiencies in transportation networks impose constraints on household access to economic and social opportunities. Similarly, a limited and unreliable power supply worsens allocative inefficiencies and makes it harder for poor households to maximize the value of their labor. About 80 million Nigerians have no access to electricity, and despite recent privatization measures, the power supply is still inadequate and unreliable because weak governance and erratic contract enforcement combine to undermine operational efficiency and financial viability.

A combination of public-sector debt and the concentration of commercial loans in the extractive industries is crowding out credit to the nonoil private sector. High rates offered on government

Figure 3.12. Public and Private Capital Stock, Nigeria and Comparators, 2017

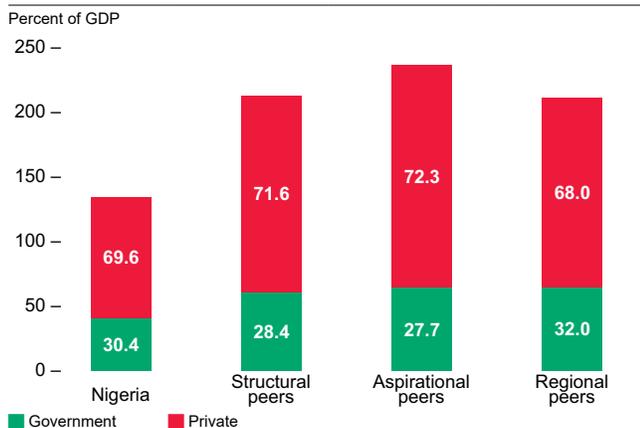
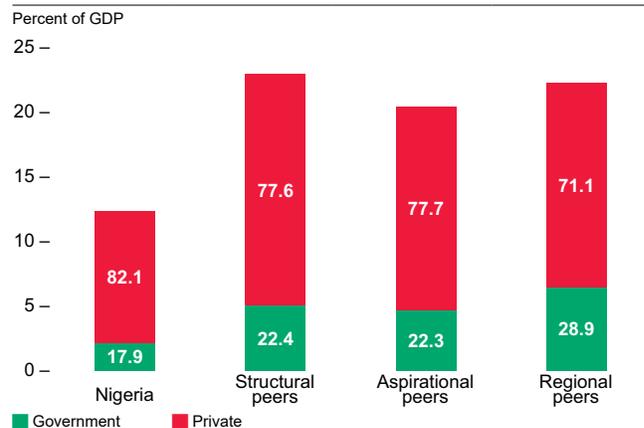
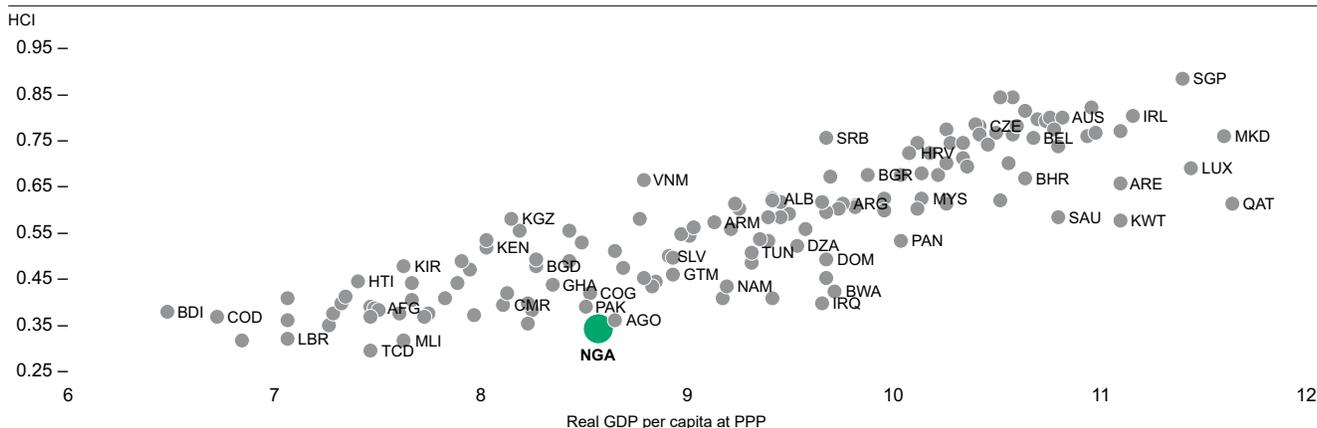


Figure 3.13. Public and Private Investment, Nigeria and Comparators, 2011–17



Source: World Bank calculations based on Calderon (forthcoming) using Penn World Tables 9.0 and 9.1.
 Note: The data labels indicate the share of private/public investment or stock in the total investment or stock.

Figure 3.14. Human Capital Index Scores and Real GDP per Capita, Nigeria and Comparators, 2017



Source: World Bank Human Capital Index.
 Note: GDP per capita values are in logs.

and central bank securities, in the context of complex monetary policy, high inflation, and no way to register collateral, among other factors, reduce commercial bank willingness to lend to nonoil sector entities. The level of domestic credit in Nigeria is below that of both its structural and aspirational peers. Moreover, the volatile oil and gas sector continues to take-up about one-third of total industry lending. Distortions in financial markets can lead to misallocation of capital and reduce aggregate productivity by creating barriers to entry in specific sectors, discouraging adoption of new technologies, and creating differentials in producer returns on capital.

Foreign direct investment (FDI) is low, limited by the slow recovery of domestic consumer demand, trade restrictions, and policy uncertainty. FDI is negligible relative to foreign portfolio investment (FPI), and, like the domestic credit supply, it goes primarily to the oil sector. The economy’s increasing reliance on FPI is costly and increases the exposure of Nigeria’s foreign reserves to external and domestic shocks. The country’s external position is now doubly sensitive to oil-price fluctuations: declining oil prices would not only reduce foreign-exchange earnings from oil and gas exports but could also induce capital flight, further deterring FDI.

Slow rates of physical capital formation are compounded by persistently poor education and health outcomes. Nigeria’s human capital indicators

are among the lowest in the world—far below what its per capita GDP would predict. It ranked 142nd of 157 countries in the World Bank’s most recent Human Capital Index (HCI), outperforming only Chad, Liberia, Mali, Niger, and South Sudan in SSA. Gains in educational attainment are usually associated with accelerated economic growth, especially in countries with low GDP per capita, but Nigeria’s educational outcomes have improved very slowly. Between 1999 and 2011, the share of Nigerians with at least some secondary education rose from 25 to about 35 percent, and since 2010 average years of schooling for Nigerians aged 15 and above have risen from 5.1 to 6.1 (Cohen and Soto 2007). However, based on the HCI, a child born in Nigeria today will only realize 34 percent of her productive potential by age 18, and Nigerian children are especially vulnerable to stunting as well as poor learning outcomes (Figure 3.14). As Nigeria’s human capital base is relatively small, modest improvements in the quality of health and education spending could have a highly positive impact on future economic growth and labor productivity.

Greater investment in human capital will be vital to support sustainable and inclusive growth. In 2016, recurrent spending on public health was just US\$16 per capita, far below the SSA average of US\$40 and the lower-middle-income country average of US\$26. Today education accounts for only 12 percent of government

spending, but Nigeria would need to raise that to at least 20 percent if it is to achieve its sustainable development goals for education. Investing more in vocational training and workforce skills development could enable Nigerian firms to more effectively leverage the productive potential of new technologies.

While physical, human, and natural capital are each important for economic growth, improvements in TFP will be essential to Nigeria’s long-term development. The country’s incomplete economic transformation is a major obstacle to inclusive growth and poverty reduction, and the productivity gaps between sectors, even when the resource sector is excluded, suggest that the Nigerian economy is not fully leveraging potential productivity gains from reallocating labor and capital, let alone improvements in within sector productivity. Policies designed to boost productivity in agriculture and remove constraints on factor mobility could not only accelerate growth but also enhance the allocative efficiency of Nigeria’s physical, financial, and human capital.

Resources and Incomplete Economic Transformation

Despite its relatively modest direct contribution to growth, the resource sector exerts an outsized influence on the Nigerian economy. Oil dominates both export earnings and public revenue, and it has profoundly influenced how other sectors have developed. Oil rose from just 3 percent of total merchandise exports in 1960 to over 90 percent in 1974, and from the 1970s through 2012 it accounted for about 80 percent of total export receipts.

Decades of oil-driven growth favored development of services at the expense of manufacturing.²⁷ In 2014, the collapse of global oil prices coupled with a drop in production caused the oil sector to contract, and the growth rate of market services plunged (Figure 3.15 and Figure 3.16). Manufacturing fared even worse in absolute terms, experiencing a small but significant contraction over 2015–18. Agriculture proved more resilient, but its output is far below its potential due to conflicts like the Boko Haram insurgency and farmer-herder clashes.

Figure 3.15. Sectoral Contribution to Growth, 2004–14

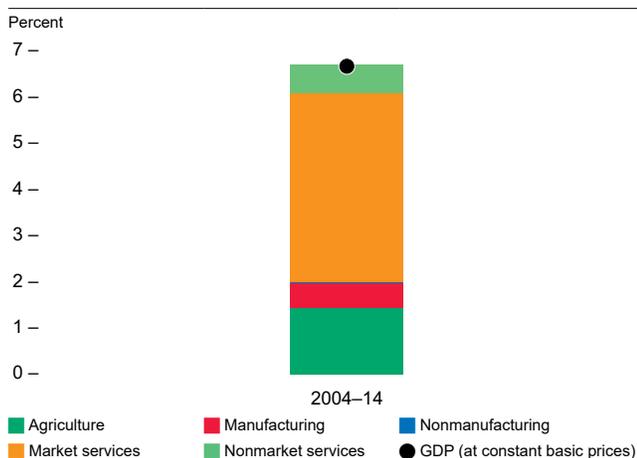
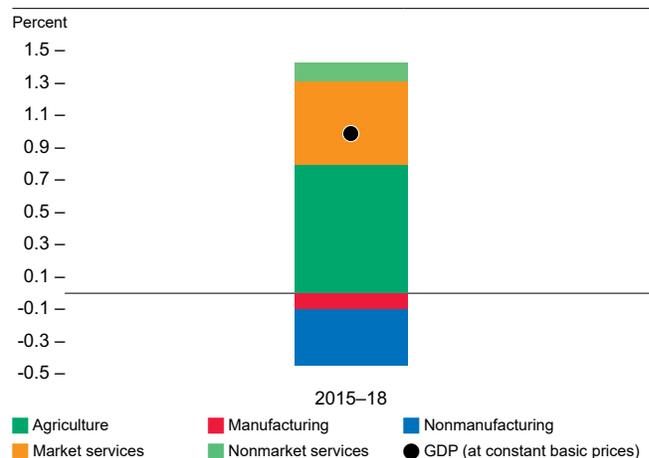


Figure 3.16. Sectoral Contribution to Growth, 2015–18



Source: World Bank calculations using the classification of Barrot, Calderon, and Serven 2018.

Note: Nonmanufacturing industry consists of extractives, utilities, and construction; market services span trade, hospitality, transport, financial, real estate, and other business activities; nonmarket services consist predominantly of the public sector, health, education, and social services.

²⁷ High-value oil exports put upward pressure on the exchange rate, making imports more competitive against domestic products. Diminished external competitiveness discourages investment in manufacturing, agriculture, and tradable services, and rising domestic purchasing power accelerates the growth of non-tradable services. Meanwhile, the large returns offered by investment in the extractive industries draw financial capital away from other sectors, further slowing the evolution of the nonresource economy. First identified in the 1970s, this is the phenomenon known as Dutch disease.

Figure 3.17. Share in Total Employment, 2005–15

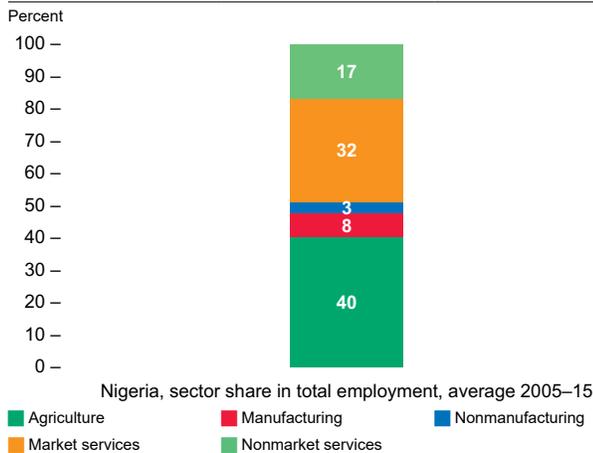
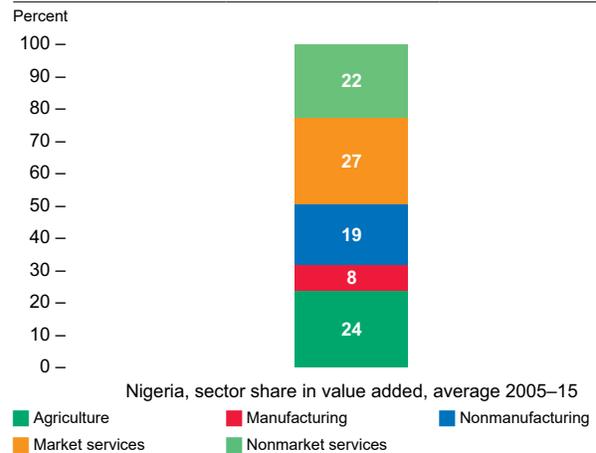


Figure 3.18. Share in Total Value Added, 2005–15



Source: World Bank staff calculations based on Barrot, Calderon, and Serven 2018.

The oil sector has been a factor in the unbalanced development of the urban economy, which is dominated by services (Figure 3.18). Market services account for 32 percent of employment, and nonmarket services, which include the public sector, account for 17 percent (Figure 3.17)²⁸. Meanwhile, manufacturing employs just 8 percent of Nigerian workers. The contributions to GDP of both services and manufacturing are consistent with their shares in total employment. By contrast, nonmanufacturing industry, which includes construction, utilities, and the oil sector, employs just 3 percent of the Nigerian labor force but accounts for 19 percent of GDP.

The incomplete transformation of the Nigerian economy is both a cause and a consequence of its sensitivity to what happens in the oil sector. Agriculture is the country’s largest employer, accounting for 40 percent of its workers (Figure 3.17), but contributes just 25 percent to GDP (Figure 3.18). Nigeria’s agricultural sector is unusually large by SSA standards, but the productivity of its labor is below the average for peer countries. Although over time labor has gradually shifted out of agriculture, the process has been slow and uneven. Although in 2015 the share of market services in GDP exceeded that of agriculture, in the average SSA country that had happened almost a decade earlier.

Nigeria's agricultural sector is vast, but productivity is low. For the past 20 years, agricultural value-added per capita has risen by less than 1 percent a year, and marginal yield is far below its potential. Most Nigerian farms are small, rain-fed rather than irrigated, with minimal physical capital. Agricultural value chains are underdeveloped due to poor infrastructure, inefficient land markets, limited access to finance, unreliable policy, and inadequate market information. These conditions discourage investment and inhibit the uptake of new technologies, slowing productivity growth.

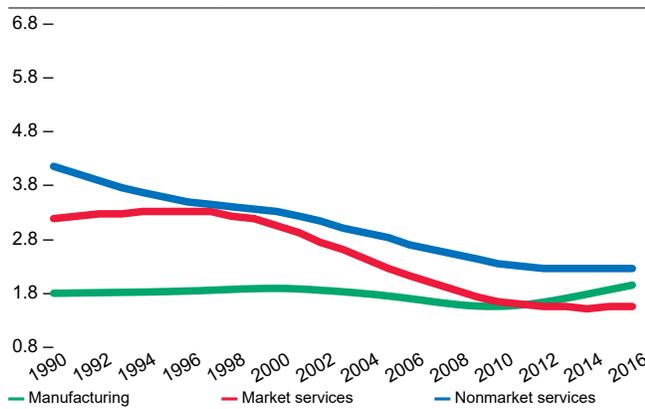
Limited urban employment opportunities slow the process of economic transformation; and throughout the economy underutilization of human capital is a major drag on productivity growth. In the traditional model of economic transformation, expanding urban manufacturing and service sectors attract a large share of the agricultural workforce by offering better income prospects. The exodus of agricultural workers creates incentives for farmers to invest in physical capital like tractors and irrigation systems, which augments the productivity of the remaining rural workforce. In Nigeria, however, this process is incomplete. The persistent abundance of rural workers keeps agricultural wages low and discourages investment in physical capital. Meanwhile, the most productive segment of the urban economy—nonmanufacturing industry (primarily the

28 Data from Barrot, Calderon, and Serven 2018, averages 2005–15.

oil sector)—cannot absorb more than a small fraction of the agricultural workforce. Unless the government can create the conditions necessary for robust growth in higher-productivity industrial and service sectors, a very large share of Nigerian workers will stay trapped in a low-wage, low-productivity equilibrium in the rural economy.

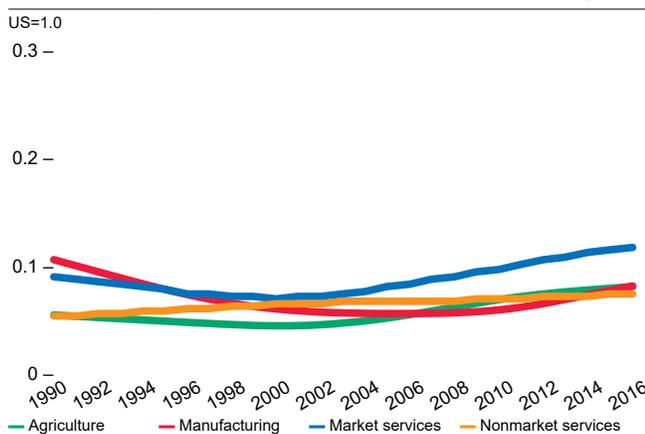
Recent sectoral growth studies have revealed vast disparities in labor productivity between nonresource sectors (Barrot, Calderon, and Serven 2018). In Nigeria, labor productivity in manufacturing is twice as high as in agriculture (Figure 3.19) and in nonmarket services (mostly the public sector) it is three times as high.

Figure 3.19. Labor Productivity of Nonresource Sectors relative to Agriculture, Nigeria



Source: World Bank calculations based on Barrot, Calderon and Serven 2018.
Note: Agriculture sector labor productivity equals unity.

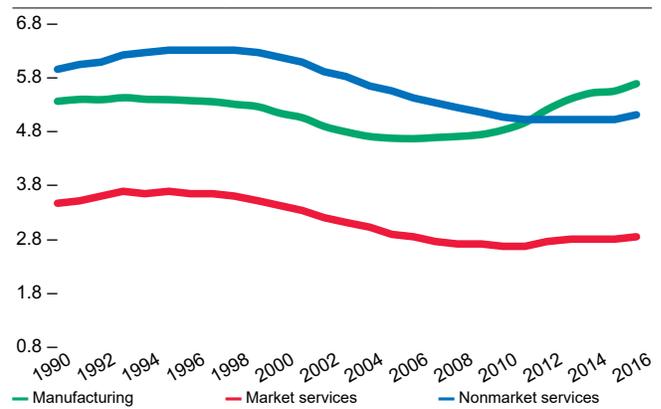
Figure 3.21. Labor Productivity in Agriculture and Other Nonresource Sectors relative to the US, Nigeria



Source: World Bank calculations based on Barrot, Calderon, and Serven 2018.
Note: Each US sector equals unity.

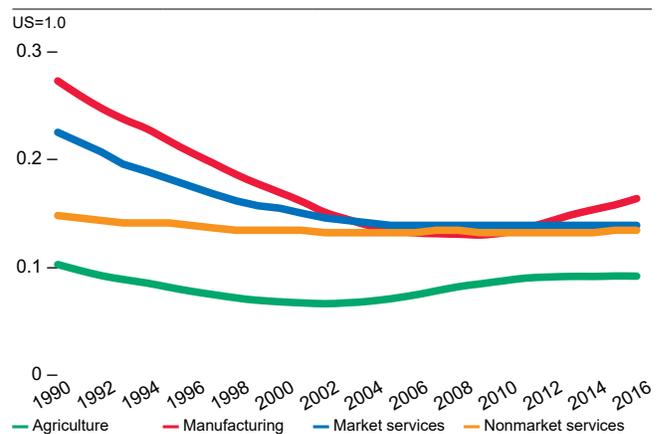
Meanwhile, elsewhere in SSA (Figure 3.20) average labor productivity in both manufacturing and nonmarket services is five times as high as in agriculture. While Nigeria is suffering from inefficiencies in the allocation of labor by sector, its labor force is also unproductive across the board (Figure 3.21 and Figure 3.22). While more human and capital investments will be needed across sectors to account for large and growing workforce, enabling the dynamic reallocation of labor will require policies that reduce both domestic and international barriers to the mobility of factors and goods, such as investments in basic infrastructure to reduce transaction costs and in technological improvements to promote productive processes.

Figure 3.20. Labor Productivity of Nonresource Sectors relative to Agriculture, SSA



Source: World Bank calculations based on Barrot, Calderon and Serven 2018.
Note: Agriculture sector labor productivity equals unity.

Figure 3.22. Labor Productivity in Agriculture and Other Nonresource Sectors relative to the US, SSA



Source: World Bank calculations based on Barrot, Calderon, and Serven 2018.
Note: Each US sector equals unity.

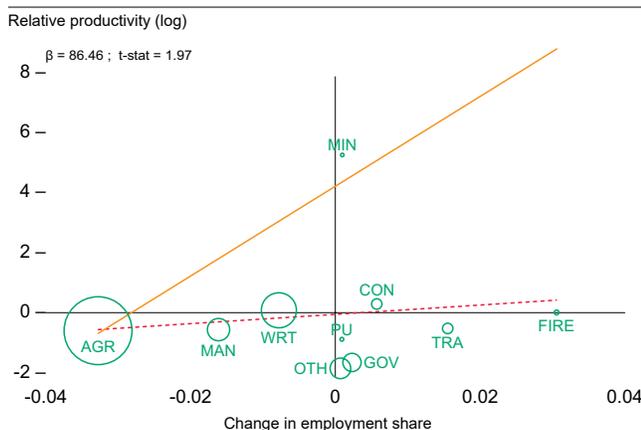
Numerous studies have shown that resource reallocation across sectors has had a trivial or even negative impact on growth in Nigeria. This is likely due to the incomplete process of economic transformation and the enclave nature of the natural-resource sector, which is highly productive but generates little direct employment and is only minimally connected to the rest of the economy. Misallocation of productive factors may also reflect the distortion in relative prices that affects exports and leads to the inefficient allocation of resources between traded and nontraded sectors that is common in resource-dependent economies. Higher oil prices are highly correlated with a stronger naira (in nominal and real terms), discouraging growth in output and productivity in non-resource base (and especially tradable) sectors. Countries with undervalued currencies tend to experience a more rapid process of growth-enhancing structural change (McMillan, Rodrik. and Verduzco 2014; De Vries et al. 2011; Enachi, Ghani, and O’Connell 2016).

The reallocation of labor has contributed to economic growth, but this is entirely due to productivity differences between the resource and non-resource sectors. Over time, employment in less-productive sectors like agriculture and manufacturing has dropped, and employment in the highly productive resource

sector has gone up (Figure 3.23; McMillan, Rodrik. and Verduzco 2014; De Vries et al. 2011; Enachi, Ghani, and O’Connell 2016). Although the resource sector is capital-intensive, its productivity is so high relative to other sectors that even modest employment gains generate a significant improvement in national productivity. When the resource sector is excluded from the analysis, the positive effect vanishes, and the increase in productivity from labor reallocation becomes insignificant.

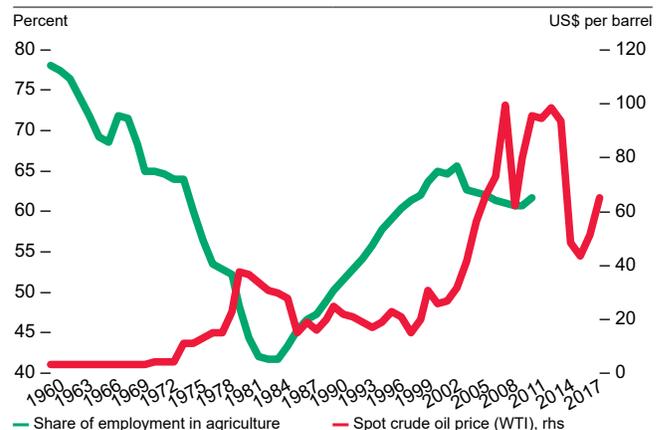
Reallocation of labor across sectors has been uneven, and low oil prices have driven labor back to agriculture, which often serves as employer of last resort. From the 1970s until the mid-1980s, high oil prices were accompanied by the sustained outflow of labor from agriculture; but between the 1980s and 2000 oil prices fell and agricultural employment rose. From 2000 to 2014, as oil prices recovered, agricultural employment again declined (Figure 3.24). Despite the enclave nature of oil production, high oil prices have clear employment spillovers onto wholesale and retail trade. As oil prices rise and the share of agricultural employment falls, employment in wholesale and retail trade also goes up, and as oil prices fall, so does the share of employment in wholesale and retail trade (Enache, Ghani, and O’Connell 2016).

Figure 3.23. Employment and Productivity in Nigeria, 1971–2011



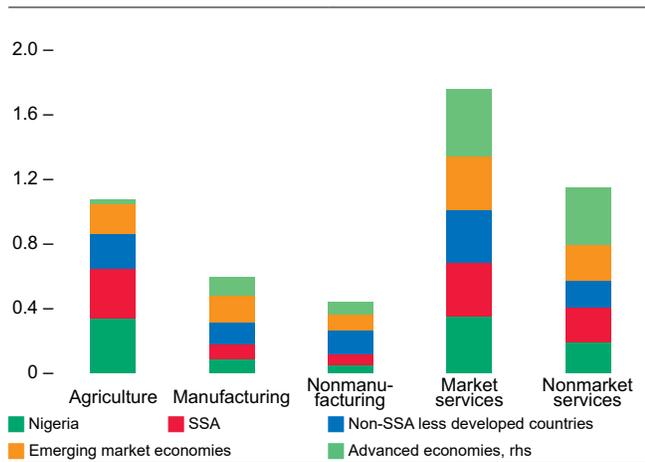
Source: Lennon (2016).

Figure 3.24. Employment in Agriculture and Global Oil Prices, 1970–2011



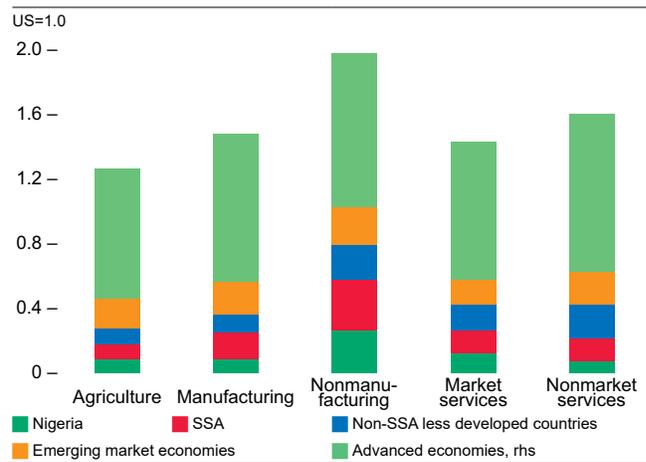
Source: World Bank calculations based on Groningen Growth and Development database; FRED.

Figure 3.25. Sectoral Employment Shares, Nigeria and Comparators, 2016



Source: World Bank calculations based on Calderon (forthcoming).

Figure 3.26. Sectoral Value-Added per Worker, Nigeria and Comparators, 2016, relative to the US



While the role of the rural economy as employer of last resort has softened the impact of economic downturns, it has also eroded the efficiency gains generated by the movement of labor between sectors. Agriculture in Nigeria employs a larger share of the workforce than it does in comparable countries, and its labor productivity is significantly lower (Figure 3.25 and Figure 3.26). Since the likelihood that agriculture would remain an automatic stabilizer to the economy during downturns, improving sector’s productivity remains crucial.

Though the persistence of productivity gaps between sectors suggests that the Nigerian economy is not fully leveraging the potential productivity gains from reallocating labor and capital, Nigeria’s economic history suggests that with the right mix of policies sustained productivity growth can be achieved. During the high-growth period of the mid-2000s, economic transformation was proceeding apace, and TFP was rising. High oil prices were contributing to growth, but governance reforms and public investment facilitated the increase in productivity. However, the subsequent downturn in oil prices drove workers back to agriculture, partly reversing these. Given the historical relationship between agricultural employment and oil prices, policies to diversify production and mitigate the impact of the oil sector on the rest of the economy

could accelerate growth and facilitate economic transformation.

Policy Options to Boost Productivity

Given Nigeria’s formidable development challenges in Nigeria, there is urgency to boost productivity to reduce the country’s heavy reliance on oil and climate-dependent resources and create an environment in which the private sector can thrive and create more and better jobs. In recent years Nigeria has moved to do so: it has, among other measures,

- improved regulation to make it easier for entrepreneurs to start and operate a business;
- launched a Central Portal for Government Services to improve transparency in public service delivery;
- ratified the Social Protection Policy and established a state and national Social Registry of poor and vulnerable households to enhance social protection;
- established a Basic Health Care Provision Fund; and
- improved payment service regulations to promote financial inclusion.

While these are notable achievements, now, given slow growth, rising poverty, and limited public revenue for much-needed investments in physical and human capital, it is critical for Nigeria to implement a bold reform program to boost productivity. Given Nigeria's fast-growing labor force, investment in human capital and its utilization is critical to boost productivity and improve living standards. Improving human capital requires investing more to raise education and health outcomes and adopting policies and programs to increase women empowerment and girls' access to schooling. Though investments in human capital are needed now, results will only be visible in the medium to longer term. In the near term, the following measures can help increase the efficiency with which Nigeria's limited physical and human capital is allocated and used.

Certain policy and institutional reforms could reduce distortions in the allocation of physical and human capital and ultimately boost productivity. Feasible in the near term, they could bring Nigeria's GDP growth rate closer to its long-run potential. The options below are far from exhaustive but highlight the key priorities: longer-term investments in human and physical capital will be crucial to sustain growth, which needs to be adequately supported by the country's macroeconomic fundamentals and competitive private sector while ensuring sufficient fiscal space to finance provision of essential public goods. The selected policy options are consistent with the priorities identified in the Government of Nigeria's Economic Recovery and Growth Plan (ERGP). In line with its objectives, the recommendations respond to major constraints on private sector development: (1) policy transparency and predictability; (2) quality and availability of inputs; (3) regulatory discretion; and (4) access to finance.

Policy Transparency and Predictability

More transparent, predictable, and evenhanded macroeconomic policies would streamline long-term economic decision-making and encourage

investment. Lack of monetary, external, and fiscal policy predictability makes longer-term production horizons less attractive, diverts local financing to short-time decisions, and pushes potential foreign investors away from Nigeria. Defining clear tax, exchange rate, inflation, banking, and other crucial policy objectives and demonstrating that policies are carried out in systematic, predictable ways would invite investment in local productive capacity. Channeling development finance through dedicated institutions, financed through the budget, could enhance policy credibility and make the allocation process more transparent. Clearly communicating fiscal policies and coordinating and harmonizing taxation across tiers of government could help firms make more informed investment decisions.

Increased countercyclicality of fiscal policy and rationalized forex policies could increase efficiency of resource allocation. Ensuring that fiscal policy is predictable, nondiscretionary, and countercyclical will be critical if Nigeria is to break the boom-bust pattern of the fiscal cycle, smooth output volatility, increase public investment in critical infrastructure, and encourage complementary private investment. Non-oil revenue mobilization is critical to ensure sustainable funds financing core public goods to avoid ever thinning spread of government services to a growing population. Rationalizing foreign-exchange policies would heighten transparency, bolster market confidence, and enhance the business climate. Multiple exchange rates create a complex scheme of implicit public subsidies and distort national accounting, and, crucially, allocation of resources. Full exchange-rate convergence across the various windows at a market-convertible rate, such as the IEFX, would again enhance transparency and build up the confidence of market participants.

A more open and transparent trade policy would foster competition among firms and help make the entire economy more productive. Trade policies supporting specific sectors and regions in a country distort factor allocations and lower productivity. The restrictive trade and exchange-rate policies directed

to import-substitution that were adopted during the downturn in global oil prices did protect domestic producers in targeted industries, but they also created barriers to the sourcing of inputs used by domestic manufacturers. Access to a wide range of affordable inputs is necessary for firms to leverage economies of scale, reduce production costs, and ensure that exports are competitive. In the medium to long term, removing distortive incentives would promote productivity by facilitating the exit of less-productive firms and by encouraging other firms to grow faster. Nigeria's recent signing of the Africa Continental Free Trade Area agreement recognizes its need to focus on such trade-enabling factors as better transportation and communications connectivity, investment in the technological skills of the workforce, and provision of incentives and financing to stimulate industrial growth.

Selected policy options that would promote policy transparency and predictability fall into three priority groups:

(i) Improving monetary policy transparency and effectiveness

- Refocus monetary policy on achieving price stability, primarily through variations in the policy rate, with open-market operations geared to controlling liquidity conditions and ensuring that interbank market transactions are conducted within a narrow band around the policy rate. This would also help reduce the risk that CBN operations crowd out private-sector borrowing.
- Unify exchange rates into a single market-driven window to eliminate market distortions and allow the exchange rate more flexibility to help buffer shocks; and remove forex restrictions.
- Improve transparency by annually publishing audited financial statements of all central bank operations.
- Strengthen the resolution framework and discontinue regulatory forbearance of undercapitalized banks.
- Evaluate and review the effectiveness and efficacy of development-finance interventions and import-substitution policies; if these policies continue,

improve their transparency by defining subsidies explicitly in the federal government's budget.

(ii) Enhancing intergovernmental fiscal coordination and subnational fiscal management

- Bolster the fiscal responsibility framework and improve intergovernmental fiscal coordination by incentivizing states to fully implement the 22-point Fiscal Sustainability Plan.
- Increase subnational own-source revenues by establishing consolidated and harmonized state revenue codes, expanding electronic tax payments and reducing cash payments, establishing consolidated state revenue accounts as part of state TSAs; and introducing a well-designed, progressive, and properly administered property tax to induce more efficient land use and provide revenue to state and local governments. To help minimize double taxation vis-à-vis federal policies, record and harmonize subnational revenue policies and administration measures across states.
- Accelerate progress under the National Action Plan for Open Government Partnership and other initiatives designed to enhance fiscal policy transparency, social accountability, and citizen engagement.

(iii) Boosting domestic revenue mobilization and improving public expenditure management and transparency

- Enhance fiscal resilience to oil shocks by expanding the nonoil revenue base and building the capacity of fiscal institutions to smooth public consumption and investment.
- Increase nonoil revenue through comprehensive tax policy and administration reforms; raise value-added tax and excise tax revenues, rationalize ineffective tax incentives, and strengthen the capacity of customs and the federal and state tax administrations to both improve collection and reduce the high cost of compliance.

- Enhance oil-revenue remittances by managing unbudgeted NNPC deductions and underpayments and by ensuring that petroleum industry bills are consistent with sustaining or increasing public revenue.
- Strengthen taxpayer engagement, increase tax morale, and address negative taxpayer perceptions by providing more clarity and transparency regarding which taxes need to be paid by whom and for what through enhanced taxpayer education; training tax officials to treat taxpayers as clients in a professional and fair way; strengthening public accountability on the collection of tax revenues; and linking taxation to improvements in the quality and relevance of public services.
- Enhance public expenditure management by costing and recognizing subsidies in the budget; removing petrol price subsidies while shielding the poor from negative impacts; improving budget implementation by strengthening multi-year budgeting practices based on realistic macroeconomic assumptions, actual past revenue outturns, and a costed impact of new revenue measures; and by monitoring and strengthening the efficiency and effectiveness of public spending.
- Further strengthen public debt management and transparency by adopting more realistic estimates of future deficit financing and providing more detailed reporting of the debt stock, including federal government arrears.

(iv) Harmonize trade policy and increase its transparency

- Review and update Nigeria's trade policy and legal framework by rerevising outdated laws and establishing monitoring and evaluation mechanisms to measure the impact of trade policy.
- Review existing non-tariff measures to assess their distortionary impact and phase out foreign exchange restrictions on 42 import groups, import prohibitions on 44 products by the Nigerian Customs Service, and local content requirements in the oil sector, which are considered in conflict with WTO rules.

- Harmonize regional tariffs by fully implementing the Economic Community of West African States (ECOWAS) common external tariff regime and by applying its rules of origin, linking regional and unilateral trade reforms to address the risks of trade diversion arising from the implementation of ECOWAS or AfCFTA.
- Gradually phase out tariffs in sectors where there are concerns about competitiveness and job losses and prepare complementary policies to support those who are negatively impacted by reforms; develop a clear adjustment mechanism for firms and industries affected by liberalization; and provide support to help domestic firms meet the standards of export markets.

Input Quality and Availability

Improving the quality of infrastructure, in particular power and transport infrastructure, would improve productivity by building up information and transportation networks, lowering logistics and transaction costs, and alleviating market access difficulties. The substantial infrastructure deficit marked by severe deficiencies in electricity and transportation networks is a major obstacle to productivity growth in Nigeria.²⁹ For example, investments in rural roads will be necessary to connect producers and consumers to markets, and urban transportation infrastructure will be crucial to manage the country's rapid urbanization. Similarly, a combination of rural electrification and increased urban power supply will be necessary to alleviate the problems that electricity access gaps pose for productivity growth. In both rural and urban areas, deficiencies in transportation networks are major barriers to the access of poor Nigerian households to economic and social opportunities. Lack of access and unreliable power both lead to allocative inefficiencies and make it difficult for poor households to direct their labor resources for market production. Approximately 80 million Nigerians have no access to electricity. The power that is available is inadequate and unreliable; a combination of inadequate governance and erratic

²⁹ The World Economic Forum (WEF) ranks Nigeria 132nd of 138 countries for infrastructure quality.

contract enforcement undermines operational efficiency, and financial viability. Because agriculture has a critical role in providing fallback employment when oil prices are low, public investment in rural infrastructure will be vital to build up agricultural productivity during oil-price downturns. The spread of digital technologies can reduce informational frictions and expand access to financial services; Nigeria's rates of mobile phone and Internet penetration could be improved through more public investment in digital connectivity.

More secure land tenure could boost investment in agriculture. Agricultural growth and land-policy reform have substantial implications for poverty reduction, employment, and higher living standards. Agricultural production in Nigeria is labor-intensive; high population growth rates, deep regional inequalities, inadequate protection of land and property rights, and periodic episodes of reverse rural-urban migration have discouraged investment in agricultural capital. Rental activity could have a crucial role in reducing the dispersion in the marginal product of land across farmers and raising the productivity of agriculture. Although rentals can help reallocate land from less to more productive farms, farms that rent land still operate far from the efficiency benchmark. This suggests that land markets are still subject to other frictions.

Enhancing the quality of education and building their skills could give workers more mobility across regions and sectors for better allocation of human capital. Ability to reap the benefits of structural transformation will depend on a well-educated and mobile labor force that can meet the evolving demands of a dynamic economy. Low stock of human capital and its subsequently small contribution to labor productivity and growth makes it imperative for Nigeria to move urgently to enhance human capital by investing more in education, health, and skills development. Slow and incomplete school-to-work transitions diminish labor mobility. Young people tend to enter the labor force too early and with too little education. Inadequate skills development leads to minimal accumulation

of intergenerational wealth and thus deters social mobility. Without more investment in human and physical capital, workers are unable to take advantage of the higher returns offered by employment in more productive sectors.

Reducing trade and transport costs would improve the allocative efficiency of domestic resources and attract foreign capital. Tariff and nontariff barriers combine to create protected sectors whose excess returns divert productive factors from their most efficient use. Nigeria's current policy structure systematically disadvantages exporters and service providers; it also incentivizes resource flows to the least-productive sectors, possibly limiting productivity growth. Import data underscore how little Nigeria is integrated into international markets. Yet importing firms in Nigeria are more productive than non-importers, suggesting that access to foreign inputs enhances labor productivity. International experience shows that the removal of trade restrictions tends to facilitate the exit of less-productive firms or accelerate firm growth; by removing those restrictions Nigeria would eliminate a major economic distortion while promoting much-needed investment in physical and human capital.

Selected policy options that would improve input quality and availability:

- Accelerate the implementation of the Power Sector Reform Program—a credible and fiscally sustainable financing plan with tariff adjustments to protect poor households while reducing the overall burden of power subsidies on the budget, combined with a robust turnaround plan for distribution companies—to unlock private investment and provide much-needed power to Nigerian firms and households.
- Enable the expansion of well-managed public-private partnerships (PPPs) in key infrastructure networks (e.g., roads, railways, and airports) by (i) adopting a legal framework for PPPs to strengthen institutions and regulations governing project origination, project preparation, contract management, contingent-

liability assessment, and processing for government guarantees; (ii) clarifying the roles and responsibilities of the numerous institutions linked to PPPs at the federal and state level; (iii) preparing a robust pipeline of infrastructure projects and ensuring that project standards, procurement, and contract management are predictable and publicly disclosed; and (iv) approving a list of prioritized PPP projects to provide regulatory clarity on how PPP projects are originated and designated, the risks the government is taking, and the guarantees to be provided.

- Build a coherent institutional and governance framework to implement and coordinate digital economy reforms across all relevant agencies and governmental levels.
- Facilitate the adoption of digital technologies to improve connectivity to inputs and markets among farmers and entrepreneurs.
- Adopt a comprehensive package of reforms designed to: (i) improve land management and mobilize private infrastructure investment to build up agriculture value chains; and (ii) remove the monopoly on agricultural insurance and enact the Plant Variety Protection Act to incentivize national and multinational agribusiness investments.
- Address high-priority measures to reduce the costs, delays, and inefficiencies involved in border and port clearance by reducing redundant formalities (simplifying and harmonizing documents, streamlining procedures, automation, etc.), promoting good governance, and expanding the availability of information.
- Improve safety and security for road freight vehicles traveling and parking along strategic routes.
- Develop a clear and comprehensive compliance-management strategy for customs and other border-related agencies.
- Expedite the implementation of reforms to align Nigeria with the WTO Trade Facilitation Agreement.
- Increase investment in education and health and adopt policies and programs to increase women's empowerment and promote girls' access to education.

- Improve workforce-skills development by formulating a national skills-development strategy and by aligning the supply of skills with the needs of the labor market.

Reduced Regulatory Discretion

Even-handed regulation would boost investor confidence, foster competition, and could encourage formalization. A high degree of market concentration characterizes the Nigerian formal sector with a few large firms dominating key industries and sectors. Inadequate competition pushes up input prices and makes Nigerian firms less competitive. Market concentration is especially distortive in upstream sectors, such as construction materials, and in business-related services, such as telecommunications. Market concentration is reinforced by regulatory obstacles and other domestic barriers to entry, as well as by import-substitution policies, which limit exposure to foreign competition.

Eliminating distortions in the tax system will be vital to treat the private sector fairly and expand the space for public investment. Nigeria's tax system interferes with the equalization of marginal products between firms. Rationalizing tax expenditures, especially pioneer-status schemes, by linking them to clearly defined policy objectives and tailoring their use to specific policy objectives would reduce investment distortions and fiscal waste. The impact of taxes is especially deleterious if the associated distortion is positively correlated with productivity—i.e., if the tax burden is greater for highly productive firms. Finally, tax exemptions reduce Nigeria's already limited fiscal space, and current efforts to start rationalizing them are not yet yielding the returns necessary to enable adequate investment in the country's fiscal priorities.

Selected policy options to reduce regulatory discretion:

- Revise business regulation to reduce transaction costs and the administrative burden for firms, e.g., by adopting the Companies Allied Matters Act.
- Improve access to information and digitize regulatory processes to reduce transaction costs for investors and increase their confidence.
- Incentivize reforms of the subnational business environment and peer-to-peer learning across states.
- Build up FDI policy and promotion and emphasize that the National Investment Promotion Commission (NIPC) is mandated to (1) establish more open and predictable entry procedures; and (2) enhance investor confidence and protect investor guarantees.
- Rationalizing tax expenditures, especially pioneer-status schemes, and establish a robust monitoring and evaluation system for entities with pioneer status. The latest list, published in August 2017 in the *Official Gazette of the Federal Republic of Nigeria*, shows as many as 99 products and industries in 39 subsectors of 11 main sectors, are benefitting from pioneer status, which grants companies a CIT exemption for up to three years from commencement of the business, extendable to another two years.
- Adopt the Nigeria National Quality Policy to consolidate, refine, and sustain an effective and efficient national quality infrastructure.

Access to Finance

Improving access to finance, particularly for small and medium-sized enterprises, can promote productivity by improving resource allocation. Credit-market imperfections lead to misallocation of resources by creating barriers to entry and inhibiting adoption of new technologies. Results of enterprise surveys in Nigeria underscore the importance of alleviating constraints on access to bank financing: over 50 percent of firms report

using internal resources for investments, and nearly 90 percent of loans require collateral, with an average value of almost 230 percent of the loan amount. Only 40 percent of Nigerian adults have a bank account, and just 6 percent have a mobile money account; neither indicator has improved since 2014 (World Bank 2019).

Because robust job creation hinges on the dynamism of small, new businesses, access to finance is critical to enable smaller firms to compete with established incumbents. Policy options include fully implementing the licensing and regulatory guidelines for payment-service banks and expediting review of applications for payment-service bank licenses. Restoring the previous minimum capital requirements for microfinance institutions, as delineated in the central bank's October 22, 2018, circular, would also help strengthen and consolidate the microfinance subsector. Nigeria's recent YouWin! competition showcased the potential impact of improving access to finance³⁰ among small firms and should serve as a model for similar initiatives. The results of the YouWin! program³¹ were positive: Competition winners were more likely than their peers to innovate, survive in the market, achieve higher sales and profits, and employ more people. Three years after the competition, winning firms were over 20 percentage points more likely than control firms to employ 10 or more workers (McKenzie 2017).

Curbing CBN use of quasi-fiscal operations would both alleviate distortions in the allocation of credit and improve policy predictability. The central bank has attempted to directly increase the flow of credit to targeted sectors through development finance operations, with the aim to overcome the shallowness of the commercial bank credit market. Many of these operations are agricultural development schemes intended to support small rural enterprises and smallholder farmers. Regardless of their merits as development policies, financing these interventions through the CBN rather than the federal budget reduces

30 Although note that the competition administered grants, not loans.

31 The Nigeria YouWin! competition attracted 24,000 grant applications from individuals that wanted to start a new business or expand one. The top 6,000 applicants were selected for a 4-day business plan training course and each winner was awarded an average grant of US\$50,000.

the transparency of fiscal policy and the effectiveness of monetary policy.

Selected policy options that would improve access to finance:

- Make the banking sector more resilient by reinforcing capital buffers, with credible time-bound recapitalization plans for banks, phasing out regulatory forbearance, and enforcing strict requirements for reporting by financial institutions.
- Apply the guidelines for licensing and regulation of payment service banks by expediting the review of applications for those licenses.
- Establish an effective structure for carrying out the National Financial Inclusion Strategy, including consolidation of the microfinance banking sector.
- Enhance the legal framework for debt resolution and foreclosure to encourage lending to SMEs.
- Improve credit information systems by enforcing current requirements and facilitating collection of credit information from additional sources to foster outreach to unbanked clients.
- Enact the Data Protection Bill to protect the privacy and security of financial data.
- Foster digital financial services, which can help banking the unbanked and potential serve as a springboard to access formal financial sectors.

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Nigeria: Key Economic Indicators

Nigeria: Key Economic Indicators

<i>Economy</i>	2015	2016	2017	2018	H1 2018	H1 2019
Real GDP Growth (% yoy)	2.7	-1.6	0.8	1.9	1.7	2.0
Nominal GDP (Naira tr)	95	103	115	129	60	67
Oil Production (mb/d)	2.1	1.8	1.9	1.9	1.9	2.0
Oil Price (Bonny light, US\$/bbl)	54.2	45.2	54.8	72.1	71.3	66.9
Inflation (%yoy, average)	9.0	15.7	16.5	12.1	13.0	11.3
<i>Real sectoral growth (% , yoy)</i>	2015	2016	2017	2018	H1 2018	H1 2019
Agriculture	3.7	4.1	3.4	2.1	2.1	2.5
Industry, of which:	-2.2	-8.9	2.1	1.9	3.4	1.3
Oil and Gas	-5.4	-14.4	4.7	1.1	4.6	1.7
Manufacturing	-1.5	-4.3	-0.2	2.1	2.0	0.3
Construction	4.4	-5.9	1.0	2.3	3.2	1.8
Services, of which:	4.8	-0.8	-0.9	1.8	0.8	2.2
Trade (wholesale and retail)	5.1	-0.2	-1.1	-0.6	-2.4	0.3
ICT	6.2	2.0	-1.0	9.7	6.8	9.2
Finance and Insurance	7.1	-4.5	1.3	2.0	7.1	-5.0
Real Estate	2.1	-6.9	-4.3	-4.7	-6.4	-1.7
Public Administration	-12.3	-4.6	-0.4	-2.0	-3.5	-8.6
Oil GDP	-5.4	-14.4	4.7	1.1	4.6	1.7
Non-Oil GDP	3.7	-0.2	0.5	2.0	1.4	2.1
Non-oil industry	0.1	-5.0	0.6	2.4	2.7	1.0
Non-Oil, Non-Agriculture	3.8	-1.7	-0.6	2.0	1.2	1.9
<i>GDP Composition (%)</i>	2015	2016	2017	2018	H1 2018	H1 2019
Total GDP (2010 basic prices)	100	100	100	100	100	100
Agriculture	20.9	21.2	21.1	21.4	18.1	19.3
Industry, of which:	20.4	18.4	22.5	26.0	28.0	28.2
Oil and Gas	6.4	5.3	9.1	10.5	12.9	9.2
Manufacturing	9.5	8.8	8.8	9.7	9.4	11.4
Construction	3.7	3.6	3.8	4.7	4.8	6.5
Services, of which:	58.8	60.4	56.4	52.6	53.9	52.6
Trade (wholesale and retail)	19.2	20.4	19.0	17.2	17.5	16.1
ICT	11.5	11.3	10.3	10.2	10.9	12.3
Finance and Insurance	3.5	3.5	3.4	3.1	3.6	3.1
Real Estate	8.7	8.2	7.6	6.8	6.5	6.1
Public Administration	2.7	2.7	2.6	2.3	2.4	2.0
Oil GDP	6.4	5.3	9.1	10.5	12.9	9.2
Non-Oil GDP	93.6	94.7	90.9	89.5	87.1	90.8
Non-oil industry	14.0	13.1	13.4	15.5	15.0	19.0
Non-Oil, Non-Agriculture	72.8	73.5	69.8	68.0	68.9	71.5

Source: National authorities and World Bank calculations.

<i>Monetary and Financial Sector</i> (% change yoy, end of period, unless indicated otherwise)	2015	2016	2017	2018	H1 2018	H1 2019
Broad Money	6.1	17.8	2.3	12.1	12.9	12.4
Narrow Money	24.6	31.5	-0.9	5.2	5.0	4.3
Net Foreign Assets	-18.7	61.8	69.6	18.5	116.5	0.7
Net Domestic Credit	12.1	24.3	-3.5	6.3	-7.9	28.9
o/w to the Federal Government (Net)	152.0	68.6	-25.4	33.7	-46.6	170.3
o/w to the Private Sector (Net)	3.1	15.8	-1.2	1.9	-1.4	12.8
<i>Monetary policy parameters:</i>						
Monetary Policy Rate (absolute rate, end of period)	11.0	14.0	14.0	14.0	14.0	13.5
Liquidity Ratio (absolute rate, end of period)	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	22.5

<i>Financial Market Indicators (end of period)</i>						
Stock Market (NSE) Index	28,642	26,875	38,243	31,431	38,279	29,967
Fitch Sovereign Long Term Foreign Debt Rating	BB-	B+	B+	B+	B+	B+
Moody's Sovereign Long Term Foreign Debt Rating	Ba3	B1	B2	B2	B2	B2
S&P Sovereign Long Term Foreign Debt Rating	B+	B	B	B	B	B

<i>External Sector</i>	2015	2016	2017	2018	H1 2018	H1 2019
Exchange rate - official (N/US\$, end of period)	197	305	306	307	306	307
Exchange rate - parallel (N/US\$, end of period)	267	490	363	370	362	361
Real effective exchange rate index (end of period)	67	86	99	87	91	83
Current Account Balance (US\$ bn)	-15.4	2.7	10.4	5.3	5.8	-5.7
Current Account Balance (%GDP)	-3.2	0.7	2.8	1.3	3.1	-2.7
Exports of Goods and Services (US\$ bn)	49	38	51	68	32	34
o/w oil and gas exports	42	32	42	58	27	27
Imports of Goods and Services (US\$ bn)	72	47	51	72	31	47
Net Direct Investment (US\$ bn)	2	3	2	1	1	1
Net Portfolio Investment (US\$ bn)	1	2	9	13	9	12
Net Other Investment (US\$ bn)	-9	-4	-2	-9	-3	-19
Remittances (net, US\$ bn)	19	19	22	24	12	12
External Reserves (US\$ bn, end of period)	29	26	39	43	48	45
Equivalent months of imports of G&S	5	7	9	7	9	6

Source: National authorities and World Bank calculations.

<i>Net Federation Account Revenues</i>						
<i>Actual (% of annual GDP)</i>	2015	2016	2017	2018	H1 2018	H1 2019
Total Federation Account Net Revenues	5.6	4.2	4.9	6.1	2.9	2.5
Oil and Gas (Net) /1	3.0	1.6	2.3	3.6	1.8	1.4
Other Extractives-related revenues and inflows /2	0.2	0.4	0.3	0.2	0.0	0.0
Non-oil Revenues (Net)	2.3	2.2	2.3	2.4	1.1	1.1
Corporate	1.0	0.9	1.0	1.1	0.4	0.4
Customs	0.5	0.5	0.5	0.5	0.2	0.3
VAT	0.8	0.8	0.8	0.8	0.4	0.4

Source: National authorities and World Bank calculations.

Notes: /1 After budgeted and discretionary deductions, but before derivation. /2 Includes Solid Minerals, NLNG Dividend, and Signature Bonus; exchange rate difference, excess PPT.

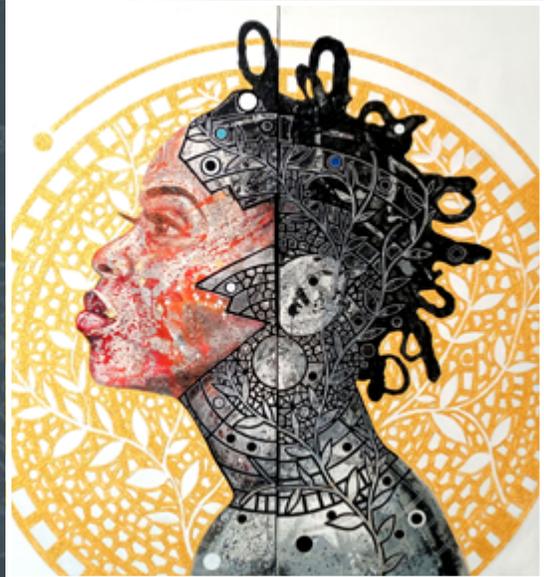
<i>FGN Fiscal Accounts</i>						
	2015	2016	2017	2018	H1 2018	H1 2019
Total FGN Revenue	2.7	2.0	2.4	2.8	1.3	1.1
Oil and Gas /1	1.4	1.0	1.2	1.6	0.8	0.6
Non-oil Revenues	0.9	0.8	0.8	0.9	0.4	0.4
Corporate	0.5	0.4	0.5	0.5	0.2	0.2
Customs	0.3	0.2	0.2	0.2	0.1	0.1
VAT	0.1	0.1	0.1	0.1	0.1	0.1
FGN Independent Revenues	0.3	0.2	0.3	0.3	0.2	0.1
Total FGN Expenditures	5.0	4.7	5.6	6.1	3.1	3.2
Recurrent Expenditures (excl. Statutory Transfers)	3.7	3.7	4.1	4.2	2.0	2.2
Capital Expenditures (calendar) /2	0.4	0.6	1.1	1.3	0.7	0.8
Statutory Transfers	0.4	0.3	0.4	0.4	0.2	0.2
Other Outflows /3	0.5	0.1	0.0	0.2	0.2	0.0
Fiscal Balance	-2.23	-2.7	-3.2	-3.3	-1.8	-2.1
FGN Debt	10.8	13.1	14.9	15.2	13.6	14.4

Source: National authorities and World Bank calculations.

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. Total expenditure for some years differs from the FGN reports as the World Bank excludes debt amortization payments from expenditure. Figures exclude GOEs and donor funding.

/1 Includes other extractives revenues. /2 The actual capital spending reported for the calendar year. /3 Other Outflows include irregular items.

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Yet We Had No Burns, Blisters
by Godwin Arikpo

Godwin Arikpo was born in 1981 in Cross River State, Nigeria. He is a multi-dimensional artist that fuses acrylics, fabrics, wood, ropes and other assemblage to create his works of art. Arikpo incorporates traditional symbols into his works to authenticate his quest for history with an imagery that is distinctive, subjective, contemporary, and simple. Arikpo obtained a B.A. in Arts in 2007 from the University of Port Harcourt. Since then he has participated in several Art Workshops, Auctions, and Exhibitions, some of which include: ArtBurst (2011, 2013), the Annual Society of Nigerian Artist Exhibition in Port Harcourt, Rivers State; Poems in the Mangrove (2012), Port Harcourt, Rivers State; Horizons of Hope Exhibition (2015), held at the Quintessence Art Gallery in Lagos; Chronicles of Truth (2015), held at the Mydrim Gallery in Lagos; Faces and Phases (2016), held at the Terra Kulture Art Gallery in Lagos; Harmattan Workshop (2016), organized by the Bruce Onobrakpeya Foundation; Art as Therapy (2018), organized by the United States Embassy; ArtHouse Contemporary Auction (2018); and Faces and Forms Contemporary Art Expo (2019).

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.