NIGERIA BIANNUAL ECONOMIC UPDATE

CONNECTING TO COMPETE

APRIL 2018

WORLD BANK GROUP

Preface

The Nigeria Biannual Economic Update is a product of the staff of the World Bank and has three broad aims. First, it reports on the key developments in the Nigerian Economy in the recent past (Chapter 1). Secondly, it summarizes the likely economic outcomes in the short-to-medium term, given the policy developments, and highlights key short-term risks and upside potentials (Chapter 2). Finally, the Update provides a more in-depth examination of selected highly relevant economic issues (Chapter 3). The Nigeria Biannual Economic Update is intended for a wide audience, including policymakers, business leaders, financial market participants, and the community of analysts and professionals engaged in Nigeria's economy.

This edition of the Update was prepared by the World Bank Macroeconomic, Trade and Investment Global Practice Nigeria Team, and was led by Gloria Joseph-Raji (Senior Economist) and Emilija Timmis (Young Professional). Somik Lall (Global Lead, Territorial Development) prepared the Special Topic (Chapter 3) based on a World Bank spatial diagnostic on Nigeria. Oversight on the report preparation was provided by Ulrich Bartsch (Lead Economist), under the overall supervision of Sona Varma (Acting Practice Manager), Francisco Carneiro (Practice Manager), Indira Konjhodzic (Country Program Coordinator) and Rachid Benmessaoud (Country Director). The report benefited greatly from valuable insights and comments from Christos Kostopoulos (Lead Economist) and Yue Man Lee (Senior Economist). Joseph Ogebe (Consultant) provided valuable contributions.

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

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Executive Summary

Recent Developments

Nigeria emerged from recession in 2017, but its non-oil, non-agriculture sector continued to decline. GDP growth was 0.8 percent, driven by expansion in oil output and continued steady growth in agriculture. The oil sector grew by 5 percent in 2017 after its decline throughout 2016 and up to Q1 2017, helped by the relative calm in the oil-producing Niger Delta region as well as the government's efforts to clear joint venture (JV) arrears and improve payments in 2017. Non-oil, non-agriculture GDP, however, contracted by 0.6 percent as aggregate demand remained weak and private sector credit, low. With labor-intensive sectors still contracting, the rate of unemployment and underemployment increased in 2017. Poverty is also estimated to have increased slightly in 2017.

The current account surplus increased to over 2 percent of GDP from 0.7 percent in 2016. This was as oil exports strengthened with increasing production and price, while imports remained subdued due to weak private demand. Foreign portfolio investment inflows resumed in response to the opening of the Investors and Exporters Foreign Exchange (IEFX) window and high yields on government debt instruments, but Foreign Direct Investment (FDI) remained low. External reserves reached a four-year high the end of 2017 and climbed even further by end-March 2018.

The Central Bank of Nigeria (CBN) tightened monetary policy significantly in 2017 and maintained exchange rate stability. The convertible Investors and Exporters window, to which the parallel market rate remains aligned, traded at 20 percent premium over the official exchange rate. Broad money growth decreased to 2 percent in 2017, compared to 18 percent in 2016. While the monetary policy rate was maintained at 14 percent since July 2016, the CBN reduced liquidity through issuing significant amounts of liquidity management bills.

Inflation slowed, in response to monetary tightening and exchange rate stability, but remains high. Food inflation in particular, remained very high; in part due to the recurring farmer-herdsmen conflicts and the displacement of farming communities in the North-East of the country. Since food comprises almost three-quarters of the consumption budget of the low-income households, high food inflation exacerbates poverty.

The fiscal situation remained challenging as revenues stagnated. Federally-collected revenues continued to underperform and fiscal deficits remained high. Only 53 and 65 percent of budgeted oil and non-oil revenues (net) were realized by the federation. The federal government's budget implementation was also hampered by revenue shortfalls as well as a delayed start of capital budget implementation. The FGN's overall deficit is estimated to have reached 3 percent of GDP. State governments were also affected by the federation revenue shortfalls.

The federal government's debt stock remained low, but debt service increasingly burdened the budget. The FGN's debt stock, estimated at 19.1 of GDP at end-2017, is low when compared internationally, but its interest payments, estimated at 1.4 percent of GDP, were equivalent to 70 percent of FGN revenue. The government rebalanced its debt towards external and longer-term components in a bid to reduce its cost of borrowing and free up capital for the private sector.

Outlook

The recovery is expected to be slow and largely oil sector-driven. The overall GDP growth rate is expected to hover just over 2 percent. Oil production is expected to remain above 2 mb/d in the medium term, but below the government's projections. Output growth in the agricultural sector is expected to contribute positively, but remain below its potential due to ongoing conflicts. Non-oil industry and services are expected to grow only slowly due to subdued consumer and investment demand. This is significantly below the government's aspirational projections, outlined in the government's Economic Recovery and Growth Plan (ERGP), of achieving 4.8 percent GDP growth in 2018 and reaching 7.0 percent by 2020, largely driven by the non-oil sectors[1]. This is because most of the structural reforms outlined in the ERGP are at preliminary stages. The Power Sector Recovery Plan aside, limited movement has been seen in developing detailed sector plans since a year ago when the plan was launched. Nigeria's oil-driven short- to medium-term outlook is particularly sensitive to oil production disruptions and price shocks. On the upside, significant fiscal reforms, monetary policy adjustments, and important improvements in the investment climate would foster long-term growth.

Fiscal pressures will remain high as revenue shortfalls continue. The 2018 Federal Government Budget has less realistic revenue targets than 2017, constrained by the lack of tax policy reforms, and limiting the capital expenditure implementation. Passing of the 2018 budget is delayed. The federal government will continue to tap into international markets to replace short-term domestic debt. Domestic interest rates are expected to decline, slowly. External reserves and current account balance are expected to start declining,

1 Government's GDP growth projection for 2018 was lowered to 3.5 percent in the 2018-2020 MTEF.

as short-term financial inflows will slow with declining yields on domestic instruments and imports will recover towards pre-crisis levels.

Monetary Policy will continue to target exchange rate stability. The CBN is expected to continue to intervene in its different forex windows to maintain stability; however, the different windows applicable to the private sector are likely to be consolidated, with most of the transactions taking place at the IEFX window. Inflation will likely remain in double digits. Monetary tightening has had limited effects on bringing core inflation down in 2017. The possible increases in recurrent spending in the run-up to the 2019 elections may add to inflationary pressures if the use of the government's overdraft facility at the CBN grows significantly.

SPECIAL TOPIC:

Connecting to Compete - Regional connections and coordination to enhance Nigeria's competitiveness[2]

Given the volatile nature of its current growth process, largely linked to the oil sector, Nigeria would benefit from policies to promote diversification and long-term inclusive growth. Spatial integration and sub-national specialization, the special focus topic of this report, have been identified as important in this regard. They are key for creating a nationally integrated market for goods and products as well as attracting much-needed private investment, which in turn could enhance productivity though scale and specialization.

With a large population and a growing middle class (from 13 percent to 19 percent of population between 2003 and 2013), Nigeria has a big home market. However, the majority of firms identify local markets—same locality, same town/city, same state—as the main sales channels. Under the dominance of local trading, regional economic specialization is less likely to emerge, as local trading leads to a replication of same economic sectors across different locations rather than specialization. Spatial fragmentation of the domestic market is exacerbated by limited connective infrastructure, reducing producers and firms' ability to reach wider markets. This dampens the potential for scale economies as well as economic collaboration and cooperation among regions. Spatial fragmentation and limited connections also hurts welfare and prospects for poverty reduction. Recent research shows that a 10 percent reduction in transport costs in rural areas would increase welfare by 13 percent. [3]

In choosing *where* to prioritize spatially connective interventions, policymakers may need to manage

2 This special feature draws from a set of diagnostics and policy note prepared the World Bank Nigeria's Social, Urban, Rural and Resilience (SURR) Global Practice in June 2017.

3 Based on research in Gollin, D., and Rogerson, R. (2014). Productivity, transport costs and subsistence agriculture. *Journal of Development Economics*, 107, 38–48.

trade-offs between goals of spatial equity and aggregate economic efficiency. Reduction in transport cost between remote and connected rural areas has a bigger welfare impact than a similar reduction in transport cost between cities and connected rural areas – local welfare gains are higher for investments supporting rural connectivity. But, for aggregate economic efficiency, there are higher gains from focusing on the development of inter-regional corridors, linking the major urban centers. For example, improvements along the LAKAJI[4] corridor would result in estimated annual benefits of over $1.34 billion.[5] Furthermore, a recent study showed that the elasticity of local GDP increase to transport investments is higher for the Southern zones.

In addition to enhanced connection, targeted efforts would be needed at the state level to lever economies of scale and agglomeration. In fact, the introduction of the "cluster" concept in the federal government's National Industrial Policy for 2007-2011 made room for establishing special economic zones (SEZs) and most recently, Nigeria's Economic Recovery and Growth Plan (2017–2020) emphasized the need for greater sub-national interventions that are best suited to realize the development potential of individual states and regions. However, sub national regions may wish to consider how their local initiatives support scale economies and add net value at the national level.

In fact, the 2007 Nigeria Industrial Development Strategy tries to develop scale economies in infrastructure provision by only allowing one industrial park (of a scale of around 30 to 50 sq. kilometres) in each of the geo-political zones to pool resources for providing high quality infrastructure. States have, however, independently set up industrial parks, without being able to fully deliver the required infrastructure (roads, reliable power, water and sanitation) and provide necessary facilities to allow businesses to invest and operate. It may be useful to consider options for strengthening inter-government coordination in the development of industrial parks and related interventions. International experience also highlights that successful place based initiatives leverage regional collaboration—across jurisdictional boundaries—to benefit from sharing and matching economies of scale and gains from specialization. In Nigeria, SEZs and place-based polices have only focused on coordination issues within the zone itself and need to enhance connections with other states (even within geopolitical zones).

For Nigeria to tap its spatial drivers of development, policymakers may want to focus on investments that reinforce agglomeration and economies of scale (i.e., around clusters and urban nodes); optimize the backward and forward linkages between rural areas and the major urban markets; and address structural and land management issues in major urban nodes and along major growth corridors to remove or alleviate barriers that undermine the growth potential. At the same time, the potential trade-offs between spatial equity and efficiency, as presented earlier, need to be acknowledged and managed.

4 The corridor from Lagos to Jibiya, via Kano is generally referred to as the LAKAJI Corridor.
5 Russ et al. (2017).

Key Data Indicators

Economy	2014	2015	2016	2017e	2018f	
Real GDP Growth (% yoy)	**6.3**	**2.7**	**-1.6**	**0.8**	**2.1**	**Economic growth remains anemic.**
Nominal GDP (US$ bn)	547	487	405	392	425	In US$, the economy shrank due to recession and depreciation.
Oil Production (mb/d)	2.2	2.1	1.8	2.0	2.1	Oil production recovered compared to 2016.
Oil Price (US$/bbl)	100.8	54.2	45.2	54	59	Oil price recovered compared to 2016 but remains hist. low.
Inflation (%yoy, average)	8.0	9.0	15.6	16.5	14.5	Inflation is expected to remain high in the short-term.
Real GDP Composition (%):						
Agriculture	22.9	23.1	24.4	25.1	25.4	Agriculture constitutes about one quarter of GDP.
Oil industry	10.4	9.6	8.3	8.7	9.2	Oil sector is small but key for forex and fiscal revenues.
Non-oil industry	14.5	14.1	13.6	13.6	13.4	Non-oil industry is larger than the oil sector.
Services	52.2	53.2	53.6	52.7	52.0	Services represent more than a half of Nigeria's economy.
Real sectoral growth (%, yoy)						
Agriculture	4.3	3.7	4.1	3.4	3.5	Agriculture performs strongly but is subject to regional conflicts and natural disasters.
Oil industry	-1.3	-5.4	-14.4	4.8	8.1	2016 recession was driven by oil price and production shocks,
Non-oil industry	13.4	0.1	-5.0	0.6	1.0	which spilled over into other sectors through
Services	6.8	4.8	-0.8	-0.9	0.8	forex shortages and fiscal retrenchment.

External Sector	2015	2016	2017e	2018f	
Exchange rate - official (N/US$, average)	196	253	305	305	Exchange rate remains fixed at 305 for govt. and oil sectors.
Exchange rate - parallel (N/US$, avg./current)	223	381	365	360	Parallel ER is aligned with CBN convertible IEFX window.
Exports of Goods and Services (US$ bn)	49.0	38.4	48.4	55.6	(Oil) exports collapsed in 2015-2016 due to oil price and production shocks.
o/w oil and gas exports	42.4	32.0	41.2	50.9	Oil and gas exports constitute over 80% of Nigeria's exports.
Imports of Goods and Services (US$ bn)	71.9	47.0	50.8	60.0	Imports contracted due to forex shortages in 2016.
Current Account Balance (US$ bn)	-15.4	2.7	8.6	7.2	Current account balance was positive as imports contracted
Current Account Balance (% GDP)	-3.2	0.7	2.2	1.7	more than exports.
Remittances (net, US$ bn)	19.4	18.8	20.4	20.4	Net remittances (4% of GDP) to Nigeria are more than double of govt. oil revenue in 2016.
External Reserves (US$ bn, end of period)	29.1	25.8	39	37	External reserves recovered in 2017.
equivalent months of imports of G&S	4.8	6.6	9.2	7.4	

Fiscal	2015	2016	2017e	
Federation				
Consolidated govt. spending (%GDP)	10.7	9.8	10.7	Nigeria's govt. is very small.
Consolidated govt. revenues (%GDP)	7.5	5.9	6.2	Its revenues halved and are among the lowest globally.
Net federally collected revenues (%GDP)	5.6	4.2	4.7	Federation revenues nearly halved since 2014…
Oil, gas and mineral (%GDP)	3.2	2.0	2.5	…as oil revenues collapsed…
Non-oil (VAT, CIT, Customs) (%GDP)	2.3	2.2	2.2	…and non-oil revenues stagnated.
Total Public Debt (% GDP)	14.2	17.3	19.1	Public debt remains low by international standards.
Federal Govt. (FGN)				
Total FGN Expenditures (Actual, %GDP)	5.0	4.7	5.1	Federal government is very small.
Total FGN Revenues (Actual, %GDP)	2.7	2.0	2.1	Its revenues collapsed to 2% GDP.
FGN Debt (%GDP)	10.8	13.1	14.2	FGN debt is low but growing with widening deficits
FGN interest-payments-to-revenue ratio (%)	39	61	70	High i-to-R since 2016 are due to low revenues.
States Govt. (incl. FCT; excl. Local Govt.)				
States Expenditures (%GDP)	4.0	3.6	4.0	States' expenditures declined dramatically…
States Total Revenue and Grants (%GDP)	3.0	2.5	2.6	…following declining revenues.
State Debt (%GDP)	3.3	4.0	4.9	States requested 2 bail-outs – 2015 and 2016.
States interest-payments-to-revenue ratio (%)	6.4	9.8	9.8	…and spend less of their revenues on debt service.

Glossary

bbl	Barrels
bn	Billion
CAB	Current Account Balance
CBN	Central Bank of Nigeria
CIT	Corporate Income Tax
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DAWN	Development Agenda for Western Nigeria
DMO	Debt Management Office
ECA	Excess Crude Account
ER	Exchange Rate
ERGP	Economic Recovery and Growth Plan
FCT	Federal Capital Territory
FDI	Foreign Direct Investment
FEC	Federal Executive Council
FGN	Federal Government of Nigeria
FOB	Free on Board
FPI	Foreign Portfolio Investment
FTZs	Free Trade Zones
G&S	Goods and Services
GDP	Gross Domestic Product
GOEs	Government-Owned Enterprises
GoN	Government of Nigeria
Govt	Government
H2	Second Half of the Calendar Year
ICT	Information and Communications Technology
IEFX	Investors and Exporters Foreign Exchange
IGR	Internally Generate Revenue
IMF	International Monetary Fund
i-to-R	Interest-Payments-to-Revenue
JV	Joint Venture
JVCC	Joint Venture Cash Call
LCU	Local Currency Unit
mb/d	Million barrels per day
MDAs	Ministries, Departments, and Agencies
MTDS	Medium Term Debt Strategy
MTEF	Medium Term Expenditure Framework
N	Naira
NBS	National Bureau of Statistics
NDDC	Niger Delta Development Commission
NEC	National Economic Council
NEPZA	Nigerian Export Processing Zones Authority
NESTS	North East States Transformation Strategy
NIIP	National Infrastructure Investment Plan
NLNG	Nigeria Liquefied Natural Gas
NNPC	Nigerian National Petroleum Corporation
NSE	Nigerian Stock Exchange
OAGF	Office of the Accountant General of the Federation
OMO	Open Market Operations
OPEC	Organization of the Petroleum Exporting Countries
o/w	Of which
PIGB	Petroleum Industry Governance Bill
PMS	Premium Motor Spirit
PPP	Purchasing Power Parity
PPT	Petroleum Profits Tax
S&P	Standard & Poor
SEZ	Special Economic Zones
SG	State Governments
SLGs	State and Local Governments
SME	Small and Medium Enterprise
SW	South West
SWF	Sovereign Wealth Fund
SWOT	Strengths Weaknesses Opportunities and Threats
T-bills	Treasury Bills
TSA	Treasury Single Account
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
USD	US Dollars
VAIDS	Voluntary Assets and Income Declaration Scheme
VAT	Value Added Tax
yoy	Year on Year

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Chapter 1:
Economic Update

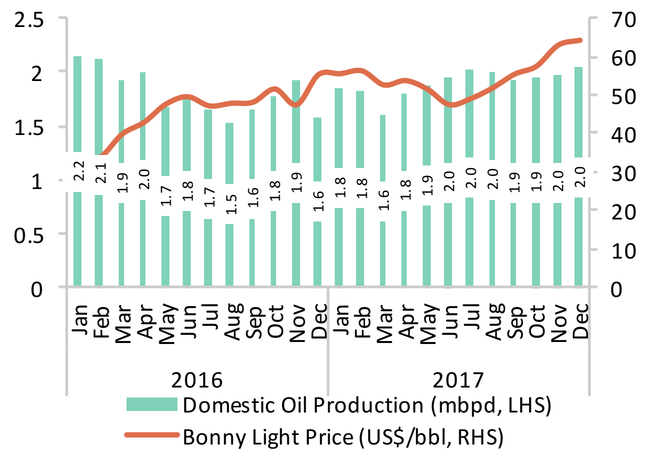
1.1 Nigeria emerged from recession in 2017, but its non-oil, non-agriculture sector continued to decline

1. **Nigeria's economy returned to growth in 2017 after it went through its first recession in 25 years in 2016.** GDP growth was 0.8 percent in 2017, driven by expansion in oil output, as well as agriculture sector output. The agriculture sector maintained its relatively steady growth as it had done throughout the recession, growing by 3.4 percent. The non-oil, non-agricultural sector in aggregate continued to shrink as aggregate demand remained weak, and credit to the private sector was crowded out by lending to the government. A few non-oil sub-sectors, however, recorded growth (albeit marginal), including construction and finance and insurance.

2. **The oil sector grew by 5 percent in 2017 after its decline throughout 2016 and up to Q1 2017.** Recovery in the oil sector benefited from the restoration of relative calm in the oil-producing Niger Delta region as well as the government's efforts to clear joint venture (JV) arrears and improve payments in 2017. There were only a few recorded acts of vandalism on the country's oil and gas infrastructure in 2017. Oil output (including condensate production) climbed to 2.0 million barrels per day (mb/d) in the second half of 2017 from an average of 1.7 mb/d in the same period of 2016. The price of Nigerian oil was also higher at US$57 per barrel, compared to US$50/bbl in H2 2016.

FIGURE 1.1:

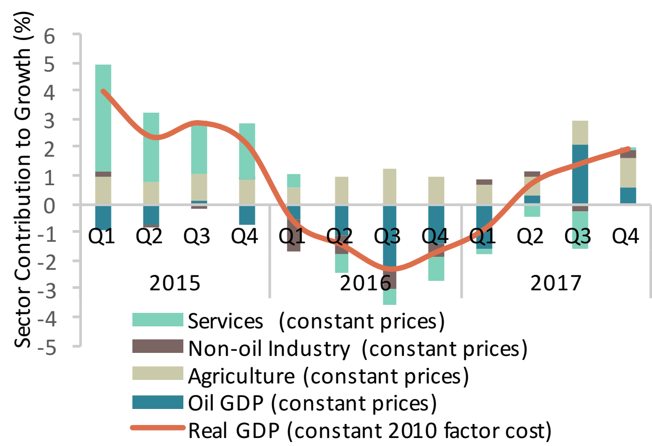
Oil Production and Price Were Higher in H2 2017



Source: NBS; S&P Global Platts.

FIGURE 1.2:

Agriculture and Oil Contributed the Most to GDP Growth



Source: NBS

3. **The non-oil economy grew by 0.5 percent, after recording a decline in 2016.** Non-oil, non-agriculture, however, contracted by 0.6 percent. Foreign exchange liquidity improved significantly relative to 2016, when it was a binding constraint on investment and growth in the non-oil sectors. However, the Central Bank of Nigeria (CBN) tightened domestic liquidity and credit to the private sector contracted (more on this in Section 1.3). Aggregate demand remained weak as real incomes dwindled in light of high inflation and increasing unemployment.

Table 1.1: The Balance of Payments of Nigeria (USD billion)

Activity Sector	Annual 2015	2016	2017	Quarterly Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Total GDP (2010 market prices)	**2.7**	**-1.6**	**0.8**	**-0.7**	**-1.6**	**-2.4**	**-1.6**	**-1.0**	**0.8**	**1.4**	**1.9**
Total GDP (2010 basic prices)	**2.8**	**-1.6**	**0.8**	**-0.7**	**-1.5**	**-2.3**	**-1.7**	**-0.9**	**0.7**	**1.4**	**1.9**
Agriculture	3.7	4.1	3.4	3.1	4.5	4.5	4.0	3.4	3.0	3.1	4.2
Industry	-2.2	-8.9	2.2	-6.7	-7.2	-12.7	-8.7	-5.8	2.2	8.8	3.9
Oil and Gas	-5.4	-14.4	4.8	-4.8	-11.6	-23.0	-17.7	-15.6	3.5	25.9	8.4
Manufacturing	-1.5	-4.3	-0.2	-7.0	-3.4	-4.4	-2.5	1.4	0.6	-2.9	0.1
Construction	4.4	-5.9	1.0	-5.4	-6.3	-6.1	-6.0	0.1	0.1	-0.5	4.1
Services	4.8	-0.8	-0.9	0.8	-1.3	-1.2	-1.5	-0.4	-0.8	-2.7	0.1
Trade (wholesale and retail)	5.1	-0.2	-1.1	2.0	0.0	-1.4	-1.4	-3.1	-1.6	-1.7	2.1
ICT	6.2	2.0	-1.0	4.1	1.4	1.1	1.4	2.7	-1.2	-4.5	-1.5
Finance and Insurance	7.1	-4.5	1.3	-11.3	-10.8	2.6	2.7	0.7	10.5	-6.0	0.2
Real Estate	2.1	-6.9	-4.3	-4.7	-5.3	-7.4	-9.3	-3.1	-3.5	-4.1	-5.9
Public Administration	-12.3	-4.6	-0.4	-4.4	-6.1	-3.6	-4.1	-2.1	1.6	-0.7	-0.5
Oil GDP	-5.4	-14.4	4.8	-4.8	-11.6	-23.0	-17.7	-15.6	3.5	25.9	8.4
Non-Oil GDP	3.7	-0.2	0.5	-0.2	-0.4	0.0	-0.3	0.7	0.4	-0.8	1.5
Non-Oil, Non-Agriculture	3.8	-1.7	-0.6	-1.1	-1.9	-1.9	-1.9	-0.1	-0.4	-2.5	0.4

Source: NBS

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

Activity Sector	Annual 2015	2016	2017	Quarterly Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Total GDP (2010 basic prices)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Agriculture	23.1	24.4	25.1	20.5	22.4	28.7	25.6	21.4	22.9	29.2	26.2
Industry	23.7	22.0	22.3	24.1	23.1	21.0	20.0	22.9	23.4	22.6	20.4
Oil and Gas	9.6	8.3	8.7	10.0	8.8	8.1	6.7	8.5	9.0	10.0	7.2
Manufacturing	9.5	9.3	9.2	9.5	9.4	9.2	9.0	9.8	9.4	8.8	8.9
Construction	3.9	3.7	3.7	4.1	4.3	3.1	3.4	4.2	4.3	3.0	3.5
Services	53.2	53.6	52.7	55.4	54.5	50.3	54.4	55.7	53.6	48.3	53.4
Trade (wholesale and retail)	16.9	17.2	16.9	18.2	17.5	16.4	16.7	17.8	17.1	15.9	16.8
ICT	11.2	11.6	11.4	12.0	12.6	10.2	11.6	12.5	12.4	9.6	11.2
Finance and Insurance	3.1	3.0	3.0	3.1	3.0	2.9	2.9	3.2	3.3	2.7	2.8
Real Estate	7.6	7.2	6.9	6.5	7.5	7.2	7.6	6.3	7.2	6.8	7.0
Public Administration	2.4	2.3	2.3	2.3	2.4	2.1	2.4	2.3	2.5	2.1	2.3
Oil GDP	9.6	8.3	8.7	10.0	8.8	8.1	6.7	8.5	9.0	10.0	7.2
Non-Oil GDP	90.4	91.7	91.3	90.0	91.2	91.9	93.3	91.5	91.0	90.0	92.8
Non-Oil, Non-Agriculture	67.3	67.2	66.2	69.4	68.8	63.2	67.7	70.0	68.0	60.8	66.6

Source: NBS

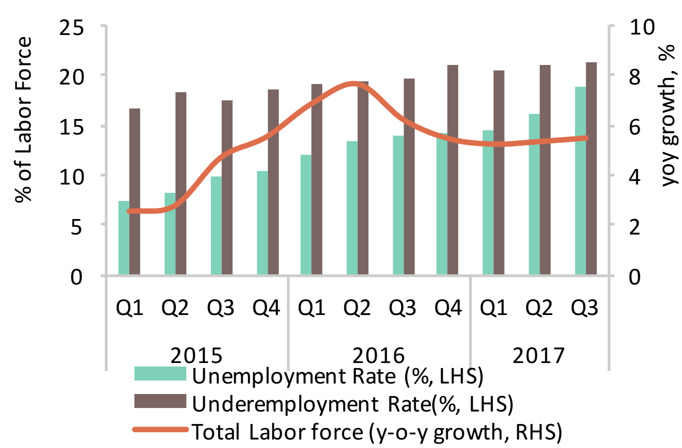
4. **With labor-intensive sectors still contracting, the rate of unemployment and underemployment increased throughout 2017.** The unemployment rate increased from 13.9 percent at the end of Q3 2016 to 18.8 percent by Q3 of 2017, and the underemployment rate from 19.7 percent in Q3 2016 to 21.2 percent in Q3 2017. Youth unemployment was much higher, growing from 19.1 percent in Q3 2016 to 25.5 percent in Q3 2017. Poverty is estimated to have increased by 0.8 percentage points in 2017 with almost half the population living in extreme poverty. [6]

1.2 The Current Account Surplus Increased and Foreign Exchange Liquidity Improved

5. **The current account surplus increased to over 2 percent of GDP in 2017, from 0.7 percent in 2016.** Oil exports strengthened with increasing production and price. Imports remained subdued, due to lack of growth in private demand and continued weakness in non-oil industry and services sector growth. The CBN maintained its restrictions on interbank foreign exchange access for 40 groups of imports, to promote import substitution. Thus, while exports grew by an estimated 32 percent, imports declined by 7 percent. Foreign Portfolio Investment (FPI) inflows resumed in response to the opening of the convertible Investors and Exporters Foreign Exchange window (IEFX) as well as high yields on domestic debt instruments (treasury bills, CBN liquidity management bills, and FGN bonds). Foreign Direct Investment (FDI) remained low, even declining from 0.9 percent of GDP to 0.6 percent, due to long-term policy uncertainty. The government raised US$4.5 billion from Eurobonds and US$300 million through Diaspora Bonds in 2017. The external reserves reached a four-year high of US$39 billion by the end of 2017 (equivalent

FIGURE 1.3:

Unemployment and Underemployment Increased in 2017

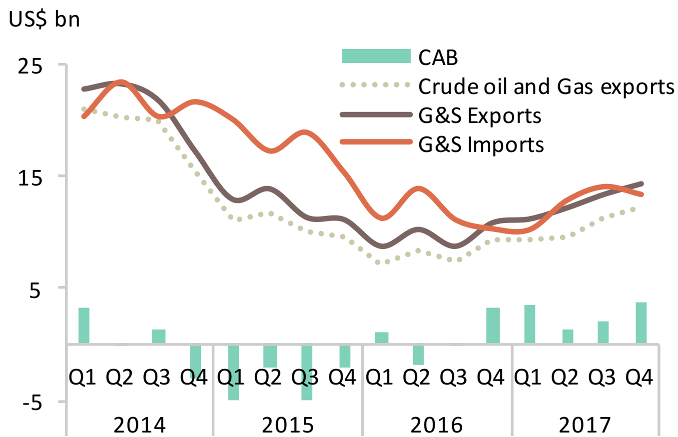


Source: NBS

6 In 2017, an estimated 49.2 percent of Nigeria's population lived below the PPP-corrected $1.90 per capita per day poverty line.

FIGURE 1.4:

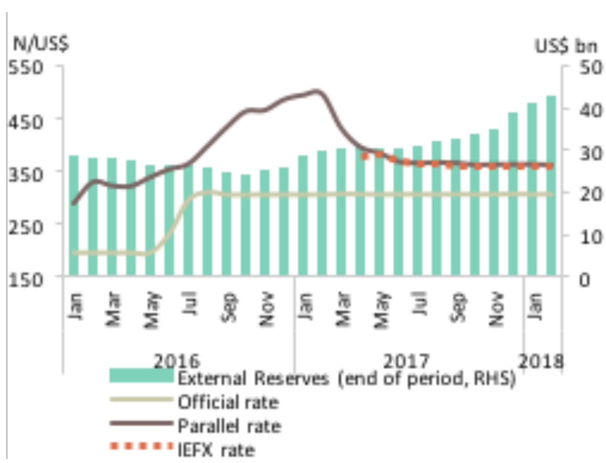
The Current Account Balance Expanded as Oil Exports Increased



Source: CBN. 2017Q4 data preliminary

FIGURE 1.5:

External Reserves Increased and IEFX Converged with Parallel Rate



Source: CBN

to 9 months of 2017 import coverage) from the low of US$24 billion in October 2016. By end-March, 2018, the external reserves had climbed further to US$46.7 billion.

6. **The CBN maintained stable exchange rates at its multiple foreign exchange windows.** With growing foreign reserves, the CBN was able to provide foreign exchange liquidity in the interbank market and keep the rates at its different interbank windows stable, up into early 2018: an officially-quoted rate of N305-N307/US$ (for petrol imports and the servicing of public external debt), an interbank intervention rate of around N328/US$, a rate of N360/US$ for 'invisibles' (tuition fees, medical fees, personal travel allowance and business travel allowance), the small and medium enterprise (SME) window, and the investors and exporters (IEFX) window. The CBN supplied over US$21 billion to the different windows (spots and forwards), as well as in swap transactions during 2017. The IEFX window provided investor confidence, which led to renewed portfolio inflows. The IEFX window recorded a turnover of US$22 billion in the eight months that it existed in 2017, and its average weekly turnover has settled above US$1.0 billion by February 2018. The CBN purchased over US$3 billion in the IEFX window in 2017.

Table 1.3:

The Balance of Payments of Nigeria (USD billion)

Activity Sector	Annual 2015	2016	2017	Quarterly Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
CURRENT ACCOUNT BALANCE	**-15.4**	**2.7**	10.4	**1.1**	**-1.7**	**0.0**	**3.3**	**3.4**	**1.4**	**2.0**	**3.7**
Trade Balance	-6.4	-0.5	13.1	-0.8	-1.8	-0.1	2.3	2.3	2.0	3.4	5.5
Exports (fob)	45.9	34.7	45.8	7.6	9.3	7.9	9.9	10.0	10.8	12.0	13.1
o/w Crude Oil and Gas	42.4	32.0	42.3	7.0	8.3	7.4	9.2	9.3	9.6	11.3	12.2
Imports (fob)	-52.3	-35.2	-32.7	-8.4	-11.1	-8.0	-7.7	-7.7	-8.8	-8.6	-7.6
o/w Oil and Gas	-8.5	-9.0	-8.2	-1.9	-2.6	-2.3	-2.1	-2.4	-2.2	-2.2	-1.3
Services(net)	-16.5	-8.0	-13.2	-1.8	-2.0	-2.4	-1.9	-1.5	-2.8	-4.3	-4.7
Credit	3.2	3.7	5.0	1.1	0.9	0.8	0.9	1.2	1.3	1.3	1.2
Debit	-19.6	-11.8	-18.3	-2.9	-2.9	-3.2	-2.8	-2.7	-4.1	-5.6	-5.9
Income(net)	-12.7	-8.6	-11.5	-1.8	-2.3	-2.1	-2.4	-2.3	-3.3	-3.0	-3.0
Current transfers(net)	20.2	19.9	22.0	5.6	4.3	4.6	5.3	4.9	5.4	5.8	5.9
FINANCIAL ACCOUNT BALANCE	**-6.7**	**0.7**	7.9	**-8.4**	**6.7**	**5.0**	**-2.6**	**3.3**	**3.2**	**-1.0**	**2.3**
Net Direct Investment	1.6	3.1	2.2	0.6	0.6	1.0	0.9	0.5	0.6	0.5	0.6
Outflows	-1.4	-1.3	-1.3	-0.3	-0.3	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3
Inflows	3.1	4.4	3.5	0.9	0.9	1.4	1.3	0.9	0.9	0.8	1.0
Net Portfolio Investment	0.9	1.7	8.5	0.2	0.5	0.7	0.3	0.4	1.0	3.3	3.8
Outflows	-1.7	-0.2	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Inflows	2.5	1.9	8.5	0.2	0.6	0.8	0.3	0.4	1.0	3.3	3.8
Net Other Investment	-9.2	-4.2	-2.8	-9.2	5.6	3.2	-3.8	2.4	1.7	-4.7	-2.1
Outflows	-10.3	-3.1	-8.7	-9.7	6.4	1.0	-0.7	-0.7	-0.3	-5.6	-2.1
Inflows	1.0	-1.1	5.9	0.6	-0.8	2.2	-3.1	3.1	2.0	0.8	0.0
CHANGE IN RESERVES											
(positive sign indicates reserve spending, i.e. reduction in reserves)	5.9	1.0	-12.2	0.7	0.8	2.7	-3.3	-3.0	-0.3	-2.8	-6.2
NET ERRORS AND OMISSIONS	16.3	-4.4	-6.1	6.5	-5.8	-7.6	2.5	-3.8	-4.3	1.8	0.2

Source: CBN. Note that 2017 Q4 figures are provisional

1.3 Monetary Policy was Tightened Significantly, Contributing to a Slight Reduction in Inflation

7. **The central bank significantly tightened broad money supply in 2017 through aggressive open market operations (OMO) to curb inflation and foreign exchange demand.** While the CBN policy rates remained unchanged throughout the year (monetary policy rate at 14 percent, cash reserve requirement at 22.5 percent and liquidity ratio at 30 percent), it tightened banking system liquidity through aggressive sales of liquidity management bills, diluting policy signals. The CBN issued N2.8 trillion (US$918 billion) worth of debt instruments to mop up liquidity in 2017. In some cases, these were through unannounced special OMOs at below market rates. Tighter monetary policy led to high money market rates consistently above 18 percent, which contributed to stronger investor sentiment. Broad money growth was only 1.7 percent in 2017, compared to 17.8 percent in 2016 and credit to the private sector declined by 1 percent, compared to a growth of 15.8 percent in 2016.

8. **Surprise moves by the CBN in December 2017 further diluted policy signals.** In the second week of December, the CBN eased banking system liquidity by not rolling over N208.6 billion worth of maturing CBN bills, when N198 billion treasury bills were redeemed by the Debt Management Office (DMO) at the same time. As a result, the short-term cost of funds in the interbank money market fell to 4 percent, 10 percentage points below the monetary policy rate. In turn, this led to a surge in foreign exchange demand at the IEFX window during that week, as foreign portfolio investors repatriated their profits from treasury bills. The CBN resumed its aggressive liquidity mop-up operations the following week and money market rates recovered to above 10 percent.

9. **While the CBN was tightening the money supply throughout 2017, it continued to finance the federal government's deficits through overdrafts.** This was despite the FGN's positive balances (through the Treasury Single Account) at the CBN throughout the year. Advances (overdrafts) to the federal government by the CBN at end-2017 were higher by 26.2 percent relative to end-2016. The CBN also continued its development finance interventions in the economy aimed at promoting growth.

10. **Banking sector performance was further eroded in 2017, contributing to tighter credit.** The latest Financial Stability Report (FSR) of the CBN (June 2017) indicates that the

level of non-performing loans (NPLs) as a percentage of total loans rose from 5.3 percent in December 2015 to 12.8 percent in December 2016 and to 15.02 percent in June 2017. Commercial banks prevented a more considerable deterioration in reported asset quality through proactive restructuring of loans—mostly loans in the oil, gas and power sectors. The aggregate capital adequacy ratio (CAR) fell from 14.7 percent in June 2016 and 13.9 percent in December 2016 to 11.5 percent in June 2017. This also contributed to the crowding out of credit to the private sector in 2017.

Table 1.4:
The Balance of Payments of Nigeria (USD billion)

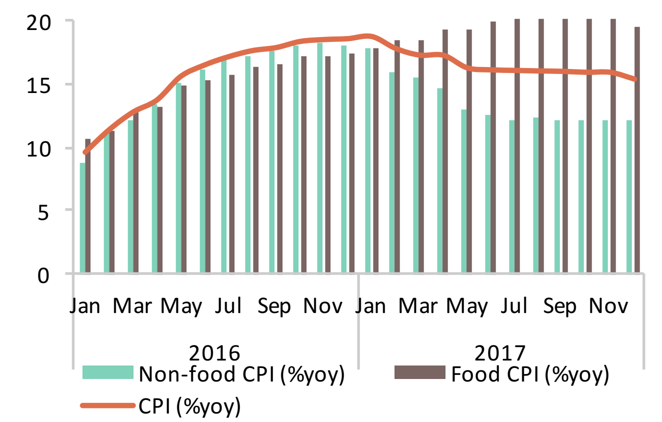
	2016	2017
Monetary & Financial Sector Indicators (% change, end of period)		
Broad Money	17.8	1.7
Narrow Money	31.5	-2.1
Net Foreign Assets	61.8	61.9
Net Domestic Credit	24.3	-3.7
o/w to the Federal Government (Net)	68.6	-26.7
o/w to the Private Sector (Net)	17.4	1.4
Monetary Policy Rate (absolute rate, end of period)	14.0	14.0
Liquidity Ratio (absolute rate, end of period)	30.0	30.0
Cash Reserve Requirement (absolute rate, end of period)	22.5	22.5
Exchange Rates (end of period)		
Exchange rate (LCU/$US)	305	306
Real effective exchange rate index (Nov 2009=100)	86.2	84.7
Financial Market Indicators (end of period)		
Stock Market (NSE) Index	26,875	38,243
Fitch Sovereign Long Term Foreign Debt Rating	B+	B+
Moody's Sovereign Long Term Foreign Debt Rating	B1	B2
S&P Sovereign Long Term Foreign Debt Rating	B	B

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

11. **Inflation declined in response to monetary tightening and exchange rate stability, but remains high.** The headline inflation (on a year-on-year basis) declined continuously from 18.7 percent in January to 15.4 percent in December 2017. It has declined further to 14.3 percent in February 2018. Food inflation remained very high, closing the year at 19.4 percent from 17.8 percent in January; in part due to the recurring farmer-herdsmen conflicts and the displacement of farming communities in the North-East of the country.

FIGURE 1.6:

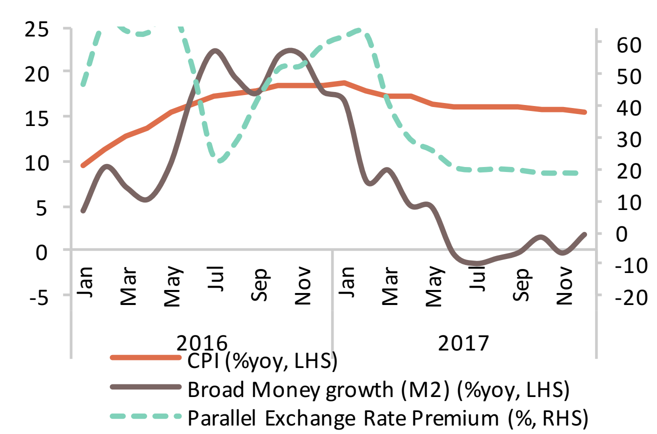
Headline Inflation Declined Slightly but Food Inflation Remained High



Source: NBS

FIGURE 1.7:

Broad Money Growth Declined



Source: NBS, CBN, Aboki FX

1.4 The Fiscal Situation Remained Challenging as Revenues Stagnated

12. **Federally collected revenues continued to underperform in 2017 and fiscal deficits remained high.**[7] Only 60 percent of targeted revenues were realized. Oil revenue performance was particularly low at 53 percent of the budgeted amount despite rising oil prices and output in 2017. One reason was that the government had not budgeted for N1.2 trillion in joint venture costs paid by the Nigeria National Petroleum Corporation (NNPC) out of government oil export revenue, resulting in much lower net oil revenues than budgeted. Non-oil revenues (customs revenue, corporate taxes, and VAT) came in at 65 percent of budget. This was slightly higher than the 56 percent collection rate achieved in 2016. The improvements came from corporate taxes and customs revenues. The VAT collection rate was slightly lower than in 2016.

7 This refers to the net measure (i.e. gross revenues net of revenue collection agency fees, Joint Venture (JV) cash calls, revenues in excess of specific benchmarks (notably the excess crude oil revenue), and any subsidies are deducted to arrive at the net measure, which is then distributed according to the existing revenue -sharing formulae.

13. **The NNPC also deducted unbudgeted fuel subsidies from oil export revenues, representing additional revenue losses.** Landing and transportation costs for imported Premium Motor Spirit (PMS or petrol) were higher than the cap on the domestic pump price. By November, the NNPC deducted subsidy payments of N128.9 billion from oil revenues due to the Federation Account in 2017. Independent oil marketers stopped importing PMS to avoid losses. In November, there was a significant drop (40 percent, relative to October) in the volume of PMS imported by NNPC. Acute fuel shortages hit the country in early December, as NNPC's capacity was strained in providing the fuel requirement for the entire country. There were also reports by the NNPC of petrol smuggling into neighboring countries where petrol costs more than Nigerian petrol.

14. **Net accrual to the Excess Crude Account (ECA) in 2017 was negative.** The account, which opened at US$3.1 billion in January 2017, had a balance of US$2.3 billion at the end of the year. The National Economic Council (NEC) approved the transfer of US$0.5 billion from the ECA to the Sovereign Wealth Fund (SWF) in May 2017. The ECA continues to exist in parallel to the SWF, which was established in 2011.

Table 1.5:

Net Federation Account Revenues (in percent of GDP)

Net Federation Account Revenues	2016			2017		
% GDP	**Budget**	**Actual**	**Budget Perf**	**Budget**	**Actual**	**Budget Perf.**
Total Federation Account Net Revenues	5.8	4.2	72%	7.8	4.7	60%
Oil and Gas (Net) /[8]	1.7	1.6	97%	4.2	2.2	53%
Other Extractives-related revenues and inflows /[9]	0.2	0.4	n/a	0.2	0.3	n/a
Non-oil Revenues (Net)	**3.9**	**2.2**	**56%**	**3.4**	**2.2**	**65%**
Corporate	1.7	0.9	53%	1.5	1.0	67%
Customs	0.8	0.5	64%	0.6	0.5	88%
VAT	1.4	0.8	55%	1.5	0.8	53%

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

15. **The federal government's 2017 budget implementation was hampered by shortfalls in federally and internally collected revenues.** Only 57 percent of the FGN's budgeted revenues were realized. Its share of oil revenue was only 53 percent of budget, and its share of non-oil revenue reached 70 percent of budget. Only 19 percent of the FGN's independent revenues were collected as challenges remain with estimating and collecting

8 The Government had not budgeted for the payments because it had envisaged a new funding mechanism (involving making contributions after payment of royalties to a joint escrow account from which payments for 'cost recovery' will be extracted before profit tax).

9 Independent marketers maintain that they are owed subsidy reimbursements of N800 billion by the Government accumulated since about 2013 (comprising subsidy, foreign exchange differentials and interest to banks).

operating surpluses from the government-owned enterprises (GOEs).[10] These revenue shortfalls, combined with the delayed start of implementation of the federal government's budget, impeded budget implementation, particularly on the capital expenditure side: only 35 percent of the funds earmarked for 2017 capital expenditures were released to line ministries by December. Recurrent expenditure on the other hand, was 98 percent implemented, over a third of which was FGN debt service. However, the calendar-year FGN capital spending (i.e. including 2016 capital spending which was implemented until May 2017) increased from 0.6 percent of GDP in 2016 to 1 percent of GDP in 2017. The FGN's debt service (interest payments only) in 2017 is estimated at 1.4 percent of GDP, equivalent to about 70 percent of the FGN's revenue. The FGN's overall deficit reached 3 percent of GDP[11], the limit set in the Fiscal Responsibility Act of 2007.

Table 1.6:

FGN Fiscal Accounts (In percent of GDP)

FGN Fiscal Accounts	2016			2017		
% GDP	**Budget (%GDP)**	**Actual (%GDP)**	**Budget Perf.**	**Budget (%GDP)**	**Actual (%GDP)**	**Budget Perf.**
Total FGN Revenue	**3.7**	**2.0**	**54%**	**3.7**	**2.1**	**57%**
Oil and Gas	0.7	0.7	97%	1.8	0.9	53%
Non-oil Revenues	1.4	0.8	56%	1.1	0.8	70%
Corporate	0.8	0.4	53%	0.7	0.5	67%
Customs	0.4	0.2	64%	0.3	0.2	88%
VAT	0.2	0.1	55%	0.2	0.1	53%
FGN Independent Revenues	1.5	0.2	16%	0.7	0.1	19%
Other Inflows /1	0.1	0.3	279%	0.1	0.2	196%
Total FGN Expenditures /6	**5.9**	**4.7**	**80%**	**6.1**	**5.1**	**84%**
Recurrent Expenditures (excl. Statutory Transfers)	4.0	3.7	92%	3.9	3.8	96%
o/w interest payments /2	1.3	1.2	96%	1.3	1.4	110%
Capital Expenditures /3	1.5	0.6	38%	1.8	1.0	53%
Statutory Transfers	0.3	0.3	98%	0.4	0.4	101%
Other Outflows /4	0.0	0.1		0.0	0.0	
Fiscal Balance	**-2.2**	**-2.7**	**124%**	**-2.4**	**-3.0**	**126%**

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

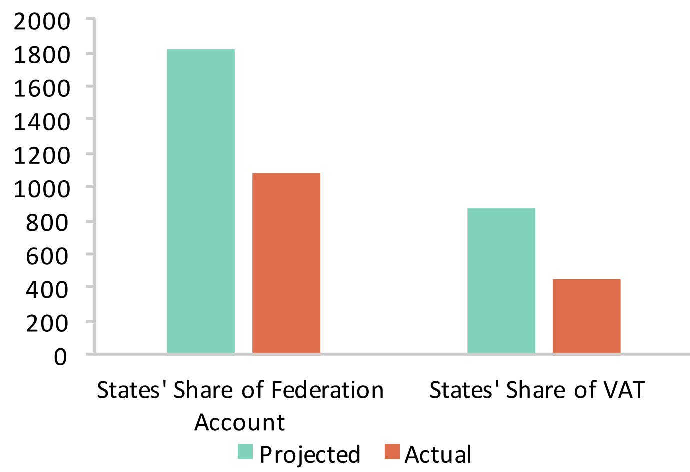
10 FG Independent revenue consists of GOE surpluses, income taxes of the Military, Police and staff of the Foreign Service, as well as MDA IGR. GOE surpluses however constitute the bulk (at least 65 percent).

11 This is lower than IMF calculation (4.3 percent of GDP) primarily because the Fund includes on-lending to SLGs under FGN spending from 2017. SG external borrowing must be guaranteed by the FGN, and currently is viewed as a contingent liability outside of FGN budgetary spending, rather than a transfer.

16. **The state governments' fiscal situation was similarly affected by the revenue shortfalls**. As indicated in our October 2017 edition of the Nigeria Bi-annual Economic Report, federation account transfers constitute the bulk of most states' revenues (about 65 percent in the first half of 2017). The states' efforts at generating revenue internally, while improving in some states, remain low overall. With the federally collected revenues lower than targeted, distributions to all tiers of government were affected. The aggregate distribution to the state governments was 43 percent lower than estimated in the federation revenue framework. The FGN's budget support facility to states was extended in May 2017 for any month that net distributable revenues fell below N600 billion.

FIGURE 1.8:

Federation Transfers to States were Lower than Projected in 2017



Source: OAGF

1.5 The Government's Debt Stock Remained Low, but Debt Service Increasingly Burdened the Budget

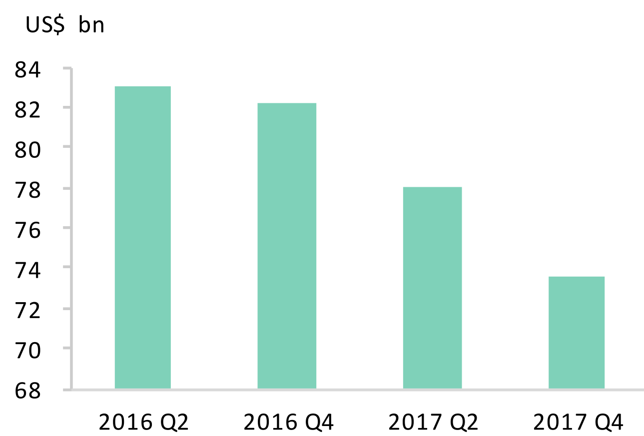
17. **At the end of 2017, the general government's debt stock is estimated at 19.1 percent of GDP,**[12] which is low compared internationally. However, it is increasing, as it grew from 17.3 percent of GDP in 2016. Federal government's debt stock dominates Nigerian public debt, at about 14.2 percent of GDP at the end of 2017. Moreover, the federal government's interest payments-to-revenue ratio reached and estimated 70 percent, constituting

12 This excludes estimated but un-documented expenditure arrears as well as CBN overdrafts.

a significant burden on the budget. The government made significant headway in its efforts to rebalance its debt towards external and longer-term instruments during 2017.[13] In 2017, the FGN raised US$4.5 billion from Eurobonds (with tenors ranging from 10 to 30 years) and US$300 million from diaspora bonds (5-year tenor). This reduced the amount of new domestic instruments issued by the FGN. Also, of the US$4.5 billion Eurobonds, US$0.5 billion was used to liquidate short-term treasury bills that matured in December 2017. This eased pressure on the domestic debt market. Nonetheless, the FGN's domestic borrowing remained elevated overall, and this, coupled with monetary tightening by the CBN and deteriorating asset quality in the banking system meant that the private sector remained crowded-out. In February 2018, the FGN successfully raised an additional US$2.5 billion in Eurobonds, primarily to replace short-term domestic treasury bills. Furthermore, in March 2018, the FGN, through its Debt Management Office (DMO) announced plans to cut back on domestic bond issuance: total borrowings for 2018 to be 30 percent lower than in 2017.

FIGURE 1.9:

The Share of Domestic Debt in the Total FGN Debt is Declining



Source: DMO

13 This was in line with one of the key pillars of its 2016-2019 Medium Term Debt Strategy (MTDS). The MTDS targets moving from a domestic to external debt ratio of 80:20 in 2016 to 60:40 by 2019. At end-2017, this ratio was 74:26, from 82:18 at end-2016. FGN domestic debt has nominal interest rates ranging from 13 to 19 percent, on average, while its commercial external debt (Eurobonds) have been issued at yields of between 5 to 8 percent. Thus, the Government intended to reduce the cost of its borrowing through rebalancing. However, in real terms, the average interest on domestic debt would appear to be lower than the average rates on the Eurobonds.

Chapter 2:
Economic Outlook

2.1 The Recovery is Expected to be Slow and Dependent on the Oil Sector

18. **The overall GDP growth rate is projected to hover just over 2 percent.** The projections assume stability in oil production and price, sustained performance of the agriculture sector, and a very slow recovery of non-oil industry and services. This is significantly below the government's aspirational projections, outlined in the ERGP, of achieving 4.8 percent GDP growth in 2018 and reaching 7.0 percent by 2020, largely driven by the non-oil sectors.[14]

19. **The oil sector is the key factor expected to carry economic growth in the short-term but cannot deliver long-term sustainable growth.** Oil production is expected to remain just above 2 mb/d in the medium term, but below the government's projections of 2.3 mb/d in 2018 and 2.5 mb/d by 2020. The oil sector recovery in the second half of 2017 was from a low base in production and price levels in the previous year. Therefore, with the room for further production expansion limited in the short term by both domestic capacity and OPEC's country-specific production cap, the oil sector growth rate will slow. Given the low oil sector share in GDP, its contribution to real GDP growth will diminish. Continued government efforts to impede militant activity in the Niger delta will remain central to the stability of oil production in the short term.

20. **While the oil price outlook for the short and medium term is positive, oil prices are expected to stay below 2013 peak prices and remain prone to volatility.** Oil price variations have little direct impact on real growth, but the 2016-17 recession demonstrated the significant spillover effects from the oil sector to the rest of the economy. The channels are foreign exchange availability in the economy, and fiscal-monetary retrenchment. The size of the potential spillover effects remains dependent on the policy response, particularly the foreign exchange supply and rate management.

14 Government's GDP growth projection for 2018 was lowered to 3.5 percent in the 2018-2020 MTEF.

21. **Agriculture sector growth is projected to remain limited by the ongoing conflicts in the North-East and the Middle-Belt regions, despite the CBN direct interventions.** Output growth in the agricultural sector is expected to contribute positively, with the overall sector growth averaging between 3 and 4 percent year-on-year. The CBN will likely continue its development financing schemes and foreign exchange restrictions to support import substitution, both of which we consider suboptimal policy measures. However, growth will remain below its potential due to the ongoing conflicts. Success in the government's efforts to contain the conflicts could support higher output growth.

22. **The recovery of non-oil industry and services is expected to be slow due to subdued domestic demand.** Some of the domestic firms face financing difficulties following the 2016 recession and tight monetary policy. Consumer demand remains subdued due to stagnating salaries, high unemployment and high inflation, limiting the attraction of long-term domestic and foreign investment inflows. The services sector (over half of GDP) is expected to enter a moderate, slow recovery.

23. **The long-term sustainability and inclusiveness of growth depends on the implementation of significant structural and fiscal reforms.** Most of the structural reforms outlined in the government's Economic Recovery and Growth Plan (ERGP) are still in early stages of implementation. The Power Sector Recovery Plan aside, limited movement is seen in developing detailed sector plans, one year after the ERGP was launched. Focus labs, which constitute one of the ERGP implementation strategies, were launched only on March 13, 2018. The government's plea for leveraging private financing is getting little traction, with limited FDI growth and continuing availability and cost issues in the supply of domestic private credit. The central bank's direct sector-specific financing schemes represent suboptimal policies.

Table 2.1:

World Bank Medium-term Macro-Fiscal Projections

	2015	2016	2017e	2018 f	2019 f	2020 f
Real GDP growth, at constant market prices	**2.7**	**-1.6**	**0.8**	**2.1**	**2.2**	**2.4**
Private Consumption	1.5	-5.7	-0.8	0.6	1.2	1.8
Government Consumption	-11.9	-15.1	1.9	19.5	-0.1	-3.0
Gross Fixed Capital Investment	-1.3	-5.0	0.9	1.2	5.1	2.3
Exports, Goods and Services	0.1	11.5	1.0	6.0	4.7	5.7
Imports, Goods and Services	-25.7	-10.4	-11.6	14.8	7.9	7.5
Real GDP growth, at constant factor prices	**2.8**	**-1.6**	**0.8**	**2.1**	**2.2**	**2.4**
Agriculture	3.7	4.1	3.4	3.5	3.8	3.9
Industry	-2.2	-8.9	2.2	3.8	3.1	4.0
Services	4.8	-0.8	-0.9	0.8	1.1	0.9
Inflation (Consumer Price Index)	**9.0**	**15.7**	**16.5**	**14.5**	**13.9**	**13.6**
Current Account Balance (% of GDP)	**-3.2**	**0.7**	**2.2**	**1.7**	**1.5**	**1.3**
Fiscal Balance (% of GDP)	**-3.2**	**-3.9**	**-4.4**	**-4.0**	**-4.0**	**-4.0**
Debt (% of GDP)	**14.2**	**17.3**	**19.1**	**20.4**	**21.5**	**22.5**

Source: World Bank. Notes: e = estimate, f = forecast

2.2 Fiscal Pressures Will Remain High as Revenue Shortfalls Continue

24. **The 2018 federal government budget has even less realistic revenue targets than the 2017 budget.** Compared to 2017 realizations, the federal government expects oil revenue to double, corporate income tax (CIT) collections to grow by 46 percent, value-added tax (VAT) collections to grow by 61 percent, customs revenue to grow by 35 percent, and the FGN's independent revenue to more than quintuple. Both oil and non-oil revenue targets are unlikely to be met, due to potential risks and lack of and delays in tax policy reforms. The following issues arise:

- **Budgeted oil revenue targets are based on an optimistic oil production assumption.** The government assumes production to reach 2.3 million barrels per day (mb/d), whereas a projection of 2.05 mb/d is probably more realistic. However, the budget is built on a conservative oil price projection of US$47 per barrel. There is a renewed threat of militant activity reducing production, as a ceasefire declared by one of the militant groups has ended. As the Excess Crude Account is nearly depleted, there is no buffer against potential negative shocks.

- **The oil-revenue deductions prior to transmission to the Federation Account will remain sizeable**. The Joint Venture Cash Call (JVCC) payments will no longer be budgeted in the federation account section of the federal government's budget, but instead will be deducted by NNPC from export proceeds before they are transferred to the Federation Account. The scheduled payments of JVCC arrears out of incremental oil production will also reduce federation revenue. Also, petroleum subsidy payments will continue to reduce net oil revenue as the pump price remains capped below the import price, and fuel shortages and smuggling will likely continue.

- **Oil sector governance reforms will influence future oil production and revenues.** The Petroleum Industry Governance Bill (PIGB) - now passed by both chambers of the National Assembly but not yet assented - and its associated laws currently debated in parliament will determine future investment levels. In the longer term, oil sector investments need to counteract the natural decline in production and increase oil production.

- **On a positive note, exchange rate depreciation may contribute positively to the actual oil revenues.** The actual oil revenues accruing to the government may be higher if oil revenues are converted at an exchange rate higher than the official exchange rate of N305/US$ assumed in the 2018 budget and the MTEF 2018-2020. Ideally, this alternative exchange rate would be a single, unified rate, rather than an additional exchange rate.

- **The ambitious non-oil revenue targets are unlikely to fully materialize in the absence of significant tax policy reforms.** However, the government's commitment to tax policy reforms has been bearish, and the ongoing tax administration efforts showed a very limited effect in 2017. The VAT rates remain among the lowest globally. Broad exemptions limit the potential collection, even if the government's efforts to address the collection inefficiencies were effective. Both CIT and customs revenue growth is expected to be slow, given the slow recovery in private demand, and further suppression of imports from the CBN's import substitution policies. The voluntary assets and income declaration scheme (VAIDS) may yield some additional inflows, and so may the additional excise and tobacco taxes that were introduced in the 2018 budget. However, the yields will be small, and implementation remains unclear given the delayed passing of the 2018 budget.

- **The government budget further assumes unrealistic additional inflows from divestment of shares in some oil joint ventures.** These financial inflows are expected to reduce the debt component of deficit financing.[15] However, the processes associated with the sales of a fraction of the government's ownership in joint ventures are unlikely to be completed in time for the proceeds to materialize in 2018.

25. **The passing of the 2018 budget has been delayed because of ongoing tensions between the executive and the parliament, as in the case of the 2017 budget.** The FGN's proposed total expenditures (about 6 percent of projected GDP) represent a 16 percent nominal growth over the 2017 budget. Capital expenditure (including the capital expenditure share of statutory transfers) is pegged at 31 percent of overall spending. The recurrent budget is generally fully implemented, starting with the beginning of the calendar year, which is also the fiscal year. However, capital expenditure implementation does not start until the budget is passed by the National Assembly. Its implementation is then scheduled to run over one full year, even if it is out of sync with the rest of the budget. Therefore, with the delayed passing of the budget combined with the likely revenue shortfalls, full capital budget implementation is unlikely within calendar year 2018.

26. **The federal government will continue to tap international markets to rebalance its debt towards external, longer-term instruments.** While the passing of the borrowing plan was delayed together with the 2018 budget, the issuance of US$ 2.5 billion Eurobonds in 2018 Q1 to replace short-term domestic debt was approved in 2017. With the multilateral donor budget support unlikely to be requested given the current set of monetary policies, the increments of external debt components will continue to rely on commercial debt, with a potential relatively further small contribution from the issuance of diaspora bonds. While increasing external debt, currently serviced at the official exchange rate, carries some risk from currency devaluation, the stock of Nigeria's public

15 In the budget, they are considered as revenues, in contrast to international fiscal accounting practices.

debt remains low, with debt sustainability issues arising from the low revenues rather than from the debt stock itself.

27. **Domestic interest rates are expected to decline slowly.** As the government reduces the relative reliance on domestic bonds and T-bills, the yields are expected to continue to decline slowly. However, with high inflation expectations, the servicing of the domestic debt will remain expensive.

2.3 Monetary Policy will Continue to Target Exchange Rate Stability

28. **The exchange rates are projected to remain managed by the CBN and stable in the absence of significant shocks.** While officials from the CBN recognize the desirability of a unified exchange rate, they are unlikely to jeopardize the current stability in the different rates. The CBN is therefore likely to continue to intervene in its different forex windows to maintain stability. Maintaining multiple exchange rates remains favorable to the government as it disguises the real burden of external debt service and fuel import costs. The different windows applicable to the private sector are more likely to be consolidated, with most of the transactions taking place at the IEFX window, especially amid dissatisfaction of private sector agents unable to access the forward sales at the retail or wholesale windows. The CBN is also likely to continue to limit domestic liquidity through indirect means. The monetary policy rate and the CRR are unlikely to change significantly in the near term. Open market operations through CBN bills are likely to continue in 2018.

29. **Inflation is expected to remain in double digits.** Monetary tightening has had limited effect on bringing core inflation down in 2017. The possible increases in recurrent spending in the run-up to the election may add to inflationary pressures if the use of the government's overdraft facility at the CBN grows significantly. Upward adjustments in fuel and electricity prices would put further pressure on non-food inflation (but are unlikely before the 2019 election). Food inflation will remain high in the face of continued unrest in the North-East and Middle-Belt regions. It is likely to decrease slightly because of base effects.

2.4 The Positive Current Account Balance is Expected to Decrease Slowly

30. **The current account balance (CAB) will remain positive but decline in the medium term.** Goods and services exports are dominated by oil and gas exports. Their value is expected to continue to increase with stable oil production and higher oil prices, bar the realization of downside risks. Meanwhile, the recovery of import growth is expected to remain subdued due to low growth in private demand, both in consumer goods and intermediate capital imports, both further limited by continued import-substitution policies led by the CBN.

31. **The net impact from the new refinery on the current account balance is expected to be small.** A new private refinery is expected to commence operations in 2020. The savings from domestically refined oil replacing fuel imports depend on the configuration of the refinery, which would define the mix of refined petroleum products and thus the value added. Possible foreign exchange savings from domestic refining would thus be confined to shipping costs, which are very small. If the refinery's capacity exceeds the domestic demand, the surpluses will be exported, but the net addition over crude oil exports, again, will be defined by the configuration of the refinery.

32. **External reserves are expected to start declining in the medium term driven by financial account developments.** Short-term financial inflows contributed significantly to the growing external reserves in 2017. However, as the yields and volumes on the government's and the CBN's short-term securities decline, net portfolio flows are expected to turn increasingly negative. The FDI is expected to remain subdued despite improvements in the business climate, given the limited growth in domestic demand. The growing value of oil and gas exports and issuance of Eurobonds would continue to contribute positively.

2.5 Downside Risks and Upside Potential

Downward Risks: What if the oil sector underwent a shock like in 2015-16?

33. **Nigeria's short- to medium-term outlook is sensitive to oil production disruptions and price shocks.** A shock to oil production and price comparable to 2016 remains a distinct possibility. The CBN would likely face the same pressures to devalue or impose foreign exchange restrictions, but the fiscal shock could be even more severe than in 2016. However, the economy would be able to avoid going into recession as monetary and external policies would be less disruptive given the rebuilt external reserves.

34. **The transmission channels of a significant oil price and production shock are foreign exchange shortages and fiscal retrenchment.** The CBN is better prepared to withstand temporary negative shocks: its foreign reserves buffer is higher than in 2014 before the oil price collapse. Assuming the oil shock would be contained in 2018 alone, and the recovery trajectory would mimic the 2017 oil sector recovery, the CBN would be able to maintain the IEFX window in its current vicinity by using a fraction of its now higher reserves. This would constrain capital flight. However, a prolonged production disruption or price crash would deplete the reserves, and the CBN would face a similar policy dilemma as in 2015-16: convertibility restrictions or devaluation. Investors would anticipate such moves, and capital flight could quickly accelerate.

35. **The fiscal shock from oil sector disruption would be more pronounced.** While the gross oil revenue reduction from a price and production shock like in 2015-16 would be comparable, the fiscal space would be constrained by growing interest bill from the debt issued in 2016-17 and the agreed recognition of N 2.7 trillion salary and contractor arrears. Pressures to honor the servicing of JVCC arrears may further reduce the government's take. The government would cut, first, capital spending, which might be reduced to the low level observed in 2016, and if that were insufficient, would need to cut even recurrent expenditure.

36. **The squeeze of fiscal space, which is very small even without further shocks, would further delay the build-up towards long-term sustainable growth.** Reduced government capital spending would result in stagnating and even further deteriorating infrastructure. Pressures on recurrent expenditure may further constrain the needed attention to the delivery of the ERGP. The current account balance would decline before recovering with oil exports.

Table 2.2:

World Bank Risk Scenario

	2015	2016	2017e	2018 f	2019 f	2020 f
Real GDP growth, at constant factor prices	**2.8**	**-1.6**	**0.8**	**0.0**	**1.2**	**1.8**
Agriculture	3.7	4.1	3.4	3.4	3.5	3.6
Industry	-2.2	-8.9	2.2	-1.6	2.5	3.7
Services	4.8	-0.8	-0.9	-0.9	-0.4	0.1
Inflation (Consumer Price Index)	**9.0**	**15.7**	**16.5**	**17.5**	**16.7**	**15.9**
Current Account Balance (% of GDP)	**-3.2**	**0.7**	**2.2**	**0.0**	**0.6**	**1.1**
Fiscal Balance (% of GDP)	**-3.2**	**-3.9**	**-4.4**	**-4.1**	**-4.0**	**-4.0**
Debt (% of GDP)	**14.2**	**17.3**	**19.1**	**20.4**	**21.6**	**22.6**

Source: World Bank.

Upward Potential: What if the government undertook more significant reforms?

37. **Significant fiscal reforms, monetary policy adjustments, and important improvements in the investment climate would foster long-term growth.** Tax policy reforms are the only option to bring the size and impact of the Nigerian government closer to structurally similar countries. The sustainability of long-term growth hinges on the reduction of Nigeria's infrastructure deficit. Significant fiscal reforms would allow increasing public investment, while more predictable monetary and exchange rate policies combined with important improvements to the investment climate would attract the needed private, long-term investment flows.

38. **Significant tax policy and administration reforms would give all tiers of government more space for service delivery and capital investments.** In the oil sector, the revenue growth would be brought about by important governance reforms to reduce leakages and incentivize new investment. Non-oil sector revenues would be boosted by broadening the tax base, improving tax administration, and a comprehensive VAT policy reform with a higher VAT rate and reduced exemptions.[16] Increased fiscal space could accommodate significant growth in capital spending, a reasonable adjustment to public sector wages, higher service delivery and reduced crowding out of private sector lending.

16 See the IMF 2018 Article IV Staff Report and Special Issues Paper.

39. **Real GDP growth could exceed population growth in the medium term.** The growth in non-oil industry and services would drive faster overall growth. In 2018, the impact would be limited, given the limited remaining time for the private sector to respond, but would show effects in 2019-20. The current account balance would decline with capital goods imports, but this would be financed by increased FDI.

Table 2.3:

World Bank Reform Scenario

	2015	2016	2017f	2018 f	2019 f	2020 f
Real GDP growth, at constant factor prices	**2.8**	**-1.6**	**0.8**	**2.2**	**2.9**	**3.6**
Agriculture	3.7	4.1	3.4	3.5	4.1	4.4
Industry	-2.2	-8.9	2.2	3.8	3.6	4.7
Services	4.8	-0.8	-0.9	0.9	1.9	**2.7**
Inflation (Consumer Price Index)	**9.0**	**15.7**	**16.5**	**14.5**	**12.8**	**12.1**
Current Account Balance (% of GDP)	**-3.2**	**0.7**	**2.2**	**1.5**	**1.1**	**0.6**
Fiscal Balance (% of GDP)	**-3.2**	**-3.9**	**-4.4**	**-4.0**	**-4.0**	**-4.0**
Debt (% of GDP)	**14.2**	**17.3**	**19.1**	**20.4**	**21.5**	**22.6**

Source: World Bank.

Chapter 3:
Connecting to compete:

Regional connections and coordination to enhance Nigeria's competitiveness

3.1 Spatial integration of domestic markets alongside opportunities for sub-national specialization have the potential to support economic diversification, enhance productivity and boost long-term inclusive growth

40. **The volatility of Nigeria's current growth process, largely linked to oil sector developments; and the stagnating progress in poverty reduction call for renewed interest in policies focusing on long-term, inclusive growth.** This includes more robust policies to reduce spatial disparities and increase competitiveness of all regions of Nigeria. Such policies also hold promise for increased non-oil revenue generation. To deliver inclusive growth, Nigeria's Economic Recovery and Growth Plan (ERGP) 2017–2020 focuses on several key sectors and infrastructure upgrading. To realize this vision, the plan aims to create jobs by developing labor-intensive sectors such as agriculture, manufacturing, housing, and construction, continuing and extending existing public works programs, and encouraging private sector participation in the economy. It will also develop infrastructure in sectors identified as having local employment potential. While the plan identifies the critical sectors (i.e., the what?) and the institutional and regulatory reforms needed (i.e., the how?), to remove distortions in the economy, an equally important issue relates to the location (i.e., the where?) of sectoral growth drivers that can contribute most effectively to faster productivity growth and structural transformation.

41. **Agglomeration economies from well-managed urban development alongside gains from regional cooperation can enhance productivity and spur innovation and economic diversification.** While the ERGP emphasizes the need for greater subnational coordination and outlines incentives to ensure that the federal and state governments work toward the same goals, a key challenge for federal and state level policy-makers is to identify the myriad of interventions that are best suited to realize the development potential of subnational regions and to reduce the large and persistent spatial disparities in living standards.

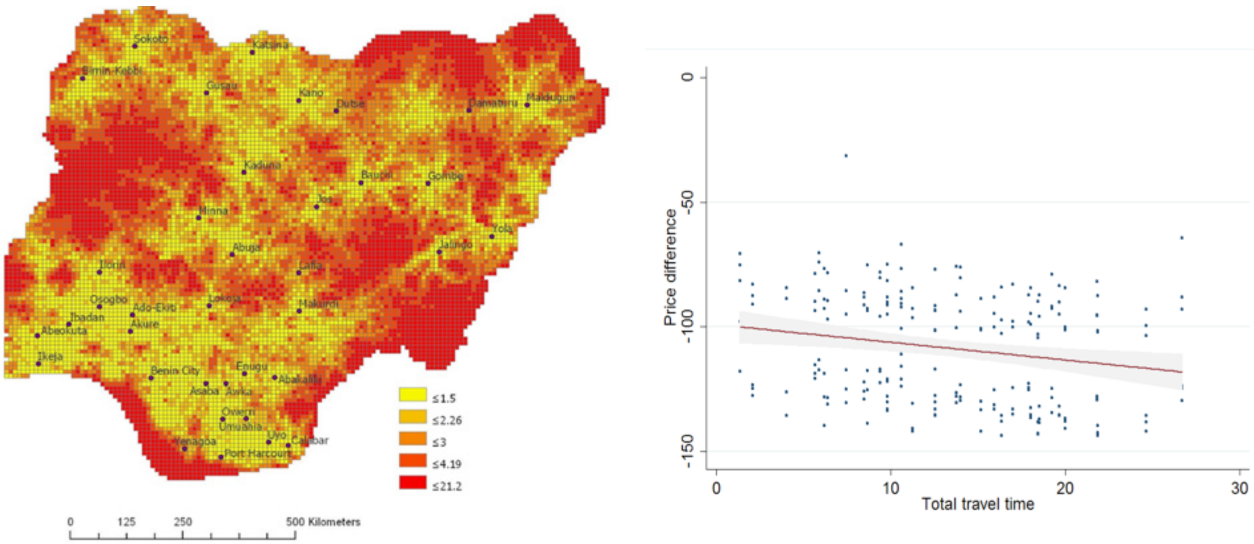
42. **There are major differences in economic development across regions in Nigeria with economic activity concentrated in the South, where educational levels and other measures of well-being level are higher.** There are major differences in economic development across regions in Nigeria with economic activity concentrated in the South, where educational levels and other measures of well-being level are higher. Evidence from spatial analysis using nighttime lights data and geotagging of all registered businesses in the country showed a consistent pattern of concentrated economic activities in the south. Access to basic infrastructure such as water and sanitation and services such as health and education also vary considerable across regions. Primary school attendance for girls is 41.5 percent in the Northeast compared with 80 percent in the Southeast. However, there exists considerable heterogeneity within broadly defined geo political regions, with the poverty rate in the South Eastern Ebonyi state -- 76 percent being almost 6 times that in Lagos, Delta or Imo.

43. **Domestic market fragmentation and limited connectivity in Nigeria have dampened the potential for economic collaboration and cooperation among regions.** Limited market integration and insufficient connective infrastructure reduces producers and firms' ability to reach wider markets.[17] For example, towns and cities in Taraba, Niger, and Delta states experience the longest travel times to reach large markets (figure 3.1, left chart). On the other hand, towns around the Lagos-Kaduna-Kano corridor have the best market access in the country. Meanwhile, analysis of commodity prices also highlights and reconfirms the lack of market integration—there is slow adjustment of local prices in reaction to changes in international commodity prices, especially in states further away from the Lagos Kaduna corridor. Figure 3.1 (right side) shows that the difference between local and international prices of rice increases with the total travel time from Lagos, a point of entry of imported commodities.

17 Russ, J., Berg, C., Damania, R., Barra, A.F., Ali, R. and Nash, J., 2017. Evaluating Transport Infrastructure Projects in Low Data Environments: An Application to Nigeria. *The Journal of Development Studies,* pp.1–20.

FIGURE 3.1:

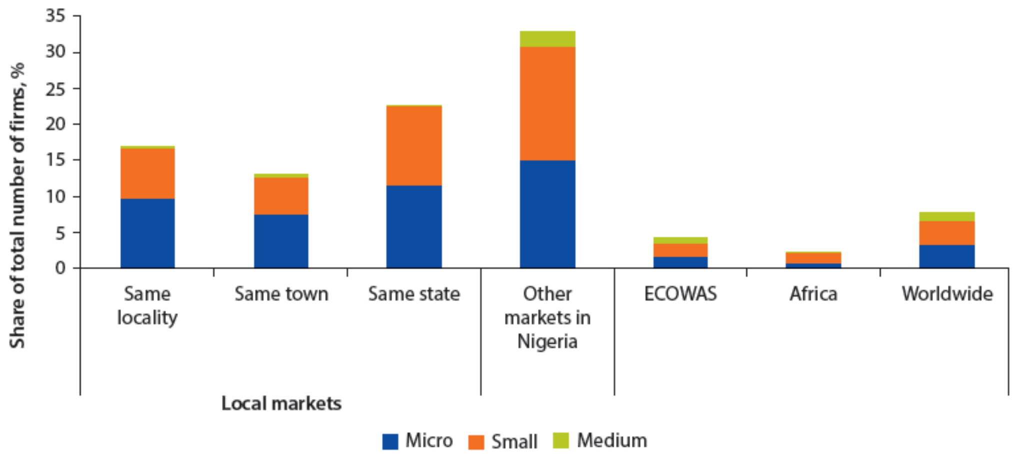
Poor Access to Markets Hindering Economic Development Opportunities in the Less-Developed Regions (left) and States Far from Lagos Insensitive to Changes in International Commodify Prices (right)



44. **Most firms trade in local markets and are unable to leverage economies of scale gains and (sub national) regional specialization.** With a large population and a growing middle class (from 13 percent to 19 percent of population between 2003 and 2013), Nigeria has a big home market. However, the majority of firms identify local markets—same locality, same town/city, same state—as the main sales channels (Figure 3.2). With the dominance of local trading, regional economic specialization is less likely to emerge, as local trading leads to a replication of economic sectors across different locations rather than specialization. However, one does observe some specialization of agriculture in the North West and specialization of mining in the South-South, but the size of these sectors combined is quite small—less than 2 percent of all businesses. For a large domestic market like Nigeria, subnational regions are operating in relative autarchy.

FIGURE 3.2:

Majority of Firms trade in local markets, not taking advantage of Nigeria's large domestic market



Source: World Bank calculations using SMEDAN 2010 survey.
Note: ECOWAS = Economic Community of West African States.

45. **Agglomeration economies from well-managed urban development alongside gains from regional cooperation can enhance productivity and spur economic diversification.** The key challenge for policymakers at the federal and state level is to identify interventions (policy, regulatory, institutional and investment, etc.) that are best suited to realize development potential of sub national regions and integrate domestic markets. These include investments in transport corridors alongside well managed urban development (as discussed above), investments in basic services, and special economic zones. However, in designing and implementing these interventions, it is essential to recognize that efforts should be differentiated by local specificities including natural endowments, economic potential, and regional capabilities. In fact, reflecting the contrast among states and the difficulties of coordinating policies in such a diverse landscape, Nigeria's Economic Recovery and Growth Plan (2017–2020) emphasizes the need for greater subnational coordination and outlines incentives to ensure that the federal and state governments work toward the same goals.

3.2 Enhancing the effectiveness of spatially-targeted efforts to support regional economic development

46. **To develop regional economic development opportunities, a wide range of spatially targeted investments have been implemented in Nigeria.** The introduction of the cluster concept in the federal government's national industrial policy for 2007-2011 made room for the establishment of special economic zones (SEZs).[18] Five types of SEZ were identified: Free Trade Zones (FTZs), Industrial Parks, Industrial Clusters, Enterprise Zones and Incubators[19]. There are currently 25 FTZs in the country, 11 of which are in the Southwest, with Lagos State having six. The industrial policy planned to locate at least one park in each of the six geo-political zones, with such parks focusing on processing products, in which the zones had both comparative and competitive advantages. The 2017 federal budget allocated about N50 billion for setting up new Special Economic Zone projects in each geopolitical region and maintenance of existing SEZs, to help expand manufacturing and exports and the 2018 budget allocated another N50 billion in additional investments for the SEZs.[20]

47. **There may be room to enhance ongoing place based industrial policies along the following dimensions:**

- **Align place based policies to support agglomeration economies:** A review of export processing zones in Southwest reveals that aside from the ones sited in Lagos, and the Ogun Guangdong in Ogun State, others, scattered throughout other states are not operational due to lack of interest by investors. Due to the export-oriented nature of activities in the zones, the benefits from agglomeration economies in and around Lagos is a key determinant of whether investors would be willing to operate in the zones. Also, it appears that, even with the tax-free incentive in the zone, the many other issues negatively impacting on export competitiveness such as the poor level of connective infrastructure, significantly reduce the incentive to locate investment in FTZs in states further away from Lagos.

18 UNDP 2015
19 Iwaugwu, I. (2011) The Cluster Concept: Will Nigeria's New Industrial Development Strategy Jumpstart the Country's Industrial Take off? Afro Asian Journal of Social Sciences, Volume 2, No. 2.4.
20 2017 FGN Budget and 2018FGN Budget Proposal

- **Policies may need to manage coordination failures "beyond the zone":** International experience highlights that successful spatial development initiatives leverage regional collaboration – across jurisdictional boundaries -- to benefit from sharing and matching, economies of scale and gains from specialization. In Nigeria, SEZs and place based polices have only focused on coordination issues within the zone itself and neglected connections with other states (even within geo-political zones).

- **Place based policies can be enhanced through national and state industrial policy alignment:** The 2007 Nigeria Industrial Development Strategy tries to develop scale economies in infrastructure provision by only allowing one industrial park (of a scale of around 30 to 50 sq. kilometres) in each of the geo-political zones to pool resources for providing high quality infrastructure. States have however independently set up industrial parks, without being able to fully deliver the required infrastructure (roads, reliable power, water and sanitation) and provide necessary facilities to allow businesses to invest and operate. The plethora of industrial parks is undermining potential benefits from proximity that scale can provide.

48. **The good news is that states are already beginning to coordinate their investment and strategic planning activities at the geo-political zone level.** The Development Agenda for Western Nigeria (DAWN) Commission has produced a Roadmap for regional integration and coordination between all states in the South West zone, which was published in 2011. The Roadmap sets out a clear set of collaborative actions for states across five development pillars which range from the spatially neutral actions proposed in the Social and Human Development; Inclusive Institutions; and Homeland Affairs pillars, to the spatially connective actions proposed under the transport and mobility aspect of the Infrastructure Development pillar, and the spatially targeted actions to promote key sectors in the Economic Development pillar. As yet, however, few of these actions have been implemented and it is proving difficult to promote coordination of activities across the six states.

49. **The Niger Delta Development Commission (NDDC), established in 2000, represents the states of the South-South zone plus Ondo, Abia and Imo.** The Commission produced a Niger Delta Master Plan in 2006 which contains a series of recommendations for coordination of investment between member states and strengthening the institutional

21 The NDDC was created by an Act of the National Assembly for the development of the oil-producing (Niger Delta) area and enjoys statutory transfers directly from the federal budget.

framework for this coordination. The Commission has delivered more than 9,000 projects since 2002, the majority of which are infrastructure and services projects, including over 3,000 individual road projects.

50. **In the North-East zone, the North-East Regional Development Plan Committee developed the North-East States Transformation Strategy (NESTS) in 2014.** This contains a mix of spatially neutral recommendations to improve access to basic services and develop human capital across the region, as well as spatially connective investments in transport infrastructure and recommendations to promote growth in key sectors. However, the majority of proposed projects in the Strategy are yet to be financed and remain unimplemented.

51. **Looking forward, priorities for public interventions regarding industrial clusters (both existing and new) in Nigeria may consider and include the following:**

- **(By the federal government):**
  Developing a Solid National Framework: Objectives, Priorities, and Targeted Strategies

  It would be beneficial if a national policy framework on industrial clusters with prioritized goals and regional strategies was provided for the states and localities to refer to. Such policy document will be key to ensuring the effectiveness of investments on industrial clusters and will provide guidance at least on the following key aspects:

  Geographic priorities for investments, given that there will be trade-offs between equity and efficiency in cluster development, i.e., SEZ in a less-developed region vs. SEZ in a leading region. This helps the government allocate scarce public resources on places that match its development goals.

  Market specialization and differentiated positioning strategies for industrial clusters across the country, to avoid unnecessary business overlap and competition. At the national level and regional level, the federal government (through its Ministry of Industry, Trade and investment) and the NEPZA need to review the market opportunities and endowments of each state/region and carefully coordinate the targeting sectors and businesses among different industrial clusters.

  Feasibility analysis of new cluster selections/formulations. Successful industrial clusters require many factors which may or may not be available for certain states/areas. To avoid poor investment decisions, the states could be guided to conduct thorough feasibility analysis when proposing/initiating any new cluster.

- **(By the federal, state, and local governments):**
  Improving External Enabling Environment: Infrastructure and Regulations

  Fully implementing the power sector reform program to improve the access to stable electricity supply for businesses. Access to stable electricity is one of the key challenges and constraints for doing business in Nigeria. The country ranked 172 out of 190 global economies on the ease of getting electricity, with a score of 35, according to the World Bank's Doing Business Report 2018, lower than the average of Sub-Saharan Africa and much lower than other comparable middle-income countries (South Africa has a score of 63 and India has a score of 85).

  Coordinating sectoral policies and regional policies. To avoid conflict and contradictory policies that may undermine the effectiveness of industrial clusters, it is necessary to ensure the consistency between sectoral policies and regional policies. For example, potential free zone investors once discovered that the Export Expansion Grant offered by the GoN were in direct competition with free zone incentives and may be more attractive than those provided to free zone investors.

- **(By the federal, state, and local governments):**
  Strengthening Financing, Operation and Management of Industrial Clusters

  Streamlining the SEZ regime and the incentive framework at the federal level to ensure there is one regulatory body and a cohesive package that is available to all investors. This will also require careful analysis of competing incentives (e.g., pioneer industry incentives, duty-drawback, manufacturer-in-bond schemes, etc.). It is also critical that the regime does not restrict linkages with the local market, but instead strengthens them.

  Establishing a codified memorandum of understanding mechanism to obtain agreement among and coordinate with multiple government stakeholders at the federal level and coordinate between the federal and state government to ensure there is information flow and coordination.

  Expanding private and public collaboration in investing and operating SEZs. Investing in SEZs places huge financial burdens on the government if private capital is not mobilized. There have been some experiments with private SEZs in Nigeria, such as the Akwa Ibom SEZ (federal level) and the Ogun Guangdong SEZ (state level). Looking forward, the government could consider focusing its renewed SEZ efforts on licensing private developers for the SEZs to relieve the fiscal burden and to leverage market drives. For this to be successful, it will be critical to conduct a demand survey to gauge the level of interest from the private sector and a feasibility study to assess the competitiveness of the zone.

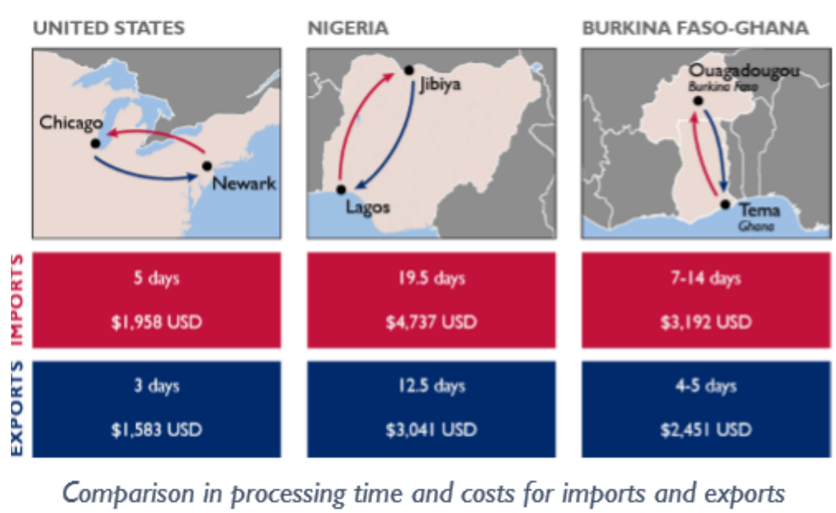
Facilitating effective investment promotion campaigns for industrial clusters. To mitigate risks and to foster sustainable economic growth, the clusters could target businesses (large and small) that could formulate or strengthen an entire value chain, rather than rely on a few anchor investors.

3.3 Coordinate transport improvements with urban and land development

52. **High domestic transport costs pose a major challenge to the economic integration of subnational regions in Nigeria, and limits their potential for economic diversification.** Consider the magnitude of the challenge: In the USA, it takes 3 days and costs $1,583 USD to export a 20-foot container of goods from Chicago to Newark. In Nigeria, transporting goods across a similar distance between Jibiya and Lagos takes 12.5 days and costs $3,041 USD (Figure 3.2). Such high transport costs hurt local producers as they cannot access markets beyond their immediate localities, especially those located out of the large urban agglomerations. Such limits on the extent of the markets that producers can access reduces regional external economies of scale and scope where towns and cities cannot specialize and develop clusters connected to regional supply chains. This severely hampers firms' capacities to focus on their core competencies, to develop the capabilities and absorptive capacities required for competing in broader and more competitive markets (including export markets), to upgrade to more productive activities, and to develop new products and services

FIGURE 3.3:

Extremely High Domestic Transport Costs in Nigeria Limit Diversification and Spatial Economic Integration



Source: USAID

53. **There have been few spatially connective interventions in Nigeria during the past decades to improve interregional connectivity.** This results from a lack of policy or strategy that prioritizes connectivity between states and regions, as well as political difficulties in planning and funding infrastructure, particularly those that cross borders of the states or geopolitical zones. Beyond infrastructure upgrades along certain parts of the primary transport corridors, some stand-alone interventions have been made in key road, rail, aviation, and port transport infrastructure to enable greater domestic and international connectivity. However, a stocktaking of these investments/interventions highlights key shortcomings.

- **An extensive transport network that is in poor condition:** While Nigeria has an extensive transport network relative to other resource-rich African countries, much of this network is in poor condition. An estimated 40 percent of federal roads, 65 percent of state roads, and 85 percent of local government roads are in poor or bad condition and require rehabilitation or reconstruction. In 2013 federal government expenditure on maintenance, rehabilitation, and (re)construction for roads and bridges; rail; aviation; and inland waterways and maritime transport came to $3 billion (74 percent, 18 percent, 7 percent, and 2 percent, respectively). International benchmarks suggest that the federal government should spend a minimum of 1.8 percent of GDP ($9.1 billion) annually on transport infrastructure—a 204 percent increase over 2013's actual figure. Around 1.2 percent of GDP ($6.3 billion) should be allocated to roads (a 186 percent increase against 2013). Yet the reality is a backlog of federal road and bridge projects due to funding constraints of over 250 projects (new and maintenance). Beyond effects on connectivity and competitiveness, these delays have explicit additional costs of around $18.8 billion (3.6 percent of GDP).

- **There may be need to better align infrastructure investments with the vision under the NIIP.** The National Infrastructure Investment Plan (NIIP) (2014) sets out government's medium-term investment priorities across the geopolitical regions. It aligns these investment proposals with the socioeconomic priorities for each region. The total national investment requirement is USD 3.0 trillion. The Plan recognizes that increased investment is required in all regions, with particular focus on reducing regional disparities.

54. **In choosing *where* to prioritize spatially connective interventions, Nigeria's policy makers may consider trade-offs between goals of spatial equity and aggregate economic efficiency.** Research done for this study differentiates the impacts of transport connectivity among three types of areas: (1) remote rural area that focuses on subsistence agriculture and eventually trades its surplus with a connected rural area; (2) connected rural areas that are active in agribusiness and trade output with the nearby city; and (3) urban areas that produce tradable manufactured goods and trade with the connected rural area, which in turn trade with the remote rural areas.

55. **Recent research based on work by Gollin and Rogerson (2014)[22] calibrated for Nigeria showed that a 10 percent reduction in transport cost between remote and connected rural areas has a bigger welfare impact than a similar reduction in transport cost between cities and connected rural areas (13 percent vs. 8 percent).** This suggests that local welfare gains are clearly higher for investments supporting rural connectivity.

Table 3.1:

Projected Welfare Gains from Reducing Transport Costs in Two Types of Areas in Nigeria[23]

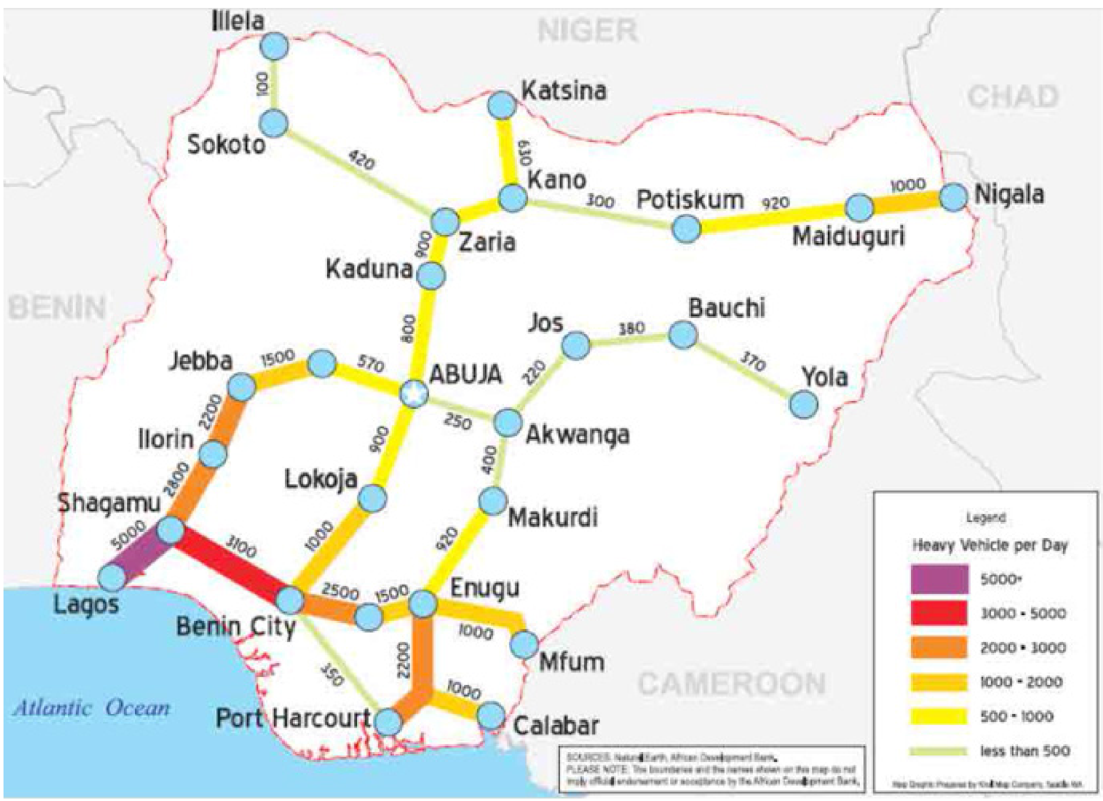
	Agricultural Share of GDP (changes in %)		Agricultural Share of Labor Force Force (changes in %)		Difference in Welfare (%)
Benchmark	**0.47**		**0.45**		**–**
Reduction of 10% in transport costs in remote rural areas	**0.45**	**(-4.3)**	**0.42**	**(-6.7)**	**13.4**
Reduction of 10% in transport cost in connected rural areas	**0.46**	**(-2.1)**	**0.44**	**(-2.2)**	**8.0**

22 Gollin, D., and Rogerson, R. (2014). Productivity, transport costs and subsistence agriculture. *Journal of Development Economics*, 107, 38–48.
23 World Bank calibrations, 2017.

56. **However, for aggregate economic efficiency, there are higher gains from focusing on the development of interregional corridors, linking the major urban centers (Figure 3.4).** While there are regional differences in traffic flows between the South and the North, much of the freight moves along urban centers. Upgrading road quality along these corridors can boost overall economic efficiency. Recent research shows that improvements along the LAKAJI[24] corridor would result in estimated annual benefits of over $1.34 billion.[25] Furthermore, a recent study showed that the elasticity of local GDP increase to transport investments is higher for the Southern zones. This is largely due to the fact that the marginal productivity of infrastructure investment would be larger in places where the network has been established.

FIGURE 3.4:

Heavy Vehicle Traffic Flows on the Federal Highway Network Showing Prominence of Key Urban Nodes



24 The corridor from Lagos to Jibiya, via Kano is generally referred to as the LAKAJI Corridor.
25 Russ et al. (2017).

57. **The bottlenecks in inter-regional connectivity in Nigeria stem from more than merely the condition and expansion of the hard infrastructure.** Poor security conditions and rent seeking along many routes are a prevailing problem. In addition, poor fleet operations and managements, as well as the lack of coordination in logistics, further exacerbate the challenges in improving connectivity. Inherent operational inefficiency raises the costs of goods and services: vehicles are extremely aged or in poor condition, which is exacerbated further by inefficient operations such as a high percentage of empty return trips. Empty running is a huge drain on fleet efficiency and network usage, and is crippling the efficiency of Nigerian road freight operations. Furthermore, in cases where spatially connective interventions were implemented, they were often executive without complementary land use policies to fully capture the economic benefits of the capital investments and to maximize the welfare gains of the population along the transport corridors. Discussions with states in the South West have highlighted the importance of and the request for coordinating land and transport investments (see Box 3.1).

Box 3.1:

"Not Just a Road"

—The Need to Better Coordinate Transport Investments with effective Land Management and Support to Local Value Chains

The Lagos Ibadan highway is a strategic transport corridor not just for the South West (SW) States but also for the rest of Nigeria. The highway connects the three SW States of Lagos, Ogun and Oyo. It is also the main route for transportation of goods from the Lagos port to the rest of the country.

Public and private stakeholders in the SW region emphasized that, currently, the highway is mainly viewed as a transport corridor rather than an economic corridor. Government plans have to date been focused on the need to upgrade the highway. But stakeholders emphasized that ineffective land management alongside the highway is preventing this major transportation corridor from playing its wider role as an economic corridor, and stimulating investment and production in the SW region. Stakeholders have complained that development along the highway is happening haphazardly with very little zoning or land management. For example, significant portions of land along the highway have been bought by religious institutions or are occupied by informal settlements leading to fragmented development in nonstrategic activities.

Stakeholders called for transport upgrading efforts to be better linked with effective land management along the corridor and other support to local value chains. In particular, technical assistance on how the land on either side of the corridor could be better zoned for strategic economic activities was highlighted. Other measures to maximize the economic impact of the corridor will depend on a thorough value chain and logistical supply chain analysis on the constraints that prominent value chains face and what could be done to alleviate these along the corridor (particularly in Oyo and Ogun states). This could inform connective infrastructure prioritization (including roads and railways)—particularly in terms of: 1) connecting the wider rural areas with the main corridor; and 2) increasing transport connections links between Lagos and the other two states (to increase commuting and firm relocation potential). It would also help the state governments of the SW to prioritize other value chain upgrading support that can be provided, such as cold storage facilities and quality certification for local firms, etc.

58. **There is urgent need to better coordinate transport investments with effective urban land management to support regional economic development opportunities.** As the objective of spatially connective interventions is to foster regional growth, it becomes important to have coordinated sector, land use, and transport policies and interventions that can develop transport corridors into economic corridors, thus triggering development

benefits for broader areas along specific corridors. Recent analysis done by the World Bank on spatial development in Nigeria identifies that the following actions can help enhance the wider economic benefits of transport investments along specific corridors:

- **Identifying key nodes and developing node-centered master plans along transport corridors.** For inter- and intra-regional economic corridors to be viable in Nigeria, they must make economic sense by encompassing the outer urban nodes and smaller nodes along and around specific corridors. Such urban nodes are not only major markets for manufactured and imported goods, but also sources of labor, technology, knowledge, and innovation. Consequently, a successful economic corridor development strategy should aim at synchronizing industrial development and sound urbanization by providing adequate physical and social infrastructure in urban centers. For higher cost efficiency of investments, node-centered master plans along the corridor area could be developed and implemented to guide future land use changes and aim to stimulate growth around key nodes along the corridors, i.e., cities/towns or industrial zones. In the short term, the land uses planned around these transport nodes should correspond to the economic opportunities brought about by the improved accessibility, such as logistic facilities and services. In the long term, the land uses and key programs to be developed around the transport nodes should cater to the needs of the leading sectors and activities identified for the area.

- **Facilitating land transactions for private developers and investors.** Although industrial parks and special economic zones can be developed by the government on public land, commercial and residential land uses (often developed on private land) also need to be incorporated in the comprehensive land use plans to encourage growth around key nodes along the transport corridors. A strengthened land management system to facilitate the land transactions for private developers interested in commercial and residential development in the area along the corridor would be beneficial. In addition, as the land management of urban land and rural land belong to different levels of government, rural-urban land conversion could be a controversial issue in the process of land use change. The state governments should take proactive actions to ensure the transparency of any conversion and transactions.

3.4 Regionally differentiated priorities for policy and investment

59. **In considering key investments for sub national regions in Nigeria, a careful identification of local challenges and opportunities is essential.** A SWOT analysis was conducted for the various geo political zones and salient features are presented in table 3.1.

Table 3.2:

SWOT analysis of the geo political zones

<table>
<tr><th>geo-political zone</th><th>Strength</th><th>Weakness</th><th>Opportunity</th><th>Threat</th></tr>
<tr><td>North West</td><td>Economically significant cities – including Kano the second largest city in the country, Kaduna which emerging as a key economic center on the corridor to Abuja and cultural centers such as Zaria.</td><td rowspan="2">Decline of manufacturing; widespread poverty, high fertility and low literacy. deficit in connective and power infrastructure, as well as provision of basic services and housing.</td><td rowspan="2">Historic ties with neighboring countries and established trade routes present an opportunity to increase levels of cross-border trade. Potential to manufacture products for the growing domestic and West African markets if trade links and connectivity can be improved</td><td rowspan="2">Desertification and associated environmental problems; threat of violence and instability from Boko Haram and inter-communal, ethnic and religious tensions.</td></tr>
<tr><td>North East</td><td>Before the Boko Haram conflict, Maiduguri was a key center of education and an economic asset for the region.</td></tr>
<tr><td>North Central</td><td>The states of the middle belt have an abundance of fertile agricultural land, with Benue state regarded as the ‘food basket’ of the country</td><td>Road density is low, and the vast sparsely populated states of the middle belt are poorly connected and markets are fragmented.</td><td>Integration of agricultural produce, including cash crops such as tropical fruits, into local agri-processing value chains; significant mineral deposits in Plateau</td><td>low-level inter-communal conflicts across the middle belt between nomadic herders and farmers; low density makes it difficult to internally generate tax revenues</td></tr>
<tr><td>South West</td><td>High economic density and concentration of manufacturing, financial services and other tradable services including entertainment; high human capital with well-educated local workforce</td><td>High unemployment and underemployment; Poor connective infrastructure;</td><td>gateway to international markets; greater cooperation and coordination between state governments offers an opportunity to deepen market integration; endowed with fertile agricultural land, abundant mineral resources</td><td>Urban congestion; sensitive to commodity price shocks</td></tr>
</table>

Source: World Bank research on spatial development in Nigeria

Taking this SWOT analysis into account, it may be useful to differentiate policy options for three particular regions where the World Bank has conducted detailed analysis.. These are meant to be illustrative examples and not a comprehensive set of options for all regions.

FOR THE NORTH-EAST REGION:

- **Policies that focus on rehabilitating and reinforcing connectivity between municipalities would be beneficial.** Before the conflict started Maiduguri was well connected to its surrounding populated and less-developed areas. However, the North East was loosely connected to the performing centers of the North and to the clusters of high performing areas in the South. Better collaboration and coordination between affected municipalities will be essential to ensure regional stability, and exploit possible positive economic and social externalities such as those achieved by coordination of service provision or transport infrastructure investments. In both type of areas, ensuring the provision of social and other support services for the affected households, as well as strengthening the local institution based on community driven interventions, are necessary for peace building.

- **Renewed efforts on rehabilitating and improving social services to help address the root cause of conflicts.** In addition to the place-based policies, development challenges need more emphasis on people-based policies to conflict and climate related stresses combined with weak institutions. As the country's least-developed region suffers from conflicts and is sparsely populated, considering alternative technologies for service provision that are not dependent on scale economies for achieving efficiency is critical. In this regard, it is essential that the choice of delivery model and the priority interventions be informed by an understanding of the type of violence, the key stresses on the local society and economy, and the range of stakeholders involved.

FOR THE SOUTH-WEST REGION:

- **Government could consider infrastructure policies that focus on enhancing the connection from the rural hinterland to the regional market center of Kano.** The analysis for the region shows considerable scope for enhancing economic growth and specialization through development along interstate corridors. Not only will these investments support local development in the zone, it is a win-win for national economic growth. Here policy makers need to consider the importance of coordinating transport investments with major land development and supporting infrastructure to get gains for "proximity" as well as address coordination failures. To complement the place-based policies, interventions to increase the pool of skilled labor through proper work training education are also needed.

FOR THE NORTH-WEST REGION:

- **Government could consider infrastructure policies that focus on enhancing the connection from the rural hinterland to the regional market center of Kano.** Densely populated agricultural states would see greater welfare gains from connecting the population to local and regional markets. This is especially important for the Northern states around the economically active Kano. Kano, Jigawa, and Kaduna host a large share of the total number of poor—17 percent—and have poor connectivity outside the Kano—Kaduna connection, as the average travel time to the nearest biggest city is twice as long as in the South West. In this case, allowing people to reach markets and access inputs, such as fertilizer and seeds, would allow the population to diversify into non-subsistence agricultural activities. This is especially true for staple crops production, such has sorghum, millet, and maize that are already produced in Kaduna and Kano and are estimated having a potential value by 2030 of $4.4 billion (northern Nigeria Report). Cross-border trade, while often informally conduced, is already existing. In areas remotely connected to the central regions, such as in Borno or at the border with Benin, these connections can be capitalized on to increase local activity. Connecting to Kano, home to West Africa's largest grain trading hub, also gives access to larger international markets. While the connection between Southern and Northern States is poor, the Kano-Katsina connection gives access to Niger and Sahel. Transborder trade is also an important asset for Kebbi, connected to Benin via Kamba and to Niger via Baguda. Estimates of the elasticities of activity to the transport suggest that improving this connection would bring benefits to the area. The place-based policies, again, need to be complemented by investments in basic services and human development to foster a stronger business environment and wider welfare gains.

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