Contents

Introductory Remarks 1

Part I: Macroeconomic Developments 2

1.1 Overview of the Economy 2
1.2 Real Sector Developments 4
1.3 Monetary Policy Developments 6
1.4 Fiscal Policy Developments 8
1.4.1 Revenues 8
1.4.2 Expenditures 10
1.4.3 Federation Account Operations 11
1.4.4 Debt and Composition 11
1.5 External Sector Developments 13
1.5.1 Trade 13
1.5.2 Balance of Payments 16

Part II: Selected Structural Policies and Reforms 17

Power 17
Agriculture 19

Part III: Thematic Issue – Improving Domestic Resource Mobilization in Nigeria 21

List of Tables
Table 1. Composition of Federal Fiscal Expenditures in Nigeria, 10
Table 2. Federation Account Operations in Nigeria, 11
Table 3. Balance of Payments Indicators 16
Table A1. Illicit Financial Flows from Top Ten Developing Countries 23

List of Figures
Figure 1: Real GDP Growth Rate, 4
Figure 2: Sectoral GDP Growth Rates, 6
Figure 3: Levels and Growth Rate of Total Deposits Money Banks’ Deposits 7
Figure 4: Market Capitalization and All Share Index 7
Figure 5: Inflation Rate 8
Figure 6: Fiscal Revenue Sources 9
Figure 7. Federal Government Oil Revenues 9
Figure 8. Domestic Debt Composition 11
Figure 9. External Debt Composition 12
Figure 10. Total Trade 13
Figure 11. Composition of Imports 14
Figure 12. Exports Composition 15
Figure 13. Foreign Private Investment Inflows 15
Figure A1: Nigerian Tax Revenue Profile 22

List of Boxes
Box 1: Global Environment 2
Box 2: GDP Rebasing in Nigeria 5
INTRODUCTORY REMARKS

This Economic Report on Nigeria is a new analytical tool of the African Development Bank (AfDB) Nigeria Field Office in pursuance of the tenets of the Nigeria Country Strategy Paper (CSP): 2013 – 2017. The new CSP provides the framework for supporting Nigeria's development efforts as articulated in the country's Transformation Agenda (TA). The strategy focuses on deepening AfDB’s role in analytical and policy advisory activities to provide an important frame of reference for deeper engagement in Nigeria. For example, there is a consensus that AfDB has a role to play in strengthening its advisory role for a sound policy environment to facilitate the implementation of the TA. This will be impossible in the absence of sound analysis that provides good understanding of macroeconomic fundamentals and developments in the country.

This report and the subsequent ones in the series, aim to fill this gap by complementing other reports on macroeconomic developments in Nigeria. It focuses on providing a snapshot assessment of the macroeconomic condition of the economy. It gives a snapshot of the Nigerian economy based on available official data; provides an analysis of the economic and financial situation against the backdrop of global developments that hold opportunities and risks for the economy; and points out strategies for dealing with these challenges. Key ongoing structural reforms being undertaken by the Federal Government are also outlined. Lastly, the report features a key thematic issue that is given deeper analytical thought. In this edition, the thematic issue of focus revolve around strategies for deepening domestic resource mobilization in the economy from the public finance perspective. Alternative sources of financing to supplement public revenues for infrastructure development in particular, would require tapping into new saving pools such as pension, insurance, and diaspora funds that can be mobilized through appropriate instruments.

The report is the product of AfDB Nigeria Field Office staff led by Dr. Ousmane Dore (Resident Representative). Support and contributions came from Mr. Andoh Mensah, the Country Programme Officer, Dr. Eric K. Ogunleye (Macroeconomic Consultant) and Dr. Benneth Obi (Economic Consultant).

The report benefitted immensely from very useful insights provided through review and comments from Dr Steve Kayizzi-Mugerwa (Director, EDRE), Dr. Nwanze Okidegbe (Chief Economic Adviser to the President), Mr. Charles Mordi (Director of Research, Central Bank of Nigeria), Dr John Litwack (Lead Economist, World Bank Nigeria Office), Mrs Barbara Barungi (Lead Economist, NGFO) and Dr Ferdinand Bakoup (Lead Economist, ORWA).
PART I: MACROECONOMIC DEVELOPMENTS

1.1. Overview of the Economy

Against the backdrop of a nascent but fragile global recovery (Box 1), the Nigerian economy has shown some strength during the first half of 2013; real economic growth recorded quarterly average of 6.4 percent, driven primarily by non-oil activities that grew by about 7.6 percent during the period. The economy has been very resilient to both domestic and external shocks. This is attributable to several ongoing reform initiatives of the Government. As the effects of the flood taper off and the global economy gradually recovers, economic growth is expected to improve and has been projected to reach 6.7 percent and 7.3 percent in 2013 and 2014, respectively. However, downside risks abound as the global recovery still remains weak. This is compounded by domestic challenges such as continued insecurity in the North-Eastern part of the country and reduced oil production resulting from oil theft and pipeline vandalism.

Box 1: Global Environment

The global economy appears to be on course to recovery in 2012 with expectations that the three-speed global recovery will continue. Hence, prior to now robust projections were made for 2013. However, all of these appear to be waning as the global economy has returned to a state of fragile and painfully weak and slow recovery. Many advanced and emerging economies, including Nigeria’s major trading partners, have been going through a somewhat uncertain recovery, with many experiencing some level of economic deterioration. The Eurozone continues to be a major source of risk to global and Nigerian economic buoyancy due to its chronic and persisting recession. The initial IMF’s World Economic Outlook projection of 0.4 percent growth contraction for 2013 in April has been further revised to 0.6 percent in July. The US, one of the major trading partners of Nigeria, continues to experience fragile recovery resulting from weak private sector demand. This is based on the belief that higher payroll tax rates and lower fiscal spending may moderate domestic demand in the immediate future. Hence, the country’s growth forecast has been reduced to 1.9 percent and 2.7 percent for 2012 and 2013, respectively. Unemployment remains high at almost 27 percent for Greece in April 2013 and 26.3 percent for Portugal at the end of the second quarter.

The projection of 2013 OECD Employment Outlook is that unemployment would decline slightly from the 8 percent recorded in May 2013 to 7.8 percent by end-2014 with youth and low skilled persons being the worst hit. The situation in emerging markets, especially Brazil, China and India, has also been fuzzy with most of them experiencing very weak domestic demand and growth that is slower than expected. In its revision in July, the IMF scaled back China’s 2013 growth forecast to 7.8 percent compared to 8.1 percent in April. Overall, the IMF has constantly revised downwards its global growth forecast for 2013 from 3.5 percent in January to 3.3 percent in April and further down to 3.1 percent in July. Similarly, while the World Bank had earlier in January 2013 projected global economy to expand by 2.4 percent, the figure was revised downward to 2.2 percent in July 2013. The weak state of the global economy, especially of trading partner countries that account for annual average of over 85 percent of Nigerian exports over the last decade may result in oil price shock and reduction in demand for crude oil, the major source of Nigeria’s exports, fiscal revenues and financing growth.
The guiding theme for the 2013 fiscal policy is “fiscal consolidation with inclusive growth” with four main pillars that include macroeconomic stability, structural reforms, governance/ institutions and investment in priority sectors. However, implementation of the fiscal policy has been largely challenging with respect to the implementation of the capital component of the budget due to the impasse between the Executive and Legislature during the first quarter over the Appropriation Act. Moreover, successful take-off in the implementation of the 2013 budget suffered greatly from a shortfall in revenues by about 26.2 percent at the end of the first quarter occasioned by drastic shortfall in oil production—a daily average of 2.2 million barrels as opposed to the projected daily production of 2.53 million barrels in the 2013 budget—due to oil theft. If the challenges of illegal oil bunkering, pipeline vandalism and oil theft are not effectively addressed, oil revenues may further slide. This could result in major shock to fiscal policy and overall economic growth.

Monetary policy has performed well over the first half of 2013. Monetary authorities have kept close watch on monetary policy instruments that focus on money supply and price stability through regular Monetary Policy Committee meetings where the policy rate that subsequently determines interest rates is decided. Monetary policy rate (MPR) was kept at 12 percent throughout the first half of 2013. Overall, domestic credit to the economy increased by 4.7 percent during the period, with net claim to the government and private sector credit growing by 2.3 percent and 3.6 percent, respectively.

External sector performance has been relatively stable during the first half of 2013 compared to the corresponding period in 2012. Crude oil and natural gas were the dominant exports during this period, accounting for about 96 percent of total exports. This reveals very high export concentration, thus underscoring the vulnerability of the economy to external shocks. It may also be a source of concern if world oil price were to fall below the reference crude oil price on which the Federal Government budget and monthly revenue allocations among the three tiers of government (Federal, State and Local) are based. In recent times, though, the price of Brent – the Nigerian crude oil – has been relatively stable, hovering above the $100 mark. While crude oil has been the major exports, refined petroleum product accounted for almost 44 percent of imports, reflecting the weak domestic refining capacity and vulnerability of the economy to vagaries of oil price movements since most businesses depend on refined petroleum products.

On the structural front, the Government continues to pursue implementation of its reform program, with focus on priority sectors that include infrastructure (power, roads and rail), agriculture, and banking, in addition to recent reforms in public financial management (PFM). The power sector reform has advanced while the railway transportation system is being restored; for example, the Lagos-Kano track is up and running after a very long time of decay. Agriculture is being transformed from subsistence into a commercial sector with high value-chain linkages to manufacturing. Thanks to well-conceived reforms which involved bank consolidation, recapitalization and managerial changes, the soundness of the financial sector has been restored, and the government is in the process of setting up a wholesale Development Bank to address the issue of lack of long-term financing in the economy. Progress on the PFM reforms includes the extension of the Integrated Payroll and Personnel Information System (IPPIS) to more Ministries, Departments and Agencies (MDAs); the adoption of a systematic performance management system for measuring ministerial and individual performance; the introduction of an E-governance system to enhance financial discipline and stability in the implementation of fiscal policies to complement the ongoing restructuring of expenditure in favor of capital expenditure.

The overall effect of prudent macroeconomic management in Nigeria has been impressive, as attested by international validation of the stable nature of the Nigerian economy with improved sovereign rating by most rating agencies. Inflationary pressure has eased, with inflation trending downward from 12 percent during the corresponding period in 2012 to 8.4 percent by end-June 2013. Gross external reserves have also increased dramatically from $44.2 billion at the end of 2012 to $48 billion by end June 2013.
However, the economy is confronted with a number of challenges. First, the strong growth performance over the years has not been sufficiently inclusive as poverty and unemployment are high. Second, infrastructure deficiency remains on the high side, limiting regional and global competitiveness. Third, economic diversification is limited with heavy reliance on crude oil and gas for fiscal revenues and foreign exchange earnings; discoveries and development of alternatives to crude oil such as shale gas by Nigeria’s oil buyers would pose further challenge in this regard.

The medium-term prospect for growth remains positive, but this would depend on the extent to which policymakers are consistent in the implementation of the reforms and other initiatives that would help build on the achievements made so far in macroeconomic management. Innovative solutions to oil theft and pipeline vandalism as outlined in this report also hold high promise for improved fiscal and growth performance. Thus, deepening the ongoing fiscal consolidation program, maintaining the momentum in the implementation of reforms, particularly in the power and agriculture sectors, and promoting private sector activities will greatly contribute to economic stability and sustained growth.

1.2. Real Sector Developments

The Nigerian economy recorded real GDP growth rates of 6.56 percent and 6.18 percent in Q1 and Q2 2013, respectively (Figure 1). This was short of the 6.63 percent and 6.66 percent projected for the periods by the country’s National Bureau of Statistics (NBS). Thus, compared to the corresponding period in 2012, economic growth has remained flat during the first half 2013. The average real GDP growth rate during the first half 2013 is below the projected annual growth rate of 6.75 percent for the year, raising concerns that overall growth may turn out to be lower than expected in 2013. A possible explanation is lower-than-expected oil output occasioned by oil theft, and pipeline vandalism that forced some oil operators to declare force majeure. The Oil sector recorded an average daily production of 2.11 million barrels per day (mbpd) in Q2, down from 2.29 mbpd in Q1 2013, and 2.38 mbpd in the same period last year. One notable development on economic activities in Nigeria is the ongoing effort to rebase the country’s GDP that is expected to have lasting effect on the structure and value of the GDP (Box 2).

![Real GDP Growth Rate, Q1 2008 – Q2 2013 (%)](source: Central Bank of Nigeria Estimates)
In line with recent trends, growth in the first half was driven mainly by the non-oil GDP, notably agriculture, airlines, hotels and restaurants, and building and construction. Non-oil activities experienced real growth of 7.36 percent in Q2, lower than the 7.89 percent achieved in Q1. Agriculture continued to be a major contributor to GDP in the first half 2013 with 36.9 percent, followed by wholesale and retail trade (20.5 percent), crude petroleum and natural gas (13.8 percent), telecommunication and post office (8.5 percent). The deceleration in non-oil GDP growth may be partly attributed to lower electricity generation during the period with its ripple effects on the manufacturing, telecommunications, and wholesale and retail trade activities. Despite this challenge, the sector contributed about 13.8 percent to real GDP in the first half 2013 compared to the sector’s contribution of 14.83 percent in first half of 2012.

This development can be attributed to the relative stability in the international market price of oil.

In addition to telecom, building and construction, hotel and restaurants, solid minerals and real estate experienced double digits growth rate during the first half of 2013 (Figure 2). This should be a welcome development to the extent that these sectors offer real potentials for diversifying the economic base and yet have remained largely untapped. A major orientation of policy for government would be to develop a strategic approach for these sectors similar to that which helped unleash the potential of the telecom industry over a decade ago. Specific policy initiatives targeted at allowing private sector participation in the sector promise to further boost economic activities in these sectors and their contribution to inclusive growth through job and wealth creation.

Box 2: GDP Rebasing in Nigeria

Based on international best practices, most countries overhaul GDP calculations to reflect changes in output, consumption and structure of the economy. Nigeria has not done this in recent times. Indeed, 1990 is the reference price in use for estimating real national economic activities. Yet, the structure of the Nigerian economy has changed significantly over the years. For instance, telecommunication was not an important economic activity in 1990. But today, this sector contributes significantly to economic growth and job creation for Nigerians. There is, therefore, widespread belief that current GDP framework may be underestimating economic activities in Nigeria.

The National Bureau of Statistics (NBS) – the Nigeria’s national statistical authority – has commenced the process of correcting this by undertaking GDP rebasing of the Nigerian economy. The methodology involves three independent approaches of output, expenditure and income followed by reconciliation among these three. Some of the key sectors from which surveys are expected to be undertaken are major establishments in all States of the Federation and Federal Capital Territory. These are manufacturing, building and construction, mining and quarry, transportation, hotels and restaurants, wholesale and retail and business services. Preliminary estimates are expected to be released toward the end of the year. The African Development Bank is supporting NBS in this process. Several milestones have been achieved so far. Notable among these are completion of the draft industry classification, detailed data on trade margins, and some of the sectoral surveys. Outstanding activities are being pursued with a view to meeting the scheduled timeline.

The possible effects of GDP rebasing on the economy could be mixed. While it has led to a reduction in the size of some economies, others have experienced increase as shown by Ghanaian experience with over 60 percent rise in GDP size as a result of rebasing GDP calculation from 1993 to 2006. For Nigeria, it is yet unsure what the effect of GDP rebasing would be. However, there is a strong belief that this would give Nigerian economy a great leap from its current 40th largest economy in the world to around 30th. While this remains to be seen, GDP rebasing will for sure alter both the growth rate of each component of GDP, their weight in the overall GDP growth rate and take into account the structural changes in the economy and new sector that have sprung up over the last twenty-three years.
The near term outlook for economic growth remains positive, with real GDP growth projected at 6.7% and 7.3% in 2013 and 2014, respectively. The medium-term prospects are also promising; Government efforts toward economic diversification and sustained implementation of the ongoing reform interventions in key sectors are expected to contribute to improved economic performance. However, there are downside risks to this projection stemming from discoveries and development of shale gas production in the United States and China that would change the face of the world energy markets.

1.3. Monetary Policy Developments

The Central Bank of Nigeria (CBN) Monetary Policy Committee supported tight monetary stance during the first half of 2013 by maintaining the Monetary Policy Rate (MPR) at 12 percent with a corridor of +/-200 basis points. The cash Reserve Requirement was also maintained at 12 percent, the Liquidity Ratio at 30 percent and the Net Open Position at 1 percent. But while maintaining the above monetary stance, the committee introduced a 50 percent Cash Reserve Requirement (CRR) on all public funds deposits in the deposit money banks’ possession. The essence of this new policy is to ensure that excess liquidity in banks’ balance sheets is evenly distributed and to further strengthen financial and macroeconomic stability. Another potential positive effect of the policy is that it would allow the deposit money banks to explore new sources of fund such as the large army of unbanked Nigerians rather than heavy reliance on cheap government deposits.

At end-June 2013, total net bank credit to the economy grew by 4.7 percent, compared to 0.9 percent decline in first half 2012. This outcome reflected growth in net claims on the government of 2.3 percent, while private sector credit grew at a modest rate of 3.6 percent. Several factors are responsible for the low credit flows to the private sector. Apart from servicing the largest Nigerian corporations in the oil and telecoms sectors and the value chains associated with them, banks perceive that lending to other segments of the markets (SMEs in particular) is too risky, especially given the recent rise in T-bills interest rates. The high yield on T-bills has made them more attractive to banks than lending to private sector. This situation is exacerbated by (i) weak infrastructure which induces high business failure among SMEs, (ii) poor capacity of SME operators to package their bankable projects in a way that make them attractive for bank lending; (iii) non-availability of acceptable collaterals; (iv) weak business environment that limits competitiveness; and (v) high lending rates that reflect the risk premium and high cost of business operations.
There was a marked improvement in banking sector deposits, (Figure 3) with demand deposits, time deposits and savings deposits growing by 5.1 percent, 7.6 percent and 4.1 percent, respectively, during the period. This provides an indication that financial inclusion is improving, although it still remains limited especially in rural areas of the country.

Stock market capitalization increased in value from N12.4 trillion as at end-June 2012 to N15.8 trillion as at end-June 2013 (Figure 4). The Nigerian Stock Exchange (NSE) All Share Index (ASI) rose by 67.4 percent relative to its value in June 2012. Despite the growth, NSE ASI remains below the pre-global financial crisis level. This could suggest that the confidence of Nigerians is yet to be fully restored in the capital market as a result of the slump that resulted from sharp practices by some market operators. Much still need to be done, therefore, to restore confidence. Ensuring transparency, accountability, responsible corporate governance, and institutional strengthening are some of the required actions to achieve this.

A 2012 survey conducted by Enhancing Financial Innovation and Access (EFInA) shows that 34.9 million adult Nigerians or 39.7 percent of the adult population are unbanked. One possible reason for the poor financial inclusion is the similarity among the banks regarding their limited diversified products and risk appetite.
The tight monetary policy stance of the Central Bank and other economic policy measures by the government resulted in inflation decelerating from double digits to single digit (Figure 5). The year-on-year headline inflation which fluctuated between 15.1 and 10.2 percent since Q2 2008 declined to 8.4 percent at the end of the first half 2013. Food and non-food inflation stood at 9.6 percent and 5.5 percent, respectively. While upward pressure on prices is usually expected for food items during the first half of the year which is usually a planting period, there were fears that the widespread flood that occurred in several parts of the country last year might result in significant rise in food inflation. This effect appears to have been offset by programs put in place through the Agricultural Transformation Agenda and other interventions such as dry season planting. All in all, inflation rate is expected to remain at single digit for the rest of the year.

1.4. Fiscal Policy Developments

Fiscal developments during the first half of the year were marked by efforts targeted at supporting critical sectors such as manufacturing and agriculture in order to support job creation and poverty reduction in the economy while maintaining macroeconomic stability. One major area of such efforts is redirecting fiscal savings from the partial removal of the petrol subsidy towards job creation and poverty reduction initiatives via the Subsidy Re-investment and Empowerment Programme (SURE-P). Fiscal consolidation as contained in the country’s Transformation Agenda also continue to guide both horizontal and vertical fiscal allocations with focus on shoring up capital expenditures relative to current spending.

1.4.1. Revenues

The gross federally collected revenue for the first half of 2013 amounted to $30.5 billion. This represents a decrease of 13.4 percent compared to the corresponding period in 2012 (Figure 6). Although fiscal revenues have been relatively stable over the years, they have been on a downward trend since the beginning of Q4 2012 when a decline of over 10 percent was recorded over the previous quarter. This outturn is linked to the structure of revenue sources in which oil is dominant, thus exposing fiscal revenues to the vagaries in the global market price of crude oil and natural gas and developments in domestic oil production.
Federally collected revenues continue to be dominated by oil and gas that accounted for a quarterly average of around 76.3 percent of total receipts during the first half of 2013, with a peak of 80.2 percent in Q1 (Figure 7). Oil revenues, driven largely by petroleum profit tax and crude oil and gas sales, have fallen steadily from $14.9 billion during Q4 2012 to $11.5 billion at the end of Q2 2013. This poor performance is essentially attributable to illegal oil bunkering, pipeline vandalism and oil theft. Government's efforts to reverse this trend include a recent approval by the Federal Executive Council to deploy about $95.4 million to equip security agencies responsible for checking this menace and strengthen their intelligence information gathering on the mode of operation of the oil thieves, especially the stealing methods and channel of sale; and introduce with the help of international community a mechanism for tracking the sale of crude oil from Nigeria in the global market.
Petroleum profit tax (PPT) is the leading contributor to fiscal oil revenue with a quarterly average of 54.1 percent in 2012 and 54.7 percent in the first half of 2013. Again, the low and fluctuating contribution of crude oil and gas sale to total oil revenues is borne out of the state of the domestic and global crude oil and gas environment. The state of uncertainty in the oil sector as a result of the continued delay in the passage of the Petroleum Industry Bill (PIB) may have dampened the contribution of PPT to oil revenue since its base is petroleum operations. Delayed passage of the PIB may perhaps have led to postponement in investment, especially by foreign investors, and thus leading to the recent divestment by some oil majors, in addition to the local content policy of the Federal Government. This may further result in shrinking oil tax base and may subsequently result in significant drop in PPT revenues.

Non-oil tax revenues recorded quarterly average of $4.3 billion in 2012 with a peak of $5.5 billion in the third quarter. This performance moderated in the first half of 2013 with quarterly average of $3.6 billion, representing a decline of about 5 percent compared to the corresponding period in 2012.

1.4.2. Expenditures

Fiscal expenditures recorded quarterly average of about $7 billion in 2012, with a peak of around $7.8 billion during the third quarter. This expenditure pattern in the first half of 2013 with quarterly average of $3.6 billion, representing a decline of about 5 percent compared to the corresponding period in 2012.

Fiscal deficit has been high though with downward trend since Q1 2013 rising back 37 percent in Q1 and 20 percent in Q2 over the preceding quarter. Given the Government’s reliance on domestic borrowing for deficit financing, there is a need to keep closer watch on fiscal deficit to ensure there is no undue pressure on domestic interest rates.

### Table 1. Composition of Federal Fiscal Expenditures in Nigeria, Billion US$

<table>
<thead>
<tr>
<th></th>
<th>Q1 2012</th>
<th>Q2 2012</th>
<th>Q3 2012</th>
<th>Q4 2012</th>
<th>Q1 2013</th>
<th>Q2 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Exp.</td>
<td>6,042.41</td>
<td>6,758.58</td>
<td>7,766.69</td>
<td>7,185.63</td>
<td>7,583.60</td>
<td>8,139.86</td>
</tr>
<tr>
<td>Recurrent</td>
<td>4,520.63</td>
<td>4,923.95</td>
<td>5,913.73</td>
<td>4,518.94</td>
<td>4,970.44</td>
<td>5,233.93</td>
</tr>
<tr>
<td>Capital</td>
<td>983.42</td>
<td>1,559.78</td>
<td>1,672.09</td>
<td>2,210.68</td>
<td>2,045.33</td>
<td>2,238.46</td>
</tr>
<tr>
<td>Transfers</td>
<td>538.23</td>
<td>275.10</td>
<td>179.91</td>
<td>455.82</td>
<td>567.96</td>
<td>667.47</td>
</tr>
</tbody>
</table>

Source: Central Bank of Nigeria
1.4.3. Federation Account Operations

From the total federally collected revenues of $15.4 billion and $15.1 billion in Q1 and Q2 2013, respectively, a total sum of $8.7 billion and $9.7 billion was transferred into the Federation Account during this period for sharing among all tiers of government after all necessary deductions have been made (Table 2).

Table 2. Federation Account Operations in Nigeria, Million US$

<table>
<thead>
<tr>
<th></th>
<th>Q3 2012</th>
<th>Q4 2012</th>
<th>Q1 2013</th>
<th>Q2 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Distributable Revenue Account</td>
<td>8,581.69</td>
<td>8,351.43</td>
<td>8,688.49</td>
<td>9,664.84</td>
</tr>
<tr>
<td>Federal Government</td>
<td>4,086.46</td>
<td>3,946.28</td>
<td>4,092.75</td>
<td>4,545.45</td>
</tr>
<tr>
<td>State Governments</td>
<td>2,072.47</td>
<td>2,001.59</td>
<td>2,075.91</td>
<td>2,305.53</td>
</tr>
<tr>
<td>Local Governments</td>
<td>1,598.22</td>
<td>1,543.17</td>
<td>1,600.45</td>
<td>1,777.43</td>
</tr>
<tr>
<td>Oil Producing States</td>
<td>825.17</td>
<td>860.33</td>
<td>919.39</td>
<td>1,036.43</td>
</tr>
<tr>
<td>VAT Pool Account</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal</td>
<td>158.30</td>
<td>168.28</td>
<td>169.87</td>
<td>177.24</td>
</tr>
<tr>
<td>States</td>
<td>529.56</td>
<td>560.97</td>
<td>566.18</td>
<td>590.91</td>
</tr>
<tr>
<td>Local</td>
<td>370.63</td>
<td>392.69</td>
<td>396.31</td>
<td>413.60</td>
</tr>
<tr>
<td>Excess Crude Account</td>
<td>166.56</td>
<td>458.68</td>
<td>2,122.12</td>
<td>1,780.48</td>
</tr>
<tr>
<td>Federal</td>
<td>76.29</td>
<td>210.24</td>
<td>972.60</td>
<td>816.02</td>
</tr>
<tr>
<td>States</td>
<td>38.78</td>
<td>106.61</td>
<td>493.32</td>
<td>413.92</td>
</tr>
<tr>
<td>Local</td>
<td>29.88</td>
<td>82.20</td>
<td>380.36</td>
<td>319.07</td>
</tr>
<tr>
<td>Oil Producing States</td>
<td>21.61</td>
<td>59.63</td>
<td>275.91</td>
<td>231.47</td>
</tr>
<tr>
<td>Other Funds</td>
<td>823.27</td>
<td>1,631.60</td>
<td>678.00</td>
<td>823.27</td>
</tr>
</tbody>
</table>


The Federation Account does not include independently-generated revenues from the three tiers of government, which could be very substantial in some cases. For instance, the Federal Government generated $4.5 billion from internal sources in Q2 2013. This is an area where there is high potential for diversifying revenues and deepening domestic resource mobilization at all levels of government. The observed decline in fiscal revenues that come principally from oil sends a clear signal that relying on the monthly revenue allocation to the three tiers of government is not sustainable in the long-term. There is, therefore, real need to further shore up fiscal revenues through more sustainable non-oil sources. As noted in part III of this report, alternative sources that need to be explored are the large informal sector and abundant non-oil minerals and natural resource deposits available in all parts of the country.

1.4.4. Debt and Composition

As at end-June 2013, total outstanding public debt amounted to $50.9 billion. While domestic debt owed exclusively by the Federal Governments amounted to about $44 billion or over 86 percent of the total, external debt owed by both the Federal and State Governments accounted for the balance of about $7 billion.

1.4.4.1. Domestic Debt

There has been concern in the past about the rising trend in the Government domestic debt.

For instance, total domestic debt rose from $30.5 billion to $35.9 billion or about 18% between 2011 and 2012. Correspondingly, domestic debt service increased from $4.6 billion to $5.7 billion or about 24% during the same period. However, thanks to the ongoing fiscal consolidation efforts, domestic debt stock has been rising at much suppressed rate in the recent past. For example, domestic debt that stood at $42 billion at end-2012 increased to about $44 billion by the end of Q2 2013, equivalent to 5 percent increase (Figure 8). Thus, the growth rate of domestic debt has been brought to a single digit, albeit it is still rising.

Source: Debt Management Office of Nigeria.

![Figure 8. Domestic Debt Composition](image-url)
The concern about the rising domestic debt that triggered the Government’s fiscal consolidation efforts is genuine because rising domestic public debt has the tendency to raise interest rates, thereby crowding out the potentials of private sector in sourcing credit in the domestic debt market. Indeed, it is widely believed that increased public domestic debt is a major cause of the increasing lending rate in the country and a major driver of portfolio investment. To reverse this growing trend, the Federal Government has instituted a robust domestic debt management policy. One of the key features of this strategy is to ensure debt sustainability by gradually reducing domestic debt. First, annual borrowing has been scheduled for steady reduction over the medium term, beginning 2011 and has been maintained to date. Second, the fiscal authorities have set up a Sinking Fund worth over $600 million in the 2013 fiscal year to repay Federal Government maturing debts. The total external debt outstanding at the end of Q2 2013 amounted to $6.92 billion, up from $6.04 billion in the corresponding period in 2012 (Figure 9). This represents about 15 percent increase over this period. Multilateral debt, principally from IBRD, IDA, ADB, ADF and EDF accounted for a quarterly average of over 80 percent during the period under review. It is noteworthy that ADB and ADF accounted for a quarterly average of 8 percent during the first two quarters in 2013.

The fact that multilateral debts dominate Nigeria’s external debt profile is a good development because the soft nature of such loans with interest rate below the commercial market...
rate and longer tenor and moratorium provides leverage for managing public debt. However, there is need for fiscal authorities to be mindful of a creeping tendency for an increase in bilateral and commercial debt whose share in total external debt rose from 8 percent in Q1 2012 to almost 13 percent at the end of Q2 2013.

The debt management strategy being implemented by the Federal Government is likely to change the dynamics of the national debt profile in the medium term. Given the higher cost of domestic borrowing which is around 8 percent per annum higher than external borrowing and the potential negative effect of domestic borrowing on private sector lending, the debt management strategy is focusing on optimal mix of 60:40 ratio for domestic and external debt to reduce total debt and service cost. One factor that may moderate success, however, is the recent drive by the Federal Government to increase foreign debt. In July 2013, for instance, the Federal Government undertook a road show for issuance of $1 billion dual tranche bond of $500 million each for 5- and 10-year tenor. There is also planned issuance of Diaspora Bond toward the end of the year. These may begin to gradually increase the total external debt, leading to an upward pressure on total debt servicing.

1.5. External Sector Developments

1.5.1. Trade

Total trade during the first half 2013 fell to $68.8 billion from about $83 billion recorded in the corresponding period in 2012, representing a decrease of about 17 percent (see Figure 10). The trade performance during the period under review mirrors the mixed developments in exports and imports with marginal fall of 4.5 percent and significant rise by 15 percent, respectively. There appears to be a worrisome downward trend in Nigerian trade volume in recent times, reflecting decline especially in exports. Weak industrial production and domestic petroleum refining capacity that necessitates high dependence on imports coupled with falling domestic oil production are the possible major causes.

Total imports amounted to $25 billion in the first half 2013, a decrease of about 18 percent compared to the corresponding period in 2012 (Figure 11). The decline in import following a long period of rising import bill in Nigeria may be signaling the impact of the import substitution policy underpinning the Government’s Agriculture Transformation Agenda. A look at the composition of imports, however, reveals a less desirable development; refined petroleum products account for a large share of total imports (about 30 percent). This reflects the weak domestic refining capacity, which exposes the economy to the vagaries of oil price move-

Figure 10. Total Trade

Source: Central Bank of Nigeria
ments. It also exposes fiscal revenues to additional shock given the partial subsidy on petrol and full subsidy on kerosene.

The prospects for improving the domestic refining capacity of Nigeria are contingent on the upstream and downstream oil sector reform, especially the subsidy reform, to ensure that investment in the petroleum refinery is profitable. This would require complete deregulation of the sector and the passage of the PIB. Recently, a deal was signed with China State Construction Engineering Corporation (CSCEC) for the construction of additional three Greenfield Refineries and a Petrochemical plant. Moreover, the Dangote Group has announced plan to invest up to $8 billion to build a refinery with a capacity of around 400,000 barrels a day by late 2016. These developments are expected to considerably improve the domestic refining capacity and subsequently curtail refined oil imports.

Nigerian total exports stood at $43.8 billion in the first half of 2013, down from $47.8 billion in the corresponding period in 2012 (Figure 12). Crude oil and natural gas continue to dominate Nigerian exports during the first half of 2013, accounting for a quarterly average of 96 percent of total exports. This reveals a very high export concentration that exposes the economy to external shocks from global market price of crude oil. Thus, sustaining the momentum in the current sectoral reform in agriculture, solid minerals and infrastructure development would go a long way toward boosting export performance.
Total foreign investment inflows into the economy rose to $15.4 billion in the first half 2013 (Figure 13). This represents a very significant improvement in foreign investment inflows by about 50 percent since end-2012, making Nigeria the most preferred foreign investment destination in Africa.

The Nigerian foreign investment landscape is dominated by portfolio investment, accounting for quarterly average of 84 percent of total foreign investment inflows in the first half of 2013. This is a slight improvement when compared to quarterly average of 82 percent in the corresponding period in 2012. The preponderance of portfolio investment in total foreign capital flows is essentially driven by the very high interest rate on T-bills. Meanwhile, foreign direct investment also recorded an increase from $214 million in second quarter 2012 to about $401 million in the corresponding period in 2013, validating Nigeria’s position as the leading choice of FDI destination in Africa.
1.5.2. Balance of Payments

Nigeria’s overall balance of payments that stood at 6.7 percent of GDP at the end of the first quarter 2013 witnessed significant improvement over both the corresponding period in the previous year and over the preceding quarter (Table 3). This good performance was driven largely by the current account component that increased from 7.3 percent of GDP in Q4 2012 to about 10 percent in Q1 2013.

External reserves have steadily risen to almost $48 billion at the end of the first quarter of 2013 corresponding to about 11.2 months of imports cover. The remarkable stability in the price of oil in the global market explains in part this outcome, but sustaining this high level of reserves is becoming challenging in the face of the ongoing oil theft that has curtailed the volume of exports. Both effective and nominal exchange rates have also been very stable around N156 and N157 to a dollar, respectively, thanks to an effective management of the exchange rate regime through weekly market interventions by the CBN.

<table>
<thead>
<tr>
<th>Table 3: Balance of Payments Indicators</th>
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</thead>
<tbody>
<tr>
<td><strong>Current Account Balance (% GDP)</strong></td>
</tr>
<tr>
<td>Capital and Financial Account Balance (% GDP)</td>
</tr>
<tr>
<td>Overall Balance (% GDP)</td>
</tr>
<tr>
<td>External Reserves - Stock (Million $)</td>
</tr>
<tr>
<td>External Reserves (Months of Imports Cover)</td>
</tr>
<tr>
<td>External Debt Stock (US$ million)</td>
</tr>
<tr>
<td>Effective Central Exchange Rate (N/S)</td>
</tr>
<tr>
<td>Average Exchange Rate (N/S)</td>
</tr>
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</table>

Source: Central Bank of Nigeria
Nigeria’s most recent decade has been marked by significant political and economic progress. Economic reforms initiated since the country’s return to democratic governance in 1999, have put the country on the road to middle-income status. The trend in macroeconomic performance underpinned by sound economic management has continued to be positive. However, the robust economic growth has not translated into sufficient employment generation. This puzzling contrast points to the urgent need for policies that will structurally transform the Nigerian economy to ensure inclusive growth, particularly the absorption of youth into the economy.

Planned and ongoing structural reforms can substantially boost prospects for inclusive growth by improving the operating environment that businesses need to take full advantage of the many opportunities in the country. The most pressing constraints remain infrastructure and finance. Thus, structural policies aimed at addressing major infrastructure gaps (mainly in power), and enhancing access to credit (especially for Agriculture and SMEs) would go a long way toward stimulating economic diversification and increasing competitiveness. While reforms are underway in diverse sectors of the economy, including electricity, agriculture, transport, petroleum, banking and finance, aviation, public financial management, health, education, etc, the focus in this report is on two critical sectors (Power and Agriculture) that have high potential for catalyzing inclusive growth.

1.5.3. Power Sector

The power sector in Nigeria is currently undergoing one of the most ambitious reforms in Africa, with the privatization of all public power assets in order to end the country’s chronic power shortages. The reform is based on the Electric Power Sector Reform Act 2005. This Act focuses on creating a regulatory agency that would serve as the institution for managing the privatization process and ensuring enforcement and compliance of the rules of the game. The reform also emphasizes privatization of hitherto government-owned company, previously National Electric Power Authority (NEPA) and now Power Holding Company of Nigeria (PHCN) that monopolized electricity generation, distribution and transmission for a very long time. It is hoped that this will remove the obstacles to private sector investment in this critical sector.

The reform objectives include highly ambitious targets for the power sector. It is projected that power generation would reach over 13,000 MW by 2015 and 40,000 by 2020. To reach these targets, efforts are being made to scale up and maintain a steady pace and timely implementation of the reforms.

The first phase in the reform process is the unbundling and privatization of the long-standing government-owned monopoly that has overseen the affairs of the power sector for so long, the PHCN. Second phase involved the development of a cost reflective electricity tariff to ensure competitive pricing that would attract
private sector participation in the privatization process and make investment in the sector attractive and sustainable. The third phase focuses on selling the 80 percent government stake in the 10 gas-fired power plants jointly owned by the three tiers of government under the management of the Delta Power Holding Company of Nigeria. These are: Olorunsogo (750 MW); Calabar (561 MW); Alaoji (450 MW); Ihovbor (450 MW); Omotoso (450 MW); Sapele (450 MW); Geregu (434 MW); Egbema (338 MW); Gbarain (225 MW); and Omoku (225 MW).

Significant progress has been recorded in the course of implementing the power sector reform. First, the hitherto government-owned monopoly in the electricity sector – PHCN – has been unbundled. Eighteen distribution and generating companies have successfully paid a total amount of around $2.5 billion, which represents the bid value for its assets. Second, a cost-reflective tariff, the Multi-Year Tariff Order (MYTO II), intended to make the sector attractive to both local and foreign investors, was finalized and became effective on 1st June 2012. The current electricity tariff has reached the cost-recovery stage with the exception of a cross subsidy for the poor households. Third, a Nigerian Bulk Electricity Trader (NBET), Nigeria Electricity Liability Management Company (NELMCO) and National Power Training Institute of Nigeria (NAPTIN) have been established and functioning. NELMCO has the mandate to assume and administer the liabilities of PHCN, NBET is responsible for contracting agreements and procure power until the new system matures for direct bilateral contracting between generation and distribution companies while NAPTIN is responsible for power sector capacity building. Fourth, in pursuance of best practices, the management of the Transmission Company of Nigeria (TCN) was handed over to Manitoba Hydro International, by means of competitive bidding. Fifth, significant efforts are ongoing to improve the gas-to-power infrastructure. Sixth, there is almost a closure to the resolution of PHCN labour issues with about 66 percent of the staff verified and payments made or being processed. Lastly, the handover of the unbundled companies to the buyers is imminent and should be fully completed by the end of October 2013.

The reform efforts have yielded some visible positive results. One, power generation has improved substantially, rising from 3,514 MW in 2011 to a peak of 4,500 MW in December 2012 before sliding to 4,458.2 MW on February 6, 2013. Two, several Independent Power Plants (IPPs) have been licensed and are expected to contribute additional 2,500 MW to power supply by December 2013 and 6,000 MW of power through greenfield IPPs and rehabilitation of existing power plants. Three, seven power plants and 150 new substations built across the country were recently inaugurated. Four, significant progress has been made in migrating from post-paid meter to a more efficient pre-paid metering system. Lastly, all the preferred bidders have fully paid up.

Despite these achievements, challenges remain. These are: (i) raising long-term finance for the emerging generation and distribution companies with estimated required annual investment worth $7.5 billion between now and 2020; for which the AfDB is planning to provide a Partial Risk Guarantee (PRG) to private investors to the tune of $380 million and above; (ii) sourcing for the required manpower with the requisite skills for the emerging distribution and generation companies; (iii) paying off the remaining staff of PHCN; (iv) insufficient gas supplies to some of the power plants across the country; (v) low water levels at Jebba, one of the main sources of national power supply; (vi) difficulty in obtaining right of way for transmission line development; and (vii) difficult terrains for undertaking power projects in some part of the country.

There are several ongoing initiatives aimed at tackling the existing challenges and consolidating on the gains made so far. First, there is a signed MoU with Power China for the construction of 20,000 MW and 10,000 km of transmission grid/substation and infrastructure within 2 years. Second, there is a subsisting MoU with Daewoo, Electrobas, ETD/ETF, General Electric and Siemens to generate 10,000 MW each. Third, approval has been given for the use of $1.72 billion and $1.65 billion proceeds from the sale of NIPP generation assets to execute new hydropower plants and critical transmission projects, respectively. Fourth, Federal Government has provided over $30 million special intervention fund to the distribution and generation companies for use in operational and maintenance activities. Fifth, the
Government has benefitted from the release of the $100 million AfDB loan to TCN and Chinese EXIM Bank’s $500 million to undertake critical transmission projects.

To ensure successful completion of the power sector reform and bring its benefits to most Nigerians, the Federal Government and other implementing agencies must focus on existing challenges and other pertinent issues. First, there is need for appropriate sequencing of the ongoing reforms to ensure smooth transition and reduce friction. Second, government must ensure sustained investments in the sector since the transmission companies would remain under the ownership of the Government. Given the checkered history of government management of such private business activities, conscious efforts must be made to ensure the transmission companies that would remain under the ownership and control of the federal Government do not slip into the state of NEPA, PHCN and NITEL. Third, Government must evolve effective institutional framework that guarantee sustainability of the reform efforts. High priority attention needs to be given to the regulatory, institutional and human capacity framework for managing post-privatization challenges. Fourth, there is need for innovative approach to solving the lingering challenge of unstable gas supply to the power generating stations. Fifth, there is need for increased investment in clean power generation to achieve optimal mix of energy sources with emphasis on hydro and solar power sources. Lastly, there is need for continued development of enabling laws and regulations that would ensure of compliance enforcement in the sector.

1.5.4. Agriculture

Transforming agriculture that employs more than 60 percent of Nigerians from subsistence to a commercially viable activity with value-chain linkages to manufacturing holds a great potential for achieving inclusive growth in Nigeria. This is the strategic thrust of the Government’s ongoing reform of the sector. This policy intervention involves targeting infrastructure spending on areas that increase the potentials of agriculture, developing agricultural credit insurance scheme, engendering privately-managed subsidized fertilizer scheme for poor farmers, and achieving import substitution for the commodities that have claimed significant foreign exchange through imports, namely, rice, wheat, sugar and fish.

A number of programs have been adopted in the past and present to improve agriculture and rural development, prominent among which are the Special Programme for Food Security (SPFS), the Fadama II and III Programmes, the Fertilizer Revolving Fund (FRF), and the Presidential Initiatives on Cassava, Rice, Vegetable Oil, etc. Another, important development in the agricultural sector is recapitalisation of the Nigerian Agricultural Bank (NAB). Other recently completed policies and programmes in the sector are Added Value Exemption for locally produced agricultural inputs such as fertilizer and simple fabricated machines. The CBN also adopted new strategies on credit delivery, the Trust Fund Model (TFM) which reduced the risk faced by banks in agricultural lending with adequate emphasis on production, processing and marketing. Another initiative is the Nigeria Incentive-Based Risk-Sharing System for Agricultural Lending (NIRSAL) - a new innovative mechanism targeted at de-risking lending to the agricultural sector. The program is designed to provide the singular transformational and one bullet solution to break the seeming jinx in Nigeria’s agricultural lending and development. This mechanism sponsored by the CBN is an approach that focuses on tackling both the agricultural value chains and the agricultural financing value chain. The goal of NIRSAL is to trigger an agricultural industrialization process through increased production and processing of the greater part of what is produced to boost economic earnings across the value chain.

The Government reform in the agriculture sector is encapsulated in the Agricultural Transformation Agenda (ATA) launched with the aim of adding 20 million metric tons of food to the domestic food supply by 2015 and creating 3.5 million jobs, among other objectives. The focus of the ATA is to drive import substitution by accelerating the production of local staples, reducing dependence on food imports and turning Nigeria into a net food exporter. The agenda is a fundamental paradigm shift from the attitude of viewing agriculture as a development programme to treating it as a business that enables active private sector participation while government provides enabling environment, policies and incentives.
The reform appears to have achieved some intended results, by (i) stimulating 2.7 million jobs in the rainy and dry seasons of 2012 across the value chain and protecting an additional 1.2 million jobs; (ii) increasing the net income of Nigerian farmers by N174 billion due to its activity in five value chains of cassava, rice, sorghum, maize and cotton and adding nine million metric tons of food in its first year of existence; (iii) focusing attention on agriculture finance through the NIRSAL with the target of delivering $3.5 billion of loans from banks at attractive interest rates; (iv) significantly improving large-scale private sector participation in agriculture. Examples of such investment include Notore and Mitsubishi joint investment of $1.3 billion, Dangote Group’s planned investment of $3.5 billion in urea plant, and Indorama investment of $1.2 billion in a new fertilizer plant; (v) with the Growth Enhancement Support (GES) scheme of the ATA government has ended direct involvement in the sale and distribution of seeds and fertilizers through the use of mobile phones. Private sector seed and fertilizer companies now sell directly to farmers, reaching 1.5 million farmers and impacting on 7.5 million lives within the first year of the scheme. This led to about $156 million fiscal savings; (vi) reducing imports of wheat and rice significantly as a result of higher domestic production of substitutes; and (vii) establishing an agriculture commodity exchange and crop processing zones to improve agribusiness.

These achievements notwithstanding, some critical challenges remain that need to be addressed. One of the most prominent of these is the land tenure and ownership system in Nigeria which constrains commercial agriculture. Other challenges include rural-urban drift, reluctance on the path of youths to engage in agriculture, weak extension services, and weak agriculture mechanization status.

To help deal with some of these identified challenges, the African Development Bank in partnership with the Government has intensified its engagement in the Nigerian agriculture sector, through the Agriculture Transformation Agenda Support Program (ATASP). The objective of this program is to support and develop agribusiness as a platform to create about 120,000 jobs along the value chain of priority commodities, increase income and ensure food security by adding 20 million tons of key commodity food crops to domestic food supply per annum. The ongoing reform holds a great potential for reducing poverty in Nigeria. However, to be successful, there is need for an integrated approach to infrastructure development in the sector and the recently introduced tariff and tax incentives in support of the sector should be temporary and strictly time-bound.
PART III: THEMATIC ISSUE
- IMPROVING DOMESTIC RESOURCE MOBILIZATION IN NIGERIA

1. Introduction

The need for active domestic resource mobilization (DRM) and utilization to driving sustainable broad-based economic growth, development and transformation has been well acknowledged. The 2002 Monterrey Consensus and the 2008 Doha conference on Financing for Development demonstrate this acknowledgment. Several factors are responsible for this position. Domestic resources provide a more stable, certain and sustainable means for development finance. Domestic resources provide a more reliable and less volatile revenues for fiscal finance. Reliance on domestic resources also create a social contract between government and citizens, thereby strengthening citizens’ oversight and supervision of the use of fiscal resources. Improved reliance on domestic resources contributes positively to state-building and government accountability. Also important is the improved policy space engendered by reliance on domestic resources.

This position is well recognized by the Government of Nigeria that has embarked over the years on reforms aimed at improving DRM in the country. In 1978, a Task Force on Tax Administration was constituted as part of the efforts to form the tax system. This Task Force introduced the Withholding Tax (WHT) regime, suggested imposition of 10 per cent special levy on bank’s excess profits, and recommended imposition of 21 or 22 per cent turnover tax on building and construction companies. Further reforms were planned in 1992 with constitution of the Study Group on Nigerian Tax System and Administration. The Group recommended the establishment of Federal Inland Revenue Service (FIRS) as the operational arm of Federal Board of Internal Revenue (FBIR) and constitution of Revenue Services at the State and Local Government levels. In the same year, another Study Group on Indirect Taxation was constituted, leading to a policy shift from direct taxation to indirect consumption based on value added tax system.

The benefits of these reforms on improved DRM have been limited. This drives home the fact that there is significant untapped DRM potential in Nigeria that requires attention. This section of the report presents a case for the need to focus more on exploring the yet untapped DRM potentials in Nigeria. It presents stylized facts about DRM in the country and provides policy recommendations that hold high promise in the efforts to improve DRM in the country.

2. Stylized Facts on Domestic Resource Mobilization in Nigeria

DRM in Nigeria is characterized by several stylized facts that reinforce the need for renewed focus. First, the economy exhibits narrow tax
Over the years, oil and gas sector has accounted for 75 percent to 80 percent of total tax receipts. Yet, the significant need for revenues to finance development activities such as narrowing the infrastructure gap reiterates the need for closing the tax revenue deficit. Such heavy reliance on oil and gas tax is a reflection of shallow tax base and DRM in Nigeria.

Second, Nigerian DRM environment exhibits poor financial market instruments. For example, Nigeria sits on large financial resources such as the Pension Fund currently worth about N3.5 trillion. However, financial instruments for deploying the fund to the sectors and areas of need in the economy are very limited. One of the few available uses to which this fund has been put is the purchase of State Government Bonds to the tune of N169.73 billion by end June 2013. More sophistication and innovative use of this and other huge resources would be assured via the development of a healthy credit risk transfer instruments and institutions, such as hedge funds.

Third, there are high capital and tax flights. Tax flights from developing countries, including Nigeria, are estimated to be several times higher than aggregate inflows from development assistance. Global Financial Integrity ranked Nigeria 7th among the top ten highest illicit capital outflows in the developing world and 1st in Africa during 2001 to 2010 (see Table A1). Some of the push factors driving illicit capital flows include corruption perception indicators, the size of the underground economy, and weak regulatory institutions.

Fourth, weak tax collection capacity. The ability of tax administrators to efficiently collect tax in Nigeria is constrained by both weak human and physical capacity, principally due to paucity of administrative capacity. This is further constrained by high level of informal economy dominated by self-employment and its associated difficulty in assessment and collection. In addition, retail trade is incredibly large but substantially informal with no documentation that could form the basis for tax computation. Here lies significant potential waiting to be tapped.

Fifth, there is a high cost of tax collection. The efficiency of a tax includes not only the administration costs, but also compliance costs. The costs of administering tax should not be too high in proportion to the revenues raised. The use of tax consultants, has contributed greatly to the rising cost of tax collection in Nigeria. Cost of collection is estimated to be between 25 percent and 35 percent of internally generated revenue. In contrast, in advanced countries and even in some African countries, the cost of tax collection ranges between 3 percent and 5 percent.

Lastly, the cumulative effects of these stylized facts give rise to another stylized fact, namely, low tax payment compliance with high evasion.

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**Figure A1: Nigerian Tax Revenue Profile**

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Oil &amp; Gas Taxes</th>
<th>Non-Oil Taxes</th>
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</thead>
<tbody>
<tr>
<td>Q1 2011</td>
<td>657.4297</td>
<td>297.7615</td>
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<tr>
<td>Q2 2011</td>
<td>307.0558</td>
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<td>Q2 2013</td>
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Source: Federal Inland Revenue Service
and avoidance. This is further worsened by lack of sufficient capacity in tax administration that reduces the probability of detection. Another contributory factor is the ridiculously low penalty on tax evaders that is hardly punitive. The effects of weak tax administrative capacity which lowers detection (probability of being caught) and low fine imposed when caught reinforce themselves to influence the decision of a taxpayer to evade tax payments.

3. Strategies for Improved DRM in Nigeria

There is a role for all stakeholders in Nigeria’s efforts to increase domestic resource mobilization and utilization. However, given the focus and orientation of this section, the strategies discussed here will be limited to the role of government as enabler, facilitator and regulator of activities that promote DRM, especially to develop innovative DRM products.

Government needs to undertake critical tax reforms with focus on regulatory, institutional and legal issues. Several areas of such reforms are discernible. These include reducing complications in tax assessment, computation and collection; broadening the tax base to include the hard-to-tax informal sectors and activities; deepening the already commenced trend of moving away from tax exemptions, concessions and holidays; and financial sector reform. Government should ensure proper sequencing of the reform initiatives to increase success and unleash the high potentials of pension and insurance funds for efficient and innovative use. The current tax regime in Nigeria is such that there is low level of compliance and limited collection and administrative capacity. Reforms should ensure a broader tax base and better tax conditions that are capable of harnessing untapped tax potentials, especially through formalization of informal sector activities and a move away from the current concentration on large tax payers. Independent estimations of the size of the Nigerian informal sector vary, with some putting it around 65 percent of GDP. If this is correct, one could imagine how much additional tax revenue would be harnessed if such huge potential is brought under the tax net.

Reforms should also focus on improving tax administration and capacity. The introduction of the Tax Identification Number (TIN) is a very important step by the FIRS to improve tax administration. To further facilitate assessment

<table>
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<tr>
<th>Country</th>
<th>2001</th>
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<td>United Arab Emirates</td>
<td>4.6</td>
<td>0</td>
<td>0.8</td>
<td>1</td>
<td>5.5</td>
<td>11.8</td>
<td>0</td>
<td>51.7</td>
<td>23.5</td>
<td>7.6</td>
<td>166.5</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>240.52</td>
<td>227.38</td>
<td>287.92</td>
<td>387.4</td>
<td>487.14</td>
<td>468.2</td>
<td>512.99</td>
<td>628.5</td>
<td>561.04</td>
<td>668.54</td>
<td>449.7</td>
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Source: Global Financial Integrity
and collection, it is important that the implementation of this strategy be further intensified for all taxpayers – individual and corporate. The reform would remain largely incomplete if attention is not paid to existing tax legislation and regulations. The whole reform process can be effectively driven through the use of technology and other innovative techniques.

Experiences in Nigeria and elsewhere have shown that, at best, time-bound tax holidays only succeed in attracting short-term investment. Once the tax holiday is over, investors tend to shift production to new areas where similar incentives are available. Generally, tax holidays encourage tax fraud and tax avoidance through use of transfer pricing as taxable businesses shift their profits to those enjoying tax holidays thereby avoiding payment of taxes. Required reforms in this respect will be those that eliminate such exemptions, concessions and holidays and consider replacing them with more transparent incentives of unlimited loss carryover and accelerated depreciation. The advantage of the proposed tax system is that they are less distortionary and will increase access to the government of the much needed fiscal revenues.

In spite of recent financial sector reform, much still need to be done regarding the effective mobilization of savings and allocating them efficiently across the wider spectrum of economic agents. Since access to financial services as a result of distance is a major challenge to effective savings, especially in the rural areas, government should focus on improving financial infrastructure in the rural communities. Specific incentives should be conceived to encourage savings from the unbanked rural population and the informal sector. Given the large percentage share of these categories of people and activities in the total economy, significant savings may be mobilized from this source in addition to the formal sector resources. Another major challenge that reform must focus on is improving rural and informal savings mobilization which are instilling in Nigerians confidence in the financial sector and reducing transaction costs and information asymmetry. Reform should also make provision for incentives to encourage rural banking.

The recently developed Financial Inclusion Policy of the CBN is a move in this direction. The target of reducing the financially excluded Nigerians to 20 percent by 2020 is also a laudable goal. The frameworks set out for implementing the strategy should be strictly adhered to ensure consistency and sustained positive outcomes. The time is ripe for government to undertake a “big push” toward formalizing the informal sector activities and businesses. The actual size of the informal sector in Nigeria remains controversial and unknown. Efforts should be made toward understanding the size and potential of this sector and charting strategies for formalizing it and bringing it under the tax net.

There is need for institutional capacity building for improved tax collection and management in Nigeria. This is particularly true for revenue collection agencies like Federal Inland Revenue Service (FIRS) and the Nigeria Customs Service (NCS). There is equally a need to develop the capacities of these institutions in the conceptualization, design, implementation and monitoring of tax policy, administration and management. Generally when institutional capacities are weak, tax collecting agencies tend to focus on collecting taxes from corporate firms and large tax payers because their taxes are easy to compute and less expensive to collect. However, these account for very small percentage of the entire economy. It is imperative, therefore, that the revenue generating institutions be equipped with the right human, technical and financial resources required to undertake their tasks of improving DRM.

It is interesting to note how much the capacities of revenue generating institutions in Nigeria have improved over the years. For instance, FIRS has been very consistent in exceeding its tax collection target since 2000 up to second quarter 2013. NCS demonstrates similar experience. These good results are the outcomes of reforms of the regulatory oversight and improved enforcement capacity of these institutions. For example, the tax system has undergone significant reform since 2004 that culminated in the National Tax Policy and establishment of the Joint Tax Board. The most prominent of these reforms are establishment of Tax Appeal Tribunal to expeditiously address tax disputes and modernization of FIRS and the NCS especially in the areas of improving autonomy, funding, IT application, and ca-
pacity building. However, challenges remain that need to be addressed. Some of these are: leakages, diversion and corruption in the tax system; weak enforcement power of the revenue collecting agencies; poor data on economic activities and tax base; and limited economic diversification.

Government has a strategic role to play in deepening and broadening the tax base. The critical action required to achieve this is active and sustainable diversification of the economy away from oil. Diversification of the economy through, for example, improved value chain in agriculture, light manufacturing and solid minerals exploitation and processing would significantly increase economic activities. This would ultimately increase the tax net and consequently tax revenues. In addition, there is need for significant improvement in the business environment. This means government would need to deepen its role as enabler with focus on improving the business environment. To attract investment and engagements in economic activities that are taxable, government would have to put in place the basic infrastructure that would make business conducive. Basic infrastructure such as stable electricity, good transport infrastructure, and other supporting logistics are indispensable in this process. There is also need to ensure level playing field for business engagements. Thus, government would need to fast track its proposed competition policy to encourage healthy business competition. Safe and secure country is also important to attract and retain domestic and foreign business activities that cut across different sectors of the economy. Government also needs to promote balanced use of carrot and stick to encourage enforcement and compliance with tax collection and payments.

Governments at different levels need to work together to address the complaints from the private sector about multiple taxation. There have been serious complaints in recent times from the business community about multiple taxations by different levels of government (Federal, State and Local). There are sometimes serious overlaps in tax jurisdictions resulting in overlaps of the various tiers of government taxing rights on business entities. The two-fold negative effect of multiple taxation on the economy is that it discourages business activities and increases the final cost of services to end users. Urgent efforts are, therefore, needed to harmonize sub-national tax policy and procedures. However, this should be preceded by comprehensive assessment of the status quo with respect to tax structure and respective jurisdiction of different tiers of government.

4. Conclusion and Way Forward

There is a role for all stakeholders in charting a successful course for improving DRM in Nigeria. However, government shares the highest burden and needs to play the initial enabling role. This would require efficient and prudent fiscal, monetary and exchange rate policies and effective coordination of these. Government should, therefore, deepen its ongoing macro and structural reform initiatives. Consistent implementation of these reforms will assure effective consolidation of gains and further rake in additional benefits. For example, effective fiscal consolidation that reduces government borrowing from the domestic capital market will ensure that private sector operators are not crowded out in the utilization of domestic resources. It would also ensure that government is not the dominant user of pension, insurance and other innovative funds.

One important first step would be to undertake a comprehensive and holistic assessment of the revenue generating institutions in Nigeria with particular focus on their existing human, technical and financial capability to undertake the task of developing, implementing and monitoring improved strategy for DRM. The assessment should also focus on identifying the existing gaps that remain and propose practical solution for dealing with them. Each revenue mobilizing agency should be directed to provide a medium-term strategy for resource mobilization that focuses on both the formal and informal sectors of the economy with emphasis on the informal sector.

Government should be quick to resolve the complaints of the business entities regarding multiple taxation. A holistic assessment of this complaint is necessary with a view to establishing the source of conflict and resolving them through proper alignment of tax jurisdiction among the three tiers of government. The existing institutional framework provided by the Joint Tax Board should be utilized to achieve
this. In addition, the government should deepen its reform efforts to widen the tax base, curb tax evasion, and promote increased enforcement and compliance by reducing the burden of compliance. Attention should also be focused on enabling and facilitating private sector activities through effective competition policy and equitable tax system and encouraging the State Governments to do same. In addition to playing these roles, government should also ensure proper coordination of its efforts and those of other stakeholders to ensure coherent approach to increased DRM.

Diaspora Bond provides additional avenue for mobilizing short-to long-term financial resources from non-resident Nigerians to facilitate flow of funds into sectors and activities of interest. The ongoing move by the Nigerian authorities to float $100 million Diaspora Bond toward the last quarter of the year is a sound idea. Nigerians in the Diaspora should see this as an opportunity to contribute to the Nigerian growth and development story by subscribing to the Fund. There is need, though, for careful examination and proper understanding of the process by undertaking detailed study of successful Diaspora Bond issuers such as Israel, India and Ethiopia, and draw lessons that would make for successful launch. Also of importance is the establishment of the Sovereign Wealth Fund (SWF) that would mobilize domestic resources and channel them toward critical areas, especially infrastructure.

Overall, Pension Fund, Insurance Fund, Diaspora Bond, SWF and large saving deposits in the economy offers excellent opportunity for increased DRM. These and other innovative DRM sources should be fully explored. However, to successfully achieve this, government would need to develop and implement appropriate policies to unleash their potentials through implementation of the recommendations in this article. The AfDB is working with different African countries in this respect with a view to strengthening capacities of domestic revenues and tax collecting institutions, supporting government tax reform policies, and supporting private sector initiatives. Some of the key areas development partners could add value are in developing effective and simplified tax code, bringing the informal sector under the tax net and providing a toolkit of economic diversification for Nigeria.

**FURTHER READING**


