Document of
The World Bank

Report No. AUS0002571

# NIGERIA PUBLIC FINANCE REVIEW:

# FISCAL ADJUSTMENT FOR BETTER AND SUSTAINABLE RESULTS

November 2022

WORLD BANK GROUP

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CURRENCY EQUIVALENTS
Exchange rate effective as of February 18, 2022
Currency unit = Nigerian Naira (NGN)
US$1 = NGN 417

GOVERNMENT FISCAL YEAR
January 1 to December 31

## ABBREVIATIONS AND ACRONYMS

| | | | |
|---|---|---|---|
| BDC | Bureau-de Change | MTEF | Medium Term Expenditure Framework |
| BEPS | Base Erosion Profit Shifting | MYTO | Multi-Year Tariff Orders |
| BOF | Budget Office of the Federation | NAFEX | Nigeria Autonomous Foreign Exchange Fixing |
| CBN | Central Bank of Nigeria | NAPIMS | National Petroleum Investment Services |
| CIT | Company Income Tax | NBET | Nigerian Bulk Electricity Trading Company |
| CNG | Compressed Natural Gas | NBS | National Bureau of Statistics |
| DEA | Data Envelopment Analysis | NEITI | Nigeria Extractive Industries Transparency Initiative |
| DISCO | Power Distribution Companies | NERC | Nigerian Electricity regulatory Commission |
| DMO | Debt Management Office | NGN | Nigerian Naira |
| ECA | Excess Crude Account | NLNG | Nigeria Liquefied Natural Gas |
| FAAC | Federation Accounts Allocation Committee | NLSS | National Living Standards Survey |
| FCT | Federal Capital Territory | NNPC | Nigerian National Petroleum Corporation |
| FGN | Federal Government of Nigeria | NPDC | Nigerian Petroleum Development Company |
| FIRS | Federal Inland Revenue Services | OAGF | Office of the Accountant General of the Federation |
| FMFBNP | Federal Ministry of Finance Budget and National Planning | OAuGF | Office of the Auditor-General for the Federation |
| FP | Financing Plan | PAF | Payment Assurance Facility |
| FPU | Fiscal Policy Unit | PIA | Petroleum Industry Act |
| GDP | Gross Domestic Product | | |
| GENCO | Companies for the Generation | PPG | Public and Publicly Guaranteed |
| GG | General Government | PPPRA | Petroleum Product Pricing Regulatory Agency |
| GIFMIS | Government Integrated Financial Management Information System | PPT | Petroleum Profit Tax |
| GOE | Government-owned Enterprises | PSC | Production Sharing Contracts |
| IEFX | Investors and Exporters forex | PSRP | Power Sector Recovery Program |
| IGR | Internally Generated Revenue | SG | State Government |
| IMF | International Monetary Fund | SME | Small and medium-sized enterprises |
| JV | Joint Venture | SRGI | Strategic Revenue Growth Initiative |
| MCP | Multiple Currency Practices | SSA | Sub-Saharan African |
| MDA | Ministries, Departments, and Agencies | TCN | Transmission Company of Nigeria |
| MDGIF | Midstream and Downstream Gas Infrastructure Fund | VAT | Value Added Tax |

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# Acknowledgments

The Nigeria Public Finance Review was prepared at the request of the Federal Ministry of Finance, Budget, and National Planning, and prepared in close collaboration with the Budget Office of the Federation, the National Bureau of Statistics (NBS), the Office of the Accountant General of the Federation (OAGF), and the Debt Management Office (DMO). Its analysis of the efficiency, equity, and impact of public revenue and expenditure management is designed to inform Nigeria's process of fiscal consolidation as the country strives to recover from the coronavirus disease 2019 (COVID-19) pandemic and meet the challenges of a dynamic global economic environment.

The Nigeria Public Finance Review is part of a programmatic effort of fiscal analytics that the World Bank is conducting with the Nigerian government. Ongoing analyses is shared as presentations and technical notes in a continuous dialogue. The emphasis is on establishing a baseline understanding of key fiscal management challenges, and on highlighting reform options to support the government's agenda to strengthen revenue and expenditure policies and programs to tackle Nigeria's key development challenges.

This Public Finance Review synthesis report was prepared by a World Bank team led by Marco Hernandez (Lead Economist), Emilija Timmis (Senior Economist), Miguel Angel Saldarriaga (Economist), Samer Matta (Senior Economist), Nyda Mukhtar (Economist), Gloria Joseph-Raji (Senior Economist), Joseph Ogebe (Research Economist), and Masami Kojima (Lead Energy Specialist).

The team is grateful to, Lilian Okpeku (Research Analyst), Leif Jensen (Senior Economist), Rajul Awasthi (Senior Public Sector Specialist), Elijah Kimani (Public Sector Specialist), Sylke Von Thadden (Consultant), Tara Vishwanath (Lead Economist), Jonathan Lain (Economist), Arthur Lagrange (Senior Economist), Yadviga Semikolenova (Lead Economist), Rei Odawara (Senior Economist), Mohammed Shuaibu (Consultant), Guillermo Palacios (Consultant), Ariel Melamud (Consultant), Juan Pradelli (Consultant), Francisco Vasquez (Consultant), Aichiro Suryo Prabowo (Consultant), Robert Beyer (Senior Economist), Wael Mansour (Senior Economist), Habib Rab (Lead Economist), Khwima Nthara (Country Manager), and Marcello Arrigo (Consultant) for their valuable contributions to this report.

The Nigeria Public Finance Review benefited from the overall supervision and guidance of Shubham Chaudhuri (Country Director), Abebe Adugna (Regional Director for Equitable Growth, Finance, and Institutions), and Francisco Carneiro (Practice Manager for Macroeconomics, Trade, and Investment).

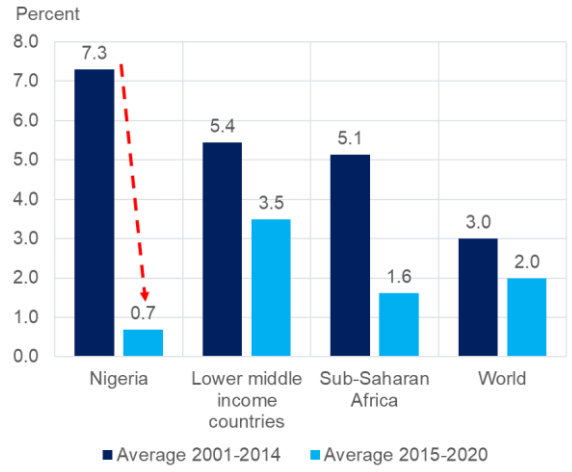
# A PRIMER ON NIGERIA'S FISCAL FRAMEWORK

# 1.1 Nigeria's macro-fiscal context

## Nigeria is at a critical historical juncture

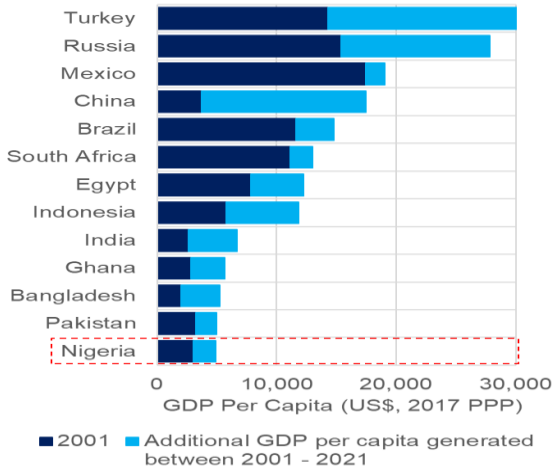
**Nigeria's development has stagnated since 2015.** Between 2001 and 2014 Nigeria was a rising star in West Africa, with an average growth rate of 7 percent per year, and among the top 15 fastest-growing economies in the world. The rising tide stopped after 2015 due to: (i) a decline in oil prices, (ii) increased insecurity, (iii) a reversal of macroeconomic reforms and heightened unpredictability of economic policy, and more recently (iv) the adverse effects of the COVID-19 pandemic (FIGURE 1.1). As a result, growth plummeted to a mere 1.1 percent average between 2015 and 2021. Subdued growth, coupled with a rapid increase in population at a rate of 2.6 percent per year (one of the highest in the region), resulted in Nigeria having the lowest real gross domestic product (GDP) per capita among its peers (FIGURE 1.2). In 2010, Nigeria's GDP per capita was 59.5 percent of Indonesia's. By the end of 2021, this figure had dropped to 41.9 percent.

FIGURE 1.1. GDP growth plummeted after the collapse in global oil prices in 2014–2015…




Source: World Development Indicators (WDI).

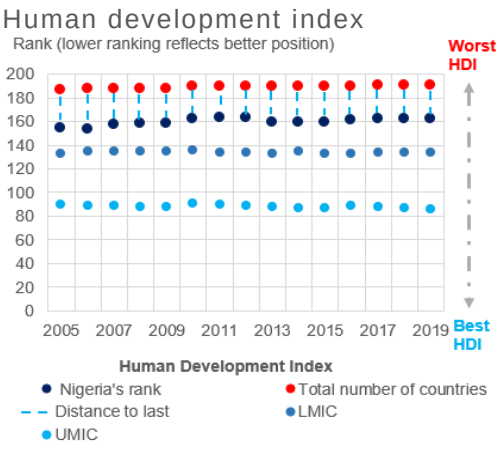
FIGURE 1.2. … and GDP per capita remains the lowest among peers.




Source: WDI.

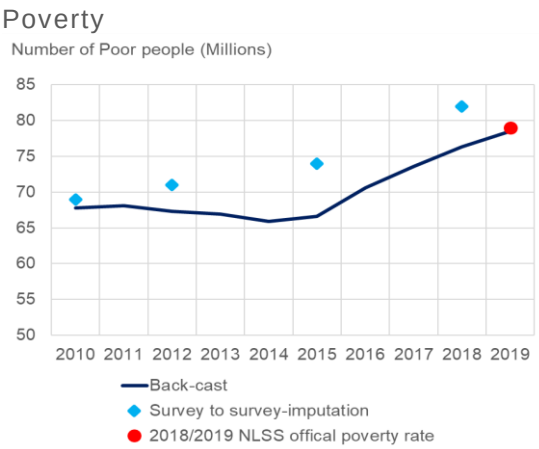
**After two decades of uneven growth, Nigeria remains a poor country with stark spatial disparities.** Growth has not been inclusive; as a result, Nigeria has the second largest population of poor people in the world and is one of the least developed countries globally (FIGURE 1.3). Before the outbreak of COVID-19, around 4 in 10 Nigerians were living in poverty. By the end of 2020, Nigeria had roughly 80 million poor people, higher than the 68 million the country had in 2010 (FIGURE 1.4). There are pronounced geographical differences in human development, with a chasm between the north and the south, and between urban growth centers and isolated rural areas. Those living in households with more dependents, less access to infrastructure, and less-educated heads are also more likely to be poor. Of those Nigerians living below the national poverty line in 2018–19, 84.1 percent lived in rural areas; while 76.1 percent lived in the North Central, Northeast, or North West regions.

FIGURE 1.3. Nigeria's development progress has stagnated over the years…




Source: United Nations Development Program (UNDP).

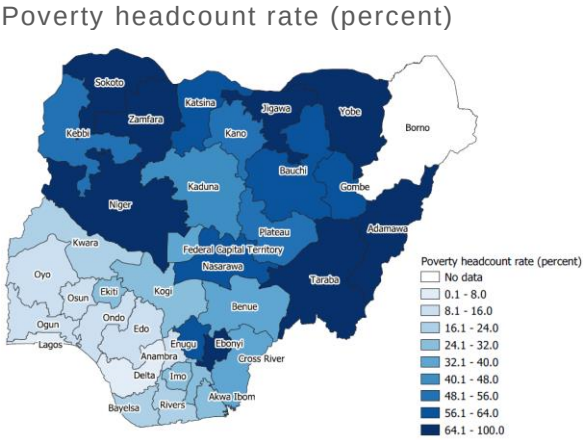
FIGURE 1.4. …and the number of poor people has been rising faster since the 2015–2016 recession.




Source: NBS and World Bank Poverty Assessment. Note: Estimates exclude Borno. Poverty rates are based on the national poverty line, with real consumption deflated temporally and spatially.

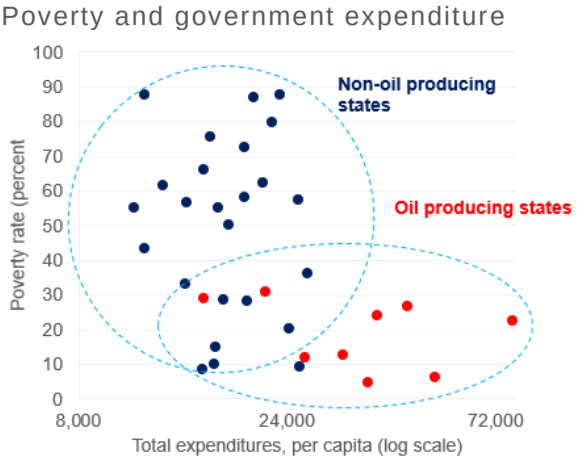
**Nigeria is highly spatially unequal, with living standards differing sharply between the north and south and between rural and urban areas**. In 2018/19, the poverty rate for Nigeria's north as a whole (pooling the North Central, North East, and North West zones) was 57.9 percent compared with 20.3 percent in the south (pooling the South East, South South, and South West zones; see FIGURE 1.5). Similarly, around 84.1 percent of those Nigerians living in poverty in 2018/19 were located in rural areas.

FIGURE 1.5. Poverty is concentrated in northern Nigeria




Source: 2018/19 NLSS, Humanitarian Data Exchange (for map shape files), and World Bank estimates. Note: Estimates exclude Borno. Consumption spatially and temporally deflated to allow for cross-state comparisons. Poverty rate calculated using Nigeria's national poverty line.

FIGURE 1.6. Expenditures per capita is lower for states facing higher poverty rates, although this correlation vanishes among states with highest expenditures per capita




Source: World Bank estimates based on State Financial Statements 2018 and 2019; 2018/19 NLSS.

**Redistribution is therefore criticial for reducing poverty and raising Nigerians' living standards, emphasizing the importance of fiscal federalism in Nigeria.** As discussed in more detail in Section 1.3 (Fiscal Federalism), states and local governments play a vital role in delivering health, education, and other key public services that could help lift Nigerians out of poverty. Yet state governments rely heavily on the federally collected revenues for much of their funding. This means that the formula that determines how much different states receive is crucial. Currently, the fiscal formula only partly aligns with states' populations and their respective development challenges; many of the funds from the federation are simply split equally across the states, while states that more effectively collect their own revenues are also rewarded more. This could limit Nigeria's ability to implement pro-poor programs in the states that most need them. As FIGURE 1.8 demonstrates, government spending is lowest in states where poverty is highest, raising questions about the efficiency of government[1].

**Nigeria is at a critical juncture.** By the end of 2021, a Nigerian had the same level of income per capita as in 2010. Even at the average per capita GDP growth rate of 1.1 percent seen in 2021 (which partly stemmed from base effects, following the 2020 recession), it will take roughly a decade to return to the same GDP per capita of 2014. Nigeria is one of the least-diversified oil producers in the world, and while economic growth, along with the fiscal and external positions, has historically improved at times of increasing oil prices, this will not be the case in 2021 and 2022. The timing of this decoupling from the cycle of global oil prices will make it harder for Nigeria to benefit from external tailwinds.

## The deteriorating macroeconomic framework is at the root of low growth, heightened economic volatility, and scarce job creation

**Macroeconomic stability and policy predictability have consistently deteriorated over the last decade.** Nigeria's economic performance, measured by GDP, is one of the most volatile among lower-middle-income countries. Macro stability, measured through a composite index of inflation and the external and fiscal positions, has significantly declined since 2014 (FIGURE 1.7) and by 2021 it reached an all-time low (FIGURE 1.8). Several factors have contributed to the deterioration of macroeconomic stability:

- **An over-reliance on oil exports results in a high degree of external volatility**. Over the last four decades, oil and gas has consistently represented more than 90 percent of Nigeria's total exports, resulting in a high degree of external volatility. In each cycle, faltering oil exports weaken confidence in the economy, resulting in diminished or even negative net capital inflows, which intensify pressure on the local currency (the naira), further discourage investment, and slow growth. The collapse of the oil price in 2015 and 2020, coupled with production problems in the oil sector, affected the current account balance which turned from a surplus of 3.7 percent of GDP in 2009–2014 to a deficit of 0.7 percent in 2015–2020.
- **Limited fiscal space.** Nigeria's limited fiscal space reflects its low total revenues and heavy dependence on crude oil exports. Prior to the COVID-19 pandemic, a full 50 percent of general government revenue came from the oil sector, and—like the external balances—the government (both federal and subnational) budgets is highly exposed to commodity prices. Following the 2015 oil shock, Nigeria's already very low general government revenue fell to an average of just 7.0 percent of GDP between 2016 and 2020, among the lowest levels in the world. Net oil and gas revenues are also stagnating due to high levels of deductions from gross oil revenues. During 2020—21, Nigeria's

[1] While funding is necessary, it is not sufficient, and ensuring spending on health, education, and other pro-poor programs is implemented efficiently is also vital; this issue is discussed in more detail in Section 4.7 (Benchmarking Nigeria's efficiency of public spending)

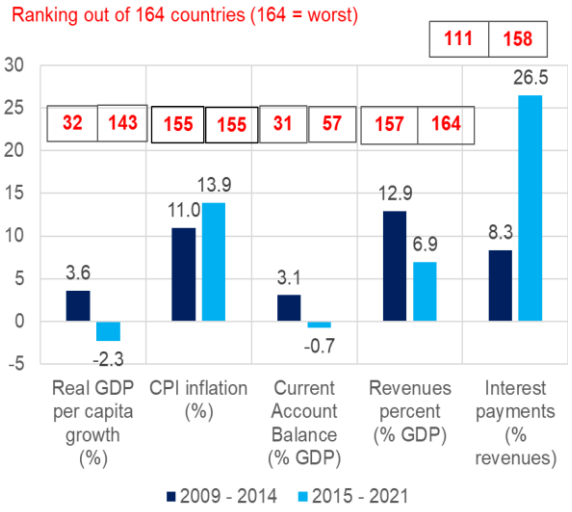
fiscal position became increasingly precarious as the general government deficit reached an average of 5.6 percent of GDP, breaching the 4 percent statutory ceiling established in the 2007 Fiscal Responsibility Act.[2]

- **Inability to run a counter-cyclical fiscal policy.** The government's dependence on volatile oil revenues and depleted fiscal buffers have shifted its fiscal policy stance from countercyclical between 2008 and 2014 to slightly procyclical between 2015 and 2021. Procyclicality in fiscal policies has amplified economic fluctuations, further discouraging new investment, exacerbating unemployment, and weakening debt sustainability.(FIGURE 1.7)
- **High borrowing costs and ad hoc borrowing strategy.** While the public debt thus far remains sustainable, the Federal government's debt-service-to-revenue ratio has risen to critical levels in recent years (FIGURE 1.7). The government's borrowing strategy is also ad hoc with budget deficit financing targets being split equally between domestic and external borrowing, without consideration for costs and practicalities. High volume of CBN borrowing is not only costly but also distorts the debt portfolio and borrowing strategies as this debt is not considered part of the official public debt stock.
- **Inconsistent monetary policy.** Monetary policy in Nigeria is not positioned to contain rising inflationary pressures. Since 2018, the Central Bank of Nigeria (CBN) has played a larger role in financing the federal government, but the CBN's current policy goals—keeping the exchange rate de-facto stable, promoting growth, and containing inflation—are not synchronized. Partly due to weak fiscal management, the CBN has increasingly sought to promote growth and industrial development since 2016. High and rising inflation rates are worsening poverty and depressing economic activity. In 2020 alone, rising prices are estimated to have pushed 7 million Nigerians into poverty.
- **Unpredictable exchange-rate policies.** In the drive to create jobs and foster economic diversification through import substitution, the CBN has imposed restrictions on the uses of foreign currency and aimed to increase and direct private credit to priority sectors. In addition, it supported industrial and agricultural development more directly through subsidized financing schemes. These policies have hurt investor confidence, with FDI flows declining significantly, and domestic producers have curtailed their production due to limited access to imported raw materials.
- **Restrictive trade policies**. Nigeria's current high trade costs and cumbersome customs procedures are a result of long-standing import prohibitions and unpredictable enforcement regimes, inhibiting the country's non-oil export competitiveness. While tariffs have decreased significantly in recent decades, the Nigerian tariff regime remains restrictive. In 2016, Nigeria's weighted average most-favored-nation tariff was two times the Sub-Saharan African (SSA) average, 5.5 times higher than in Indonesia, and nine times higher than in Mexico.

[2] In line with the 2007 Fiscal Responsibility Act which established a 3 percent of GDP for the Federal Government fiscal deficit, 34 of Nigeria's 36 States have limited their fiscal deficits, with a collective ceiling around 1 percnet of the GDP.

FIGURE 1.7. Most macro-fiscal indicators significantly worsened after 2015…

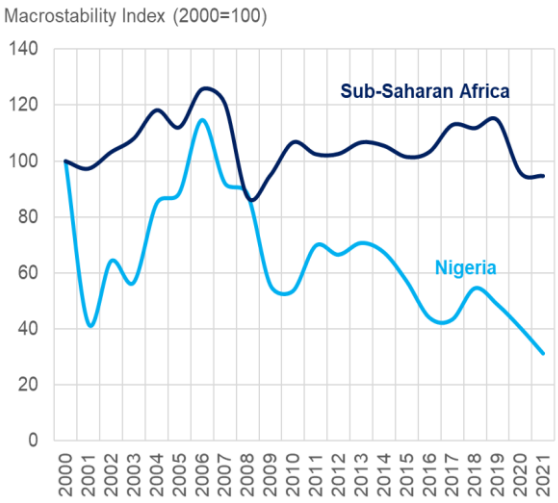
Macroeconomic indicators




Source: WEO.

FIGURE 1.8. … and Nigeria's macro stability reached a low in 2021.

Macrostability Index (2000=100)[3]

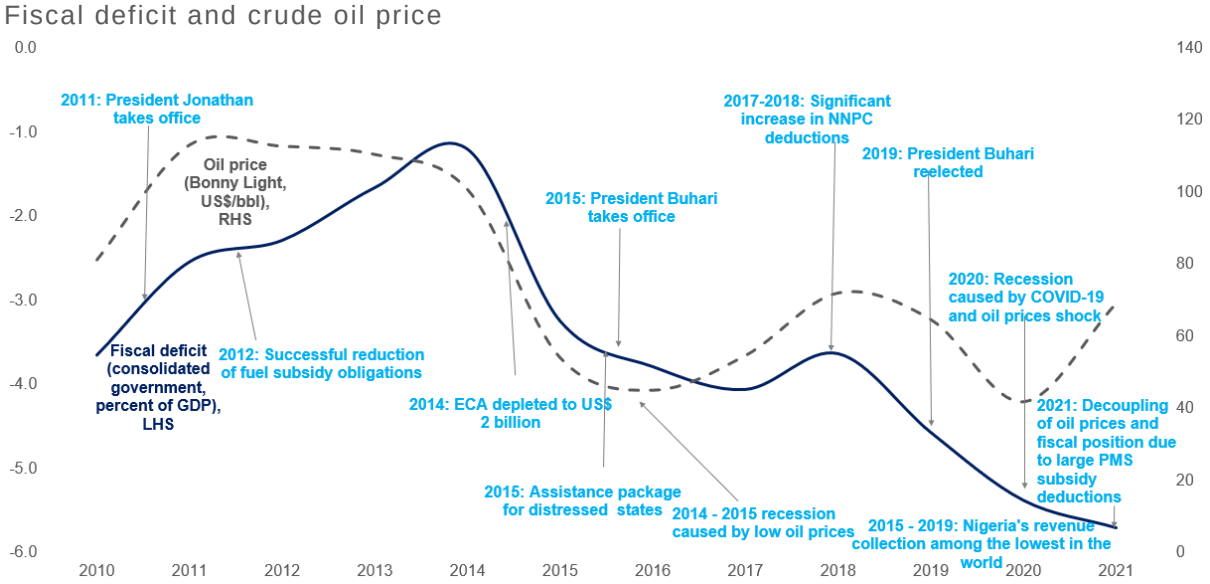



Sources: WEO and OAGF

**Periods of low oil prices and fiscal pressure have enhanced the appetite for reform but sustaining commitments past the periods of crisis has proved difficult.** Macro-fiscal crises have encouraged diversification and fiscal consolidation, both at the state and federal levels. Yet, it has been challenging to implement such measures when they imposed costs on citizens (through increased cost of living, such as subsidies reductions). Further, once an economic crisis subsides, the momentum for reform typically wanes (FIGURE 1.9). This pattern has been replicated during the period of structural adjustment in the 1980s, debt forgiveness in 2006, and since mid-2014 with the fall of oil prices and production.

[3] Measured by a standardized composite index of inflation, current account, and overall fiscal balance, with 2000 as the base year.

FIGURE 1.9. Fiscal deficit trails oil prices and consolidation measures have not been sustained

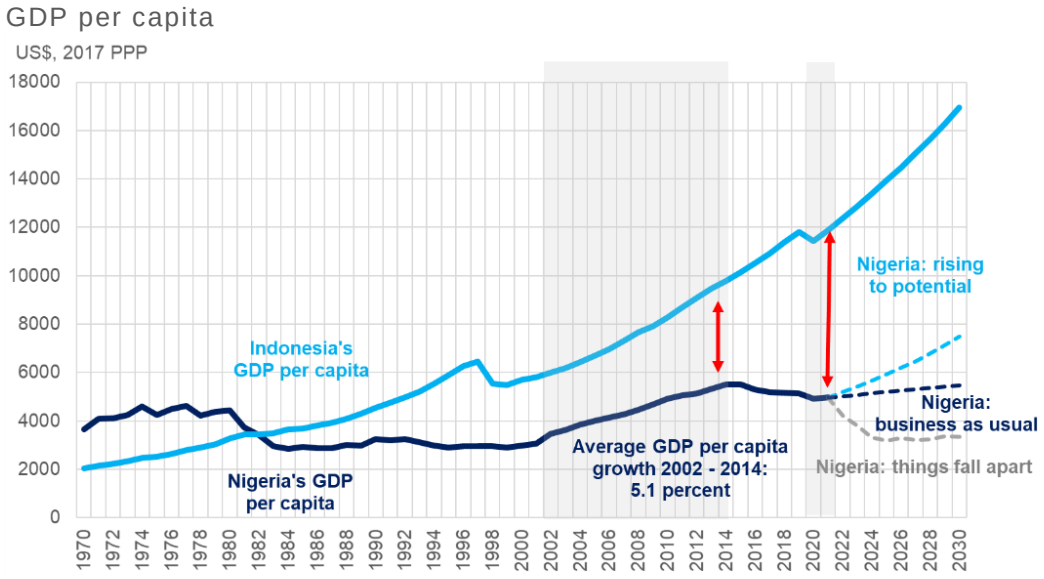



Sources: OAGF, NBS and CBN.

**Nigeria has a choice to make**. Laying foundations for robust and inclusive growth through fiscal reform can increase substantially the welfare of Nigerian citizens and accelerate convergence with other middle-income economies (FIGURE 1.10FIGURE 1.10. Higher economic growth and stronger fiscal management can help Nigeria rise to its potential

). Under this scenario, Nigeria's per capita GDP growth could exceed population growth by at least two percentage points over the next decade and increase from 41 percent of Indonesia's GDP per capita in 2021 to roughly 50 percent by 2030. By contrast, a business-as-usual scenario, where risks to fiscal and debt sustainability are not addressed, no longer allows Nigeria to finance its large development needs and improve the living standards of its population. Under this scenario, per capita GDP growth will still be positive, but insufficient to catch up with other middle-income peers, and by 2030 Nigeria's GDP per capita will be barely 30 percent of Indonesia's.

FIGURE 1.10. Higher economic growth and stronger fiscal management can help Nigeria rise to its potential

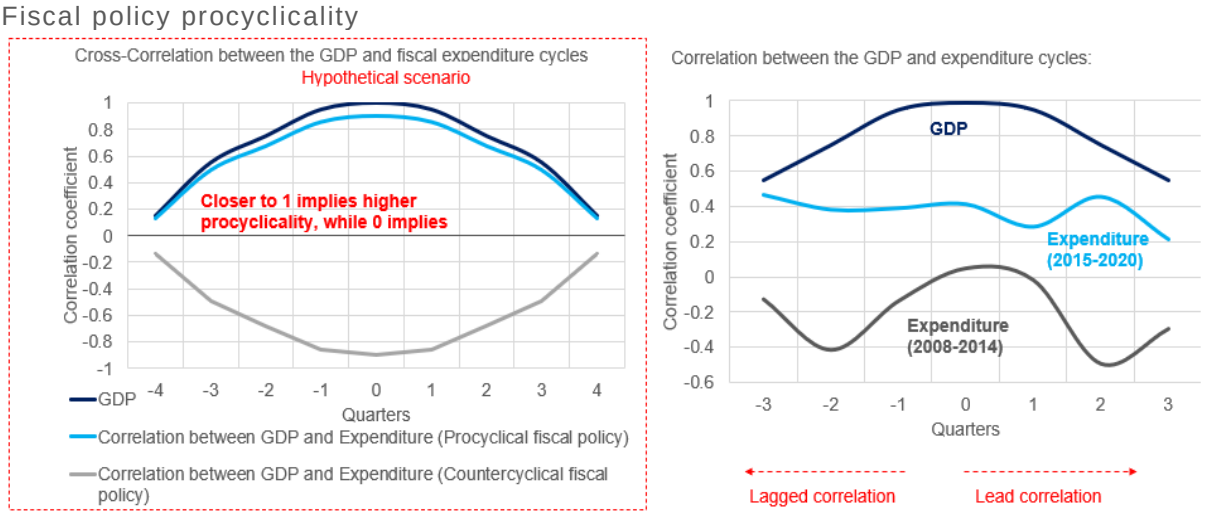



Sources: NBS, International Monetary Fund (IMF) and World Bank

## Nigeria's public spending is procyclical

**The procyclicality of public spending implies that primary spending and real GDP growth move in the same direction.** A bias for recurrent spending, combined with dependence on volatile revenues, renders Nigeria's public spending procyclical. In many developing countries, a sizable recurrent spending tends to make overall public spending more rigid and countercyclical, while capital spending, usually considered more flexible, tends to be procyclical. In Nigeria, however, the opposite seems to be true: real GDP growth is positively correlated with personnel spending, and negatively correlated with capital expenditures. It must again be noted that general government expenditure has historically been very low in Nigeria, and as a result has had a modest impact on the economic cycle; on the other hand, the oil-driven economic cycle has a major effect on revenues, and consequently on public expenditures.

FIGURE 1.11. Nigeria's fiscal policy became procyclical after 2014



Sources: OAGF, NBS, and World Bank calculations.
Notes: Cross-correlation of the cycles of GDP and public expenditure. The x-axis indicates the period of the quarterly correlation; t=0 is the contemporaneous correlation; negative numbers are lagged correlations, and positive numbers are lead correlations. The GDP line depicts the business cycle, and it is used as a benchmark: the closer the variable of interest is to that line, the more procyclical it is because it follows the business cycle.

**Procyclical fiscal policies tend to generate macroeconomic instability and amplify economic fluctuations**. This discourages new investment, undermines human capital through high unemployment, causes volatility in government revenues and the terms of trade, and undermines debt sustainability.[4] Furthermore, there is significant evidence across the world that a procyclical fiscal stance has a negative impact on welfare and poverty outcomes.[5] Although the procyclicality of fiscal policy might appear common across resource-rich countries in Sub-Saharan Africa, countries such as Botswana and South Africa have been able to avoid it.

## Current fiscal policies do not set Nigeria on a fiscally sustainable path

**A business-as-usual scenario, in which fiscal policies on subsidies, revenues, expenditures, and budgets remain unchanged, is not sufficient to lead Nigeria to a sustainable fiscal path that can finance broad-based growth[6]**. Our baseline scenario (see TABLE 1.1 for assumptions) suggests that reforms already enacted are not enough to stabilize Nigeria's debt trajectory. Recovery and stabilization in the oil sector and the wider economy, some minor reforms in non-oil revenues, marginal adjustments in personnel costs and strong decline in capex are not sufficient to ensure a stable debt path. The revenue trajectory remains flat, despite the recovery in oil prices and production and marginal reforms on non-oil revenues. Fiscal space is narrowed by the growing interest burden, which imposes a cap on capital spending and endangers the provision of basic services for a growing population. Market borrowing is insufficient to cover all financing needs, which results in continued borrowing from the Central Bank, with negative consequences on inflation and domestic interest rates. This scenario is not sustainable in the long run, even before considering additional risks.

TABLE 1.1. Macroeconomic outlook and policy assumptions

| Macro variable | 2022 | 2023 | 2024–25 |
|---|---|---|---|
| GDP growth (%) | 3.8 | 4.0 | 4.0 |
| Inflation (%) | 14.8 | 13.5 | 11.0 |
| Oil Production (mbpd) | 1.6 | 1.7 | 1.8 |
| Oil Price (US$/bbl) | 85 | 75 | 75 |
| Policy assumptions | • No petrol subsidy removal.<br>• Money Transfer Levy introduced.<br>• No reversals in VAT rate increase.<br>• Personnel cost freeze for the Federal Government in nominal terms from 2024 onwards.<br>• Medium-Term Expenditure Framework 2022–2024 for the Federal Government for non-interest recurrent expenditures.<br>• Capital expenditures for Federal Government for the period 2021–2022 follow the 2017–2019 average level (1.3 percent of GDP) and then gradually decrease to 0.8 percent of GDP | | |

[4] Bernanke (1983), Eichengreen and Hausmann (2004), Martin and Rogers (1997), Hercowitz and Strawczynski (2004), and Brueckner and Carneiro (2017) for extensive discussion on the impact of the procyclicality of fiscal stance.
[5] Woo, J. (2005). Social polarization, fiscal instability, and growth. European Economic Review, 49(6), 1451-1477;
[6]These scenarios highlight the impact of the fiscal challenegs that will be explained in detail later in the report.

| Macro variable | 2022 | 2023 | 2024–25 |
|---|---|---|---|
| | • In the case of state governments, personnel costs follow federal government minimum wage increases until 2023, and are then adjusted by inflation. Non-interest, non-personnel recurrent expenditures are set to follow inflation. Capital expenditures are adjusted by inflation until they reach their 2014–2020 average level (1.5% of GDP). | | |
| Borrowing assumptions | • The borrowing strategy assumes wide access to international capital markets and multilateral financing.<br>• The federal government is assumed to successfully issue US$6 billion per year in Eurobonds, access US$0.6 billion per year from multilateral creditors, and roll over its stock of T-bills, while domestic borrowing follows the MTEF 2021–2023 projections.<br>• All residual borrowing needs are covered by the CBN. In the case of state governments, they access US$2 billion per year from multilateral creditors, with residual needs covered by commercial banks (50 percent), bond issuances (30 percent) and the CBN (20 percent). | | |

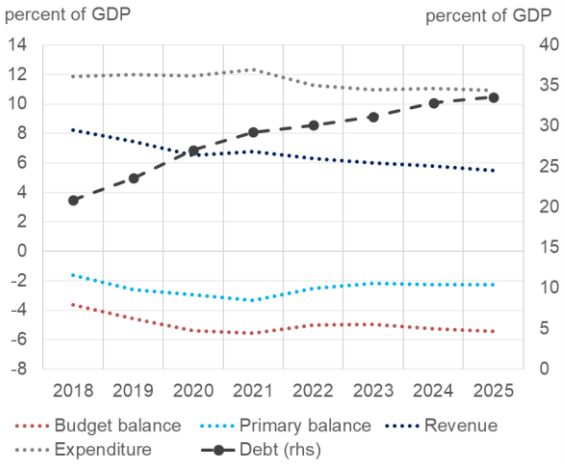
## Nigeria faces multiple additional risks

**Nigeria faces risks that include, among others, lower growth, instability in oil prices and production, a real interest rate shock and contingent liabilities (such as those from Public-Private Partnerships, government-owned enterprises, and energy-related liabilities)**. Our baseline scenario presented a set of optimistic assumptions. However, Nigeria has faced two fiscal crises in the past five years due to oil revenue shocks, highlighting its vulnerability to systemic risk. There are pressures on recurrent expenditures, stemming from inflation and from the politically driven cycle that affects the negotiation of minimum wages. Moreover, the underlying reasons for past crises have not been fully addressed.

FIGURE 1.12. Current fiscal policies do not put Nigeria on a fiscally sustainable path: without revenue reforms, expenditures stagnate, and debt continues to grow

Revenue, expenditure, debt and fiscal balance

**In a scenario in which most fiscal risks materialize, deficit and debt levels become unviable in the medium term**. In a risk scenario in which oil and gas revenues decline 30 percent between 2022 and 2025 relative to the baseline, the federal government suffers a one-off contingent liability shock of 3 percent of GDP in 2022 (below-the-line), and there is no access to international capital markets, the fiscal situation deteriorates rapidly.



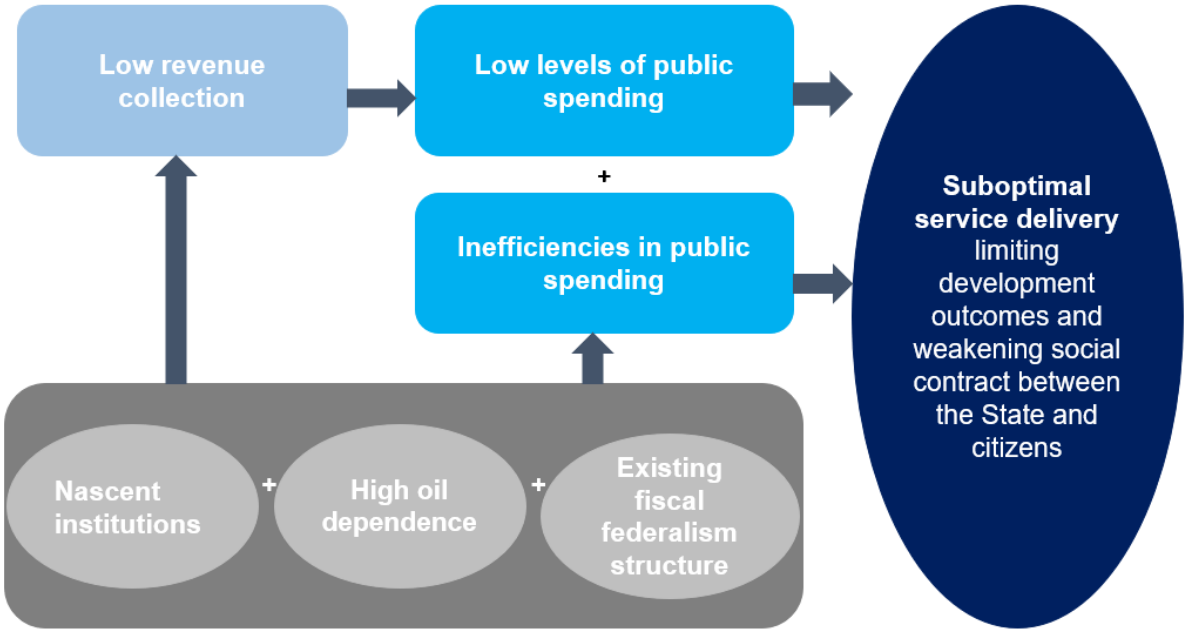

Sources:OAGF, DMO and World Bank

- In response to these shocks, a strong adjustment of capital expenditure for the Federal Government takes place, bringing it down from 1.3 percent of GDP in 2021 to 0.5 percent of GDP in 2025, thus reaching a level last attained in 2015–2016. State governments maintain capital expenditure at their 2015–2019 average level (1.3 percent of GDP). In this scenario, there is no access to international capital markets, thus forcing higher CBN financing. The federal government replaces Eurobond issuances with domestic bonds.
- Despite the projected cut to capital expenditures, deficit and debt levels are unviable in the medium term. In this scenario, the federal government's deficit goes from 4.4 percent of GDP in 2020 down to 3.8 percent in 2022, but it rises again to 4.5 percent in 2025.
- The debt stock reaches 35.1 percent of GDP (up 10 percentage points from its 2020 level). Federal interest payments as a share of revenues go from an estimated 98 percent in 2020 to 168.7 percent in 2025, and borrowing from the CBN reaches 4.6 percent of GDP in 2025 (with an accumulated stock of CBN overdraft of 13.2 percent of GDP). For state governments, between 2021 and 2025 the deficit remains near an average of 0.6 percent of GDP, while debt increases from 3.9 percent of GDP in 2020 to 5.7 percent in 2025. The trajectory of these variables makes this scenario unsustainable in the medium term, particularly at the federal level.

## A comprehensive fiscal reform package would allow the government to invest in people and deliver better development outcomes

**Promotion of economic growth and economic welfare in Nigeria require higher public spending than its existing very low levels.** To achieve this in a sustainable manner, fiscal space needs to be created through (i) mobilizing revenues effectively and equitably; (ii) allocating spending more efficiently; and (iii) strengthening fiscal management institutions for sustained results.

FIGURE 1.13. Improving service delivery requires raising the level and efficiency of spending




**A scenario can be envisioned where increased and diversified public revenues, combined with expenditure rationalization, may also help reduce inflation and domestic interest rates gradually.** This can shrink CBN financing which can contribute to lowering current expenditures, thus enabling a virtuous cycle (

TABLE 1.2 and FIGURE 1.14, FIGURE 1.15, FIGURE 1.16, FIGURE 1.17).

**Reforms must begin on the revenue side, with a focus on non-oil revenues to reduce dependency on the oil and gas sector**. Aside from specific increases in certain taxes, tax expenditures can also be revised to increase the tax base. That said, addressing certain inefficiencies on the expenditure side, particularly around energy subsidies and personnel costs, can help free up fiscal space to raise critical expenditure for social sector service delivery and infrastructure.

**Such a scenario assumes a gradual and comprehensive implementation of reforms in non-oil revenues from 2022 to 2025.** Concretely, it accounts for the introduction of an excise tax on cigarettes, alcohol, airtime, petrol, and diesel (which would raise 1 percent of GDP), the rationalization of Corporate Income Tax incentives (saving 0.7 percent of GDP), improvements in VAT administration to enhance compliance (adding 1.4 percent of GDP) and new taxation on cross-border digital transactions as well as on petrol and diesel (which would add 0.2 percent of GDP). At the state level, a property tax reform is introduced (which would increase revenues by 0.2 percent of GDP in 2022). Overall, these reforms would increase non-oil revenues for the general government from 2.3 percent of GDP in 2020 to 6.2 percent in 2025.

- On the expenditure side, some rationalization is introduced. Energy subsidies are eliminated through the introduction of higher tariffs in 2023. Personnel costs are adjusted from 4.2 percent of GDP in 2021 to 3.9 percent in 2023 and then are stabilized. A fall in interest rates reduces the cost of debt. An infrastructure plan is set in motion, making it possible to slightly increase capital expenditures. At the state level, capital expenditures are slightly higher, averaging 2 percent of GDP in 2021–2025.

- In the reform scenario, the federal government issues domestic bonds for ₦1.4 trillion and multilateral agencies provide an additional of US$1 billion per year, which replaces CBN financing.
- The fall in domestic interest rates and inflation contributes to mitigating fiscal vulnerabilities. Domestic interest rates are reduced by 2.5 percentage points and inflation falls by 2 percentage points in 2022, 1 percentage point in 2024 and 1 percentage point in 2025, in contrast with the stable level of the baseline scenario. In turn, the federal government attains a deficit of 2.3 percent of GDP and the debt stock increases to 27.9 percent of GDP in 2025. The state governments' fiscal deficit averages 0.6 percent of GDP.

TABLE 1.2. Summary table of three macro-fiscal scenarios

| Scenario | Assumptions | Outcomes |
|---|---|---|
| S1: BUINESSES AS USUAL | • High O&G prices are maintained and help stabilize prices and production<br>• Petrol subsidy is removed by mid-2023<br>• NNPL Ltd adheres to the Petroleum Industry Act in what it can retain<br>• Marginal non-oil revenue reforms are undertaken: full implementation of VAT rate and introduction of an electronic money transfer levy<br>• Continuation of recurrent expenditure policy and capex adjustment to reduce fiscal deficit<br>• Wide access is granted to ICM and multilateral financing, while the CBN covers residual gross borrowing needs | • Revenues stagnate at around 7 percent of GDP by 2026<br>• Expenditure pressures remain strong, and revenue constraints result in expenditure being only around 10 percent of GDP by 2026<br>• Fiscal deficit therefore is expected to be higher than the limits stipulated in the Fiscal Responsibility Act and debt levels are expected to be higher than 2018 levels by at least 15 percentage points of GDP |
| S2: THINGS FALL APART | • O&G deductions, especially the fuel subsidy, continue beyond 2023<br>• Oil prices fall and oil production does not rise<br>• No fiscal adjustment is undertaken on both the non-oil revenue and expenditure sides<br>• Government resorts to higher CBN borrowing (3 percent of GDP per year) | • Revenues barely reach 5 percent of GDP in 2026<br>• Expenditure levels hover around 10 percent of GDP with growing expenditure pressures due to increasing interest payments<br>• Debt levels are 20+ percentage points higher than 2018 levels and fiscal deficit remains around 6 percent of GDP |
| S3: RISING TO POTENTIAL | • Gradual and comprehensive implementation of non-oil taxes reform (excise, CIT incentives, VAT compliance, property)<br>• Complete and sustainable elimination of petrol and power subsidies<br>• Oil production rises to OPEC quota levels<br>• Lower domestic debt interest costs<br>• Efficiency gains in personnel costs | • Diversification of revenue sources:<br>• Revenues rise to over 10 percent of GDP by 2026, with further improvements expected in the longer term<br>• Expenditure increases to 13 percent of GDP by 2026, fueled by more room for higher Capital Expenditure spending<br>• Fiscal deficit remains within the limits of the fiscal responsibility act under 3 percent of GDP and debt levels decrease |

| | | |
|---|---|---|
| | • Implementation of infrastructure plan<br>• Higher multilateral financing and lower CBN financing | and are only 7 percentage points higher than 2018 levels. |

FIGURE 1.14. GG revenues in baseline (S1), risk (S2) and reform (S3) scenario (percent of GDP)

Government revenues

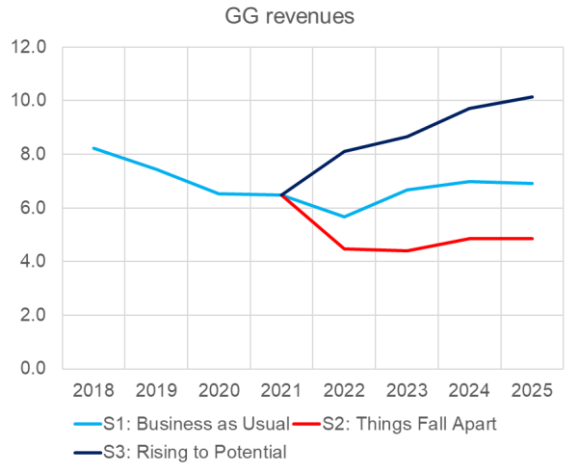



FIGURE 1.15. GG expenditure in baseline (S1), risk (S2) and reform (S3) scenario (percent of GDP)

Government expenditure

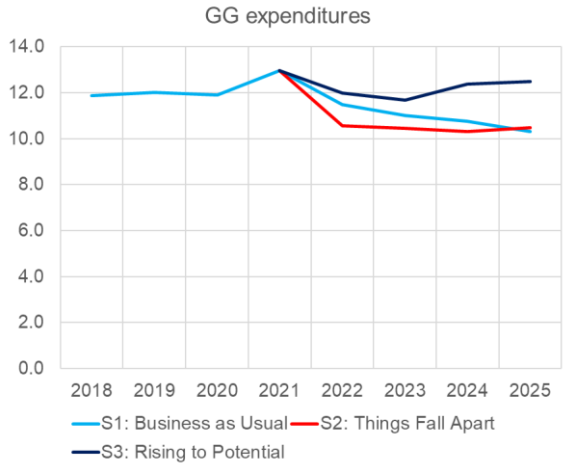



FIGURE 1.16. GG fiscal balance in baseline (S1), risk (S2) and reform (S3) scenario (percent of GDP)

Government fiscal balance

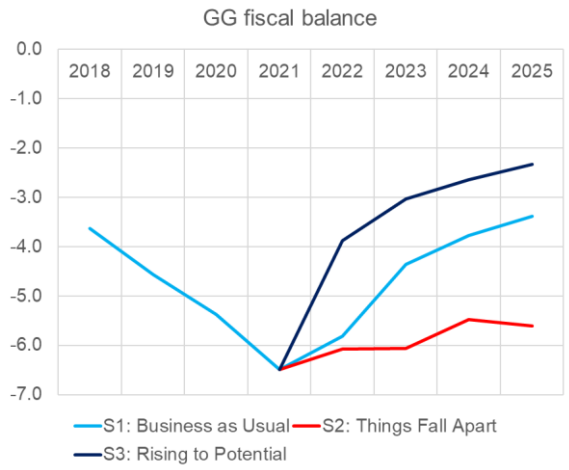
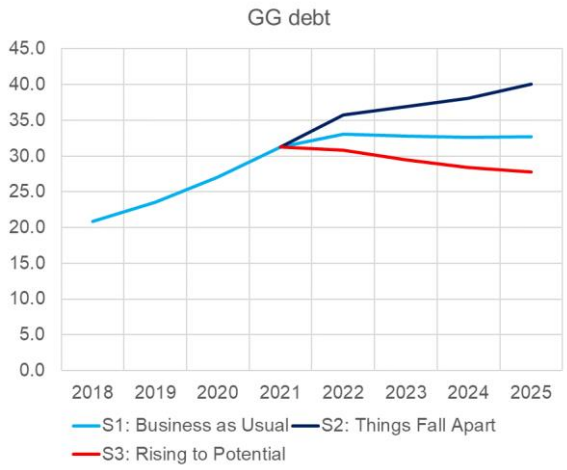



FIGURE 1.17. GG debt in baseline (S1), risk (S2) and reform (S3) scenario (percent of GDP)

General government debt

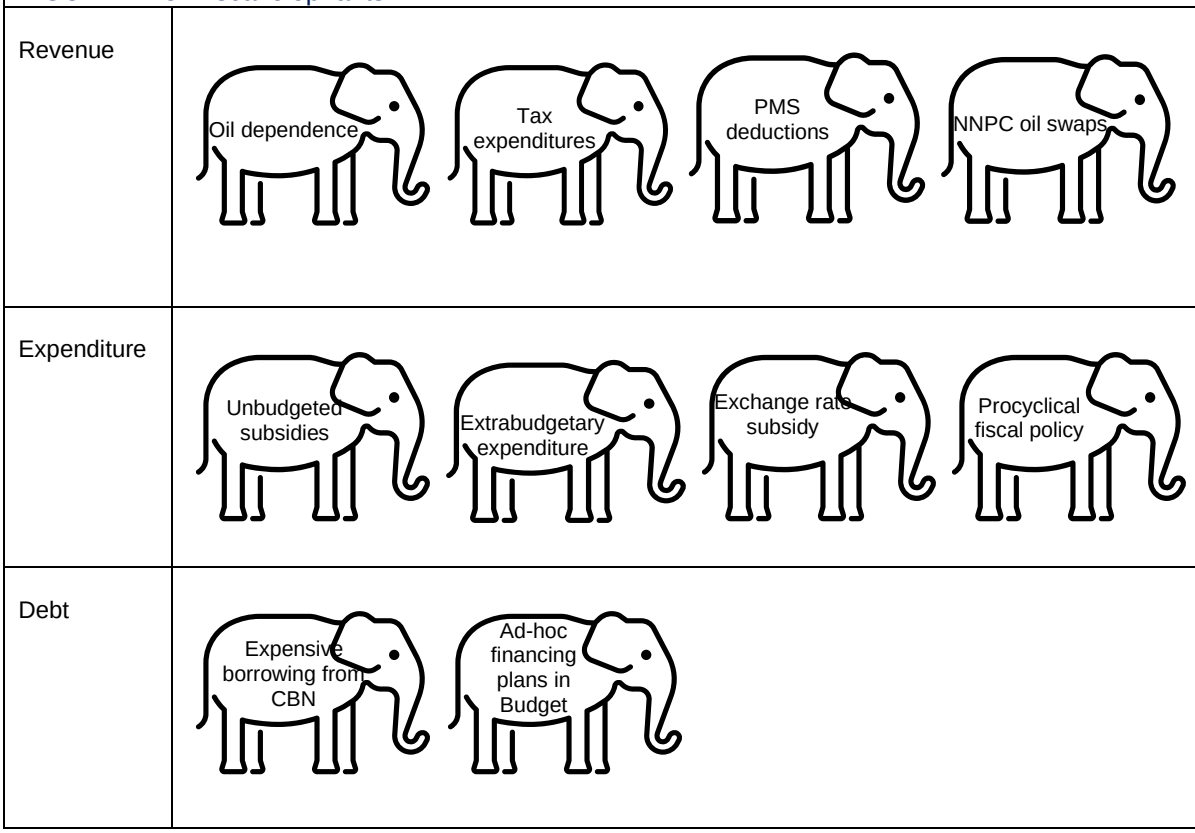



Source: World Bank estimates

## 1.2 An upfront look at Nigeria's "fiscal elephants": Key fiscal flows and leaks

**The multiplicity of fiscal challenges complicates the path towards Nigeria's development objectives (FIGURE 1.18).** This section presents an overview of these challenges and sets the context for an analysis of the revenues and expenditures of the federation.

FIGURE 1.18. Fiscal elephants




### Limited revenues

**Nigeria's public revenues are among the lowest globally.** Revenues are not only low but have also followed a worrying declining trend over the past decade. Dependency on oil has defined the country's fiscal trajectory. Oil and gas revenues represent 50 percent[7] of Nigeria's federation revenues, the single largest revenue head, and no other revenue source has been expanded in recent years. Shocks to oil prices and global demand have severe repercussions on the Nigerian economy, especially on public expenditures and investments that are directly curtailed because of revenue shortfalls. Diversification away from oil revenues is difficult, as policy and administrative focus on non-oil revenue generation has been weak, with income and consumption taxes still underutilized and fragmented across different tiers of government. (See section 2.1: Domestic Revenue mobilization). Tax morale is also low, as the trust between the citizen and state is weakened due to low levels of public service delivery and weak institutions, making it difficult for Nigeria to diversify away from oil.

[7] Average FAAC oil and gas revenue between 2015–2020.

**Tax expenditures further erode Nigeria's revenue base.** Nigeria has generous tax incentives granted by multiple agencies in an ad hoc fashion. They are not monitored, not reported in the budget, and are estimated to have a significant cost in terms of forgone revenue. VAT revenues account for the bulk of forgone revenues, largely due to a significant part of the tax base being exempted from VAT, in combination with compliance issues. In 2020, if all commodities in the VAT system had been taxed, Nigeria could have generated about ₦6 trillion from the existing tax structure. Instead, it only collected ₦1.8 trillion.

## Deductions from oil and gas revenue

**Nigeria is the only country in the world that subsidizes petrol and no other petroleum product; this subsidy is opaque, as it is deducted from the revenues that the Nigerian National Petroleum Corporation (NNPC) transfers to the federation.** Nigeria currently imports all the petrol that is sold in the country. The NNPC is the sole importer of petrol, which means that it imports it at world prices, and then re-sells the petrol to domestic distributors at the price determined by government. Since December 200, the government has frozen the pump price of petrol at the pump at ₦165 per liter, which covers about one-third of the cost of supply and contrasts sharply against the global average of ₦592 per liter at the beginning of June, ranking Nigeria's pump price the eighth lowest among 170 economies surveyed. The NNPC makes up for the gap between the cost and the price charged by deducting the shortfall from the proceeds of the sale of the Federation's crude oil and gas—equity oil and gas as well as taxes, royalties, and profit oil paid in kind by other companies—before transferring what remains to the Federation Account.

**The cost of the petrol subsidy is enormous and volatile.** Because the subsidy fluctuates with global petrol prices, which tend to follow movements in crude oil prices, it is susceptible to sudden and unpredictable changes. In 2020, when oil prices were low, the subsidy totaled ₦107 billion, consuming 4 percent of the federation's oil and gas revenues paid in kind to the NNPC. As oil prices increased during 2021, the price of petrol also rose, and the cost of the subsidy soared to ₦1,430 billion in nominal terms. This amounted to 0.8 percent of GDP, about double what the federal government spending on health and social protection combined. Based on global petrol prices and futures data, in 2022 the government could spend more than ₦20,000 per person on the petrol subsidy, about five times what it had spent on public health in 2021.

**Although the subsidy is intended to shield Nigerian consumers from higher petrol prices, only a small fraction of it benefits poor and middle-class households.** Households in the bottom 40 percent of the income distribution purchase just 3 percent of all subsidized petrol sold in Nigeria. Meanwhile, households in the top 40 percent purchase about 20 percent, and firms and MDAs consume 74 percent. Although some subsidy benefits may be passed to consumers indirectly in the form of lower costs of goods and services reliant on transportation using petrol, these gains also likely accrue much more to wealthy households because they generally consume more of everything.

## Power sector subsidies

**The federal government subsidizes electricity prices through a public subsidy**. Electricity tariffs are set through a Multi-Year Tariff Order (MYTO), and different tariff rates apply based on how much electricity a user consumes. Before 2022, average tariffs were below the cost-reflective tariff, i.e., the tariff that fully reflects the cost of generating, transmitting, and selling power to the final consumer, for all consumers. Because the power sector has been private since 2013, the federal government has financed below-cost electricity prices through a public subsidy. As with the petrol subsidy, the benefits of the electricity subsidy accrued primarily to wealthy households.

Before 2020, an estimated 80 percent of the public electricity subsidy benefitted the wealthiest 40 percent of households, while only 8 percent benefitted households in the bottom 40 percent, and less than 2 percent benefitted households in the poorest 20 percent

**Between 2015 and 2021, the public subsidy imposed a mounting fiscal burden.** Nigeria electricity tariffs are set in nominal terms, making public electricity subsidies highly vulnerable to global oil prices, exchange rates, and domestic inflation. Between 2015 and 2020, the tariff shortfall widened significantly: administrative tariffs remained constant, while the depreciation of the naira drove up the cost of production and high inflation rates diminished the real value of tariff payments. During this period, the government was forced to cover an estimated ₦2,168 billion (roughly US$7 billion) in revenue shortfalls among electricity providers. In 2019 alone, total government support to the electricity sector reached ₦524 billion (US$1.7 billion), equal to about 0.4 percent of GDP. In the same year, the government allocated just ₦428 billion to the health sector.

**In 2020, through the Power Sector Recovery Program (PSRP), the government reformed the electricity tariff structure and implemented an annual financing plan to track potential financing gaps, with the goal of eliminating the public subsidy by 2023.** While the government continues to set administrative prices for electricity, under the new tariff scale the cross-subsidy is almost entirely self-financed: above-cost tariffs on high-volume energy consumers compensate for below-cost tariffs on low-volume consumers, at a relatively small cost to the government. The reforms increased the average tariff by 38 percent, pushing the overall rate structure close to cost-recovery levels, while strengthening payment discipline to reinforce the sector's financial stability. Importantly, poor households were shielded from the rate increase, greatly improving the progressivity of the tariff structure.

## Extrabudgetary entities

**There are hundreds of extrabudgetary units at the federal government level**. In addition to 832 federal government budgetary units, there are 532 extrabudgetary units at the federal government tier alone. As outlined in the Federal Government PEFA 2019 report, most of them receive some budgetary contributions. The number of budgetary and extrabudgetary funds at the subnational tiers of government remains to be estimated. Proliferation of extra-budgetary funds into hundreds of individual units can also be associated with a dilution of accountability and control, atomization of political governance, fragmentation and degradation of the overall quality of public financial management, and problems in reporting and consolidating fiscal data (IMF, 2010).

**A lack of information about extrabudgetary prevents proper budgeting, cash-management, internal and external control, and measurement and monitoring of fiscal risks.** Several of Nigeria's government-owned enterprise (GOEs)—including major ones such as the NNPC—operate outside the budgetary framework, despite increasing efforts to bring them within the remit of the government's budget. This results in the absence of reliable estimates of the government-owned enterprise's contribution to total public spending, and a dearth of information about their balance sheets which has the potential to create fiscal risks of unpredictable magnitude.

## Exchange rate subsidies

**Nigeria's multiple exchange-rate regime has created a hidden subsidy**. To stabilize the value of the naira against the dollar, in 2015 the CBN established a set of preferential exchange rates that differ from the official rate. These policies are collectively known as multiple currency practices (MCP). Under the MCP system, the CBN established three main preferential exchange

rates: (i) the official rate, which is used solely by the government; (ii) the Investor and Export Foreign Exchange Window (IEFX) rate, also called the Nigeria Autonomous Foreign Exchange Fixing or NAFEX, which is used primarily by firms; and (iii) the bureau de change (BDC) rate, which is used by licensed currency traders. The government also established a set of preferential rates for highly specific purposes, such as families transferring funds to students abroad. Households and firms that lack access to a preferential rate tend to use the parallel (black market or curbside) rate.

**Nigeria's MCP system has created an enormous fiscal cost while undermining the transparency and effectiveness of monetary policy.** This cost is borne by all tiers of the government, which exchanges its dollar-denominated revenues for naira at the CBN at the artificially low official rate. As these revenues derive from the oil sector and customs administration, the MCP system acts as an implicit tax levied by the CBN on federation revenue. Meanwhile, the CBN accumulates surplus naira, which it has used to implement its own expenditure policies—a highly unconventional practice. The system also benefits well-connected currency speculators and the select group of firms and households with access to preferential rates, distorting economic incentives while creating vested interests that favor the status quo.

**In 2020, as the full cost of the MCP system became increasingly clear, the government implemented an important but incomplete reform**. Between 2017 and the first quarter of 2021, the use of multiple exchange rates cost the government an estimated US$144.13 billion, and the government faced rising domestic and external pressure to reform the system.[8] In May 2021, the CBN established the NAFEX rate as the guiding rate for the economy, replacing the official exchange rate. In August 2021, the CBN tied the NAFEX to the more market reflective IEFX rate at a maximum differential of 2 percent, and it now supplies foreign exchange to the few official BDC windows at rates close to the NAFEX.

## Borrowing from the Central Bank

**Nigeria's established borrowing practices are costly and do not deliver sufficient resources to cover the public deficit**. Financing targets in the budget seem ad hoc, without proper consideration for the cost and tenor of the instruments. Recently, the federal government has ramped up borrowing from the central bank through its overdraft facility, thus raising the cost of financing significantly. While legal caveats exist to limit such borrowing, these are mostly ignored. As any adjustment in the budget (including financing) requires parliamentary approval, the federal government has resorted to overextending its overdraft facility instead of undertaking more prudent reforms in expenditure and cash management, to the point that the stock of the overdraft has reached 8.5 percent of GDP. This trend has complicated the macroeconomic management with a visible impact on inflation, costs of debt servicing, and debt transparency.

[8] In addition to foreign currency-denominated revenues, this amount includes new disbursements from foreign loans. However, this amount is net of external debt service, which is also remitted at the preferential exchange rate, creating an additional subsidy to the CBN.

## 1.3 Key features of fiscal federalism in Nigeria and the role of the Federal Government

### Nigeria is a federation with three tiers of government, which share responsibility for revenue collection and expenditure

**As in all federal countries, devolution and decentralization add complexity but also bring advantages by taking the government closer to the people**. Nigeria's federalism, while important to govern a country of over 200 million people, presents challenges that can prove detrimental to fiscal sustainability and the equitable delivery of services across the nation.

**Nigeria's federal structure has evolved over time**. The country's modern structure was first introduced in 1946 by the Richards Constitution, which organized Nigeria's territory into a federation of three regions and 23 provinces. This arrangement changed to a federation of 12 states and 96 divisions in 1967, and then to 19 states and 200 local governments in 1976. The number of sub-national units multiplied from the time of military rule, which started in 1966, until civil authority returned in 1999. The 1999 Constitution of the Federal Republic of Nigeria (FRN) and its later amendments provide for a federal system of government composed of a Federal Government, 36 States, a Federal Capital Territory (FCT) and 774 Local Governments.

**The assignment of tax powers to various tiers of governments is enshrined in the Constitution and has mostly remained stable (TABLE 1.3).** Nigeria operates a decentralized tax system where each level of government is independently responsible for the collection of taxes within its jurisdiction, with the Federal Inland Revenue Service (FIRS) and the revenue services of the states being responsible for tax collection in their respective constituencies. FIRS administers the Companies Income Tax (CIT), Education Tax, Stamp Duties, Custom Duties, Excise Duties, Withholding Tax and Value Added Tax (VAT); state revenue services administer the Personal Income Tax (PIT), Withholding Taxes, and in some states, property tax (referred to as Land Use Charge); Local Governments mainly administer levies. Most of the FIRS-collected revenues, along with oil, gas and mining revenue and customs revenue collected by the federal government through the Nigeria Customs Service, are channeled into the Federation Account, whose funds are then distributed to the different tiers of government through the formulae managed by the Federation Accounts Allocation Committee (FAAC) (with some caveats established by the Constitution).

**The autonomy of states and local governments with regard to taxes is limited to their collection, as rates and bases are generally set at the federal level.** While this helps avoid harmful tax competition between states (especially on mobile income sources, e.g., capital income), it has the potential to undermine the efficiency of tax collection. On personal income taxes (items 12, 14, 15 in TABLE 1.3), the rates and bases are set by the federal government. This system does not follow best practice for federations, which is to align the responsibilities for both setting tax policy and collecting tax revenues within the boundaries of each jurisdiction[9].

[9] Country alignment along the OECD classification of 'own tax revenues'. OECD (2021), Ch 3 [*Fiscal Federalism 2022—Making Federalism Work*].

TABLE 1.3. Nigeria revenue generation responsibilities: The vast majority of revenues are collected at the federal level as FAAC revenues, to be shared among the three tiers of governments

| Tier | No | Type of Tax/Levy | Legislation | Collection | Retention |
|---|---|---|---|---|---|
| FAAC - Federation Account | 1 | Oil, gas, & mining revenues, including Petroleum Profit Tax | Federal G | Federal G | Pooled for sharing |
| | 2 | Company Income Tax (CIT)—Non-Petroleum Profit Tax | Federal G | Federal G | Pooled for sharing |
| | 3 | Customs and Excise Taxes | Federal G | Federal G | Pooled for sharing |
| FAAC - VAT | 4 | Value Added Tax (VAT) | Federal G | Federal G & States | Pooled for sharing |
| Federal Government Independent Revenue | 5 | Personal Income Tax (PIT)—PAYEE-Armed forces, Nigeria Police Force, Ministry of Foreign Affairs, (Abuja) | Federal G | Federal G | Federal G |
| | 6 | Withholding tax (corporate bodies, Abuja residents, non-resident individuals) | Federal G | Federal G | Federal G |
| | 7 | Capital gains tax (corporate bodies, , non-resident individuals) | Federal G | Federal G | Federal G |
| | 8 | Stamp duties (corporate bodies, Abuja residents) | Federal G | Federal G | Federal G |
| | 9 | Pool betting and lotteries, gaming and casino (Abuja) | Federal G | Federal G | Federal G |
| | 10 | Road taxes (Abuja, Federal Highways) | Federal G | Federal G | Federal G |
| | 11 | Business premise taxes (Abuja) | Federal G | Federal G | Federal G |
| State/Local Government Independently Generated Revenue | **12** | Personal Income Tax (PIT)—PAYEE-all individuals resident in states, whether Federal or State employees | Federal G | States | States |
| | 13 | Property tax and ratings | States | States & Local | States & Local |
| | 14 | Withholding tax (individuals only in states) | Federal G | States | States |
| | 15 | Capital gains tax (individuals only in states) | Federal G | States | States |
| | 16 | Stamp duties (in states) | States | States | States |
| | 17 | Pool betting and lotteries, gaming and casino (in states) | States | States | States |
| | 18 | Road taxes (state roads) | States | States | States |
| | 19 | Business premises (in states) | States | States | States |
| | 20 | Development levy (in states) | States | States | States |
| | 21 | Naming of Streets | States | States | States |
| | 22 | Licenses and fees | Local | Local | Local |
| | 23 | Motor park dues | Local | Local | Local |
| | 24 | Motor vehicle | States | Local | Local |
| | 25 | Gift Tax | Federal G | States | States |

**Over time, expenditure responsibilities across the various tiers of governments have been modified in the Constitution and related government legislations and decrees (TABLE 1.4).** Since the enactment of the 1999 Constitution, they have been broadly aligned with international practice. States currently account for around 33 percent of consolidated government expenditures. While they have the ability to spend resources according to their constitutionally stipulated mandate, there is considerable overlap with the federal spending mandate, especially in key service delivery sectors such as health and education.

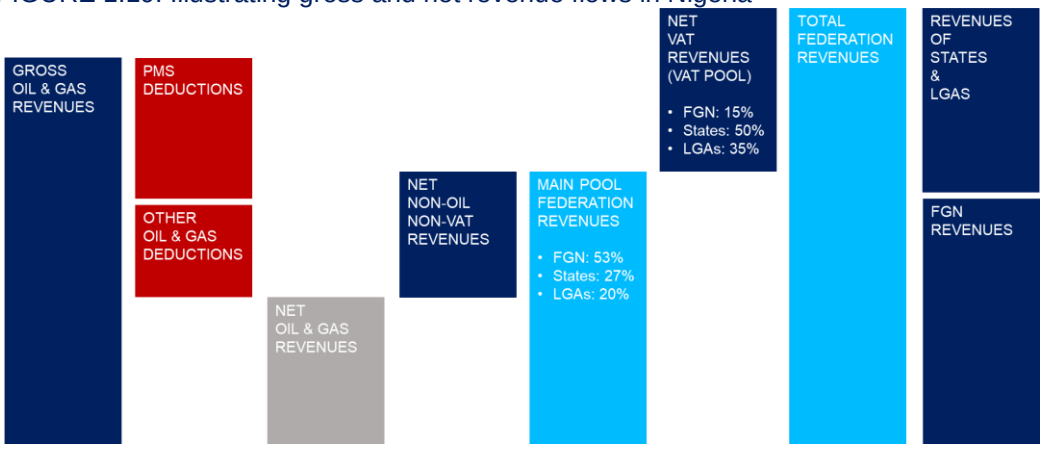
TABLE 1.4. Expenditure Responsibilities by tier of government

| | |
|---|---|
| Federal only | Defense; Shipping; Federal trunk roads; Aviation; Railways; Posts, telegraphs and telephones; Police and other security services; Regulation of labor, interstate commerce, telecommunications; Mines and minerals; Social Security; Insurance; National statistical system; National Parks; Guidelines for minimum education standards at all levels; Water resources affecting more than one state. |
| Federal-State (shared) | Antiquities and monuments; Electricity; Industrial, commercial and agricultural development; Scientific and technological research; Statistics and surveys; University, technological and post-primary education; Health and social welfare. |
| State-Local (shared) | Primary, adult and vocational education; Health services; Development of agriculture and non-mineral natural resources. |
| Local government | Economic planning and development; Cemeteries, burial grounds; Homes for the destitute and infirm; Markets; Sewage and refuse disposal; Roads, streets, street lighting, drains, other public facilities. |
| Source: Khemani (2001), Fiscal Federalism and Service Delivery in Nigeria: The Role of States and Local Governments. | |

## Nigeria's fiscal federalism is anchored in revenue sharing, based primarily on the derivation principle

**As per the 1999 Constitution, all revenues to be shared by the different tiers of government are collected in the Federation Account (FIGURE 1.19).** The distribution formulae, both vertical and horizontal (across different states) are determined by the National Assembly and implemented by the Revenue Mobilization Allocation and Fiscal Commission under the Revenue (Federation Account) Act. However, the Constitution specifies that 13 percent of revenue accruing directly from natural resources shall be a first line charge for distribution to the States from which oil and other natural resource revenue is derived.

FIGURE 1.19. Illustrating gross and net revenue flows in Nigeria




Source: OAGF

**Revenue Mobilization Allocation and Fiscal Commission is also empowered to review the revenue sharing formulae from time to time, and to advise governments and revenue collecting agencies on improving their administrative efficiency to garner more revenues.** The prevailing formula for the allocation of revenue is presented in TABLE 1.5 and TABLE 1.6**Error! Reference source not found.**. TABLE 1.5 shows the formula for vertical distribution of revenue to the Federal, States and Local Governments; TABLE 1.6 outlines the horizontal formula for distribution of revenue between the States and Local Governments.

BOX 1.1. Revenue Nomenclature: What is FAAC?

**REVENUE NOMENCLATURE IN NIGERIA: WHAT IS FAAC?**

Federally collected revenues are the key source of revenues for all tiers of government. In Nigeria, they are collectively referred to as 'FAAC Revenues'.

FAAC stands for the Federation Account Allocation Committee (FAAC). FAAC meets on the monthly basis to formally implement the allocation of the federally collected revenues across tiers of government. Colloquially, 'FAAC' revenues refer to all federally account; distribution of federation savings, and the VAT:

| FAAC Revenues | | |
|---|---|---|
| (Net) Federation Account: | Other federation account revenues' refers to the shared cumulated savings from: | VAT pool |
| Oil and gas revenues (after 'derivation')<br><br>Corporate Income Tax and related revenues<br><br>Customs revenues | Oil and gas revenues<br><br>Non-oil revenues<br><br>Exchange rate gains and differences<br><br>Refunds (e.g. Paris Club refunds)<br><br>Other ad hoc windfalls and savings | VAT |
| At the federal government level, the FG share of Net FAAC is referred to as 'FG share of Federation Account'<br><br>At the state level, the state share of Net Federation account is referred to as 'Gross Statutory Allocation'. It is 'gross' because it is before any deduction for debt service which would be paid by FG on SG's behalf. | At all tiers, these are normally itemized in FAAC and fiscal reports | Normally referred to as 'share of VAT'. |

Derivation refers to oil-producing states' revenues from oil production: 13 percent of oil and gas revenues transferred to FAAC are deducted from the total pot prior to any sharing and allocated across oil-producing states in proportion to their actual oil production during the period.

After FAAC, reference is often made to internally generated revenue (IGR), which stands for 'independently generated revenues' collected and retained by a specific federating unit.

**Capital Receipts:** in addition to revenues and grants, state budgets often refer to 'Capital Receipts'. These tend to consist of non-current inflows, mainly composed of financing items (external and domestic loans), and for the purpose of this report and in line with the IMF Government Finance Statistics are not considered revenues.

**The FAAC revenue sharing process takes place monthly.** The technical sub-committee of FAAC, made up of the Accountant General of the Federation, the Accountant Generals of the 36 States of the Federation, the Chairman of RMAFC and representatives of Federation Account revenue generating agencies, meets to compute and reconcile the revenue to be shared. Then,

the main FAAC meeting decides on the allocation of the accrued revenue to the various tiers of government based on the formulae prescribed by law.

TABLE 1.5. FAAC Vertical Revenue Sharing Formula

| FAAC Revenue Sharing Rules | percent | percent |
|---|---|---|
| Receiving tier: | | |
| **SG Derivation* | *13% of FAAC oil and gas revenues prior to sharing across tiers* | |
| Receiving tier: | Federation Account (Net) =100 | VAT (Net) =100 |
| **SG share:** | **26.72** | **50** |
| **LG share:** | **20.6** | **35** |
| **FG Share:** | **52.68:** | **15:** |
| o/w: FG Retained share for FG Budget | 48.5 | 14 |
| o/w: FCT | 1 | 1 |
| o/w: Extrabudgetary Funds (EBFs): | 3.18: | n/a |
| Ecology and Derivation | 1 | n/a |
| Stabilization Account | 0.5 | n/a |
| Development of Natural Resources | 1.68 | n/a |

NOTE: the formula for sharing the Other FAAC revenues depends on which revenues the savings are derived from. If (as is mostly the case) the savings originate from oil revenues, they follow the oil revenue sharing: 13% of total savings go to the oil-producing states based on the derivation principle; and the net amount is shared across all three tiers based on the Federation Account (Net) sharing formula.

TABLE 1.6. FAAC Horizontal Revenue Sharing Formula across State Governments

| Source of State revenues | How much of the total pot (vertical formula) | Horizontal formula for sharing across states |
|---|---|---|
| **FAAC Derivation (oil)** | Oil producing states receive 13% of total oil revenues before it is shared across tiers | •Proportional to the state's oil production |
| **Share of Federal Account (FAAC Gross Statutory Allocation )** | States receive 26.72% of Net Federation Account revenues (oil and gas and non-oil (customs and corporate tax) | •40% equally across states<br>•30% proportionally by population<br>•10% proportionally by land mass and terrain<br>•10% based on social development factors<br>•10% reward generation of IGR |
| **FAAC other revenues** (ad hoc, contains various savings, mostly from oil) | Mix:<br>• Oil-producing states receive 13% percent of the total pot before it is shared across tiers; and<br>• all states receive 26.72% of Net pot | •13% proportional to the state's oil production<br>•40% equally across states<br>•30% proportionally by population<br>•10% proportionally by land mass and terrain<br>•10% based on social development factors<br>•10% reward generation of IGR |
| **FAAC VAT** | 50% of VAT Pool | •50% equally to all states<br>•30% proportional to population<br>•20% on the basis of relative state contributions (derivation) |

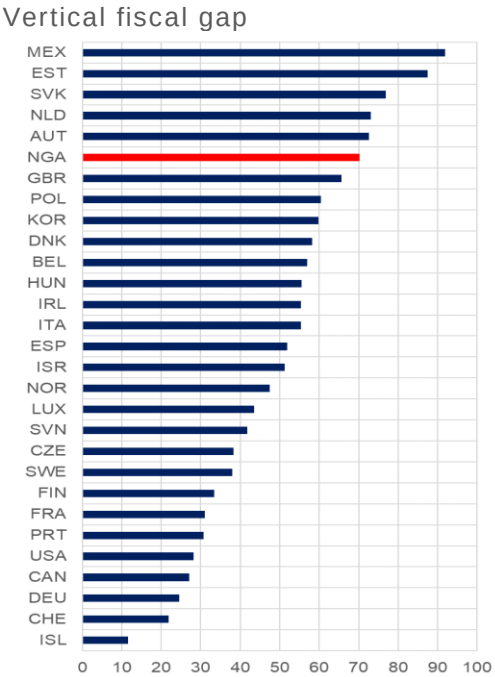
## Nigeria's fiscal federalism structure has contributed to narrowing fiscal space

**Fiscal federalism is meant to provide relatively equal fiscal opportunities to deliver services at all tiers across the federation, while also establishing a subnational fiscal accountability structure and equating higher service delivery to higher revenue mobilization.** The federal government can implement national policies and standards through fiscal transfers, which consist of expenditure allocations to state or local governments. In Nigeria, where fiscal transfers focus solely on revenue sharing, national standard setting via fiscal means is absent.

**The vertical fiscal imbalance in Nigeria is significant, with states only collecting around 11 percent on average of revenues, while accounting for over 30 percent of expenditure.** Nigerian revenue collection arrangements are centralistic, with most of the revenues collected at centrally and distributed across all tiers of government. Amongst federal countries, only Mexico and Austria have established a fiscal gap larger than Nigeria (FIGURE 1.20). However, revenue sharing in Nigeria is unconditional, with the receiving states able to spend the funds as if they were own-source revenues. This sets Nigeria apart from other federations, where a share of federal transfers is conditional upon states achieving certain standards or volume in service delivery (BOX 1.2), and federal governments can thus use fiscal transfers to set the direction for the utilization of fiscal space at state level.

**With most of their funds coming from federation revenue-sharing transfers, states are consequently more exposed to macro-fiscal shocks, which makes respecting budget constraints more difficult and contributes to larger national fiscal deficits.** In addition, with suboptimal fiscal transparency and financial management practices at state level, the exact amounts of state debt and arrears were not correctly ascertained until recently and could have adversely affected the debt and fiscal sustainability of the federation.

FIGURE 1.20. Nigeria's vertical fiscal gap in the international context (OECD)




Source: OECD
Note: Fiscal Gap = [(%) subnational government Spending - (%) subnational government Revenue]/(%) subnational government Spending. Federal as well as unitary countries are represented in the table.

**The federal government administers and take political decisions for the majority of revenue collection.** This means that although subnational governments benefit from a large proportion of federally collected revenues, they do not bear the political cost of the decisions needed to generate them. For example, VAT legislation—and therefore the political cost of VAT reform—rests with the federal government, which however retains only 14 percent of all collections, including those from any reform-induced gains (e.g., from raising the VAT rate). The main benefitting tiers—states (50 percent) and local governments (35 percent)—do not shoulder the political burden of potentially unpopular revenue reforms. This can result in a lack of incentives

for the federal government to push for such reforms, and compromise national revenue collection as a whole.

**The reliance on federation resources, rather than own-source revenue generation, dilutes the accountability of the states to their citizens.** States also have lower accountability for their expenditure, as state governments are not taxing citizens to the same level as the federal government, as tax policy decisions for most major taxes are made at the federal government level. This reduces expenditure efficiency and makes budget constraints more malleable, with implications for the fiscal sustainability of both the states and the consolidated government. IGR revenues are highly volatile, which in combination with a slightly decreasing proportion of FAAC revenues, have made it difficult for states to allocate spending for human and physical capital investments (TABLE 1.7).

TABLE 1.7. Development in components of the fiscal gap. 2015-2020

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| **States' revenues (percent of GDP)** | 3.0 | 2.5 | 2.7 | 3.3 | 2.9 | 2.6 |
| **States' expenditure (percent of GDP)** | 4.0 | 3.6 | 3.5 | 3.8 | 3.4 | 3.6 |
| *As a percent of States' total revenues* | | | | | | |
| FAAC revenues | 73.4 | 65.9 | 65.9 | 68.8 | 65.3 | 64.5 |
| IGR revenues | 25.1 | 32.5 | 29.5 | 27.1 | 30.9 | 27.8 |
| Other revenues | 1.4 | 1.5 | 4.6 | 4.2 | 3.8 | 7.7 |

## Blurred expenditure mandates, with concurrent roles in core service delivery, dilute accountability at state level

**Overreliance on federation revenue shares can jeopardize the ability of states to run their own budgets and formulate and achieve their own policy objectives.** While education and health expenditure are the responsibility of state governments, the federal government maintains a degree of involvement.[10] Notably, the federal ministries of education and health are responsible for setting standards and developing policies related to education and health service delivery, which are implemented at state level. While this dynamic brings about consistency on the policy front, it also results in administrative overlap and challenges. With limited data sharing mechanisms in place, policy coordination becomes difficult and problem-solving is slow. Moreover, the political chain of accountability becomes diluted, with citizens unable to assign clear responsibility for good or poor service delivery to specific political actors.

**Local governments are responsible for municipal services but also economic planning, which is often a more centralized function[11].** While this can help add a bottom-up aspect to the planning cycle, it is difficult for a tier of government that does not have oversight of key service delivery or top-down priorities to contribute effectively to economic planning.

[10] Elemo, Olufunmbi. "Fiscal Federalism, Subnational Politics, and State Creation in Contemporary Nigeria." Oxford Handbooks Online, 25 Oct. 2018, https://www.oxfordhandbooks.com/view/10.1093/oxfordhb/9780198804307.001.0001/oxfordhb-9780198804307-e-19.
[11] This report does not cover the local governments due to lack of data availability

BOX 1.2. The Federalism Dividend. Country examples on standard- and performance-orientation of fiscal transfers and collaboration on efficiency of tax collection.

THE FEDERALISM DIVIDEND

In recent decades, several countries have introduced performance objectives, standards and indicators, marking the evolution of fiscal unconditional transfers or modernization of conditional grants systems. Countries have linked performance (outputs or outcomes) objectives and targets to financing through soft-wired measures, such as indicative service standards or reference unit costs, to deliver a given output. Financial and non-financial sanctions for non-compliance are also soft, and a "collaborative federalism"—on sector standards and fiscal relations—becomes an important vehicle for ensuring efficiency in the use of fiscal transfers. This box outlines some examples of good practice from Australia and Canada, where outcome-based national standards are linked to fiscal transfers.

**Australia:** The *Intergovernmental Agreement on Federal Financial Relations* is the principal mechanism for transferring funds from the Commonwealth to state and territory governments. Two types of intergovernmental agreements are in place:

- National agreements, which clarify the roles and responsibilities that guide the Commonwealth, states and territories, and define objectives, outcomes, outputs, performance indicators and benchmarks in the delivery of services across six key areas: health care, education, affordable housing, skills and workforce development, disability and indigenous reform
- National partnership agreements, which define mutually agreed objectives, outcomes, outputs and performance benchmarks or milestones related to the delivery of specific projects, improvements in service delivery, or other reforms.

National agreements give subnational governments substantial flexibility in delivering services to communities, while imposing a high degree of accountability for achieving improved outcomes, as assessed by quantitative information on a series of outcome indicators. The Council of Australian Governments provides an intergovernmental forum, promoting policy reforms of national significance or those that require a coordinated response across all levels of government. The council maintains a platform to publish and monitor all national agreements and prepares an annual performance report covering federal and provincial levels.

**Canada:** The *Canadian Social Transfer (CST)* is a federal block transfer to provinces and territories to support post-secondary education, social assistance and social services, and early childhood development, early learning and childcare. The grant is calculated on an equal per capita cash basis, and specific information on "weights" and notional allocations of the grant's three priority areas—support for children, post-secondary education, and social programs—are regularly assessed. Predictability for subnational government is provided in medium-term forecasts of the grant, including price indexation. Canada has two main block grants: the CST and the Canada Health Transfer, which from a technical point of view, lends itself better to a performance-budgeting model than the social transfer program. The health sector's *Established Program Financing* model provides a simple but complete planning and budgeting system framework, with cost-sharing arrangements to incentivize subnational government and full overview and oversight of affordable costs at sector and sub-sector levels.

## The horizontal distribution of resources among states does not fully address regional inequalities

**With most distributable revenues being allocated equally to all the states, the current revenue sharing formula prioritize fairness, (i.e., the same share for every state), over equity, (i.e., more resources to those who have the higher needs)., resulting in large regional gaps in terms of service delivery and development outcomes.** The horizontal revenue distribution does not explicitly take the fiscal gap of the states into account. In fact, a major portion of the horizontal allocation (40 percent) is based on the principle of equal distribution of revenues to all states. Other relevant criteria are population (30 percent), terrain and land mass (10 percent), and social development needs (10 percent), which could be construed as proxies

for the fiscal needs of the states. Some elements of "performance" have been added (e.g., 20 percent of transfers are based on internally generated revenue efforts) but such measures can put smaller states at a disadvantage and negate the equalization aspects offered by other elements of the formula.

**It is usually not recommended that performance and equalization aspects should be accounted for within the same transfer or grant, because to some extent they will be at cross-purposes with each other.** As a result, the horizontal distribution of resources in Nigeria may not be serving its purpose of reducing regional inequalities, when measured in terms of allowing subnational governments to provide the same basket of goods and services to every citizen in the country. Furthermore, as mentioned previously, revenue sharing transfers remain unconditional in nature, providing no guarantee that a state's actual spending behavior will be aligned with the criteria behind the identification of its fiscal needs.

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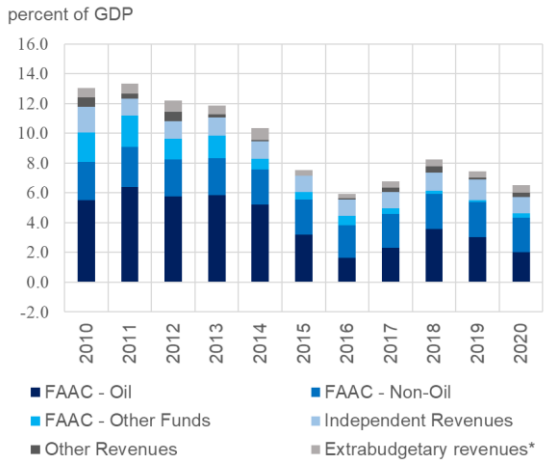
# PUBLIC REVENUES

## 2.1 Domestic revenue mobilization: The key priority for fiscal sustainability in Nigeria

**Nigeria's revenues-to-GDP ratio is among the lowest in the world and continues to decline.** Even during the commodity price boom of 2012, Nigeria's revenue-to-GDP ratio was only 12 percent, compared to an average of 21.5 percent in Sub-Saharan Africa (SSA). Revenues are not only low but have also followed a worrying declining trend over the past decade, even before the COVID-19 pandemic (FIGURE 2.1). Due to over-reliance on oil, the end of the commodity super-cycle in 2014–2015, and the subsequent economic deceleration, revenues plummeted to 5.9 percent of GDP in 2016. Since then, Nigeria has failed to shore up its revenues as the country's revenue-to-GDP ratio consistently ranked among the worst five globally between 2015 and 2019 (FIGURE 2.2). This highlights the urgency to marshal resources for a post-COVID recovery that promotes fiscal sustainability as well as inclusive and sustainable development.

FIGURE 2.1. Nigeria's revenues declined steadily over the past decade…

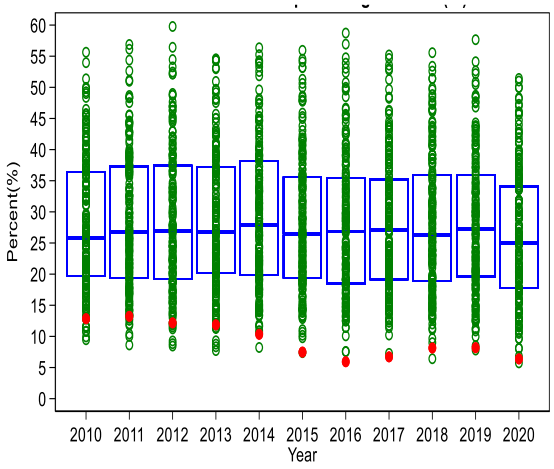
Revenue (percent of GDP)




Sources: Office of the Auditor-General for the Federation (OAuGF) and NBS

FIGURE 2.2. … as a result they are among the lowest in the world

Revenue (percent of GDP)




Source: World Bank MFMod
Note: The red dot represents the value for Nigeria, while the green dot represents the values for all years. The Box Plots represent the observations that fall in the second and third quartiles of each distribution, while the low and high whiskets represrnt the minimum and maximum observatins, respectively. Finally, the horizontal line inside the box represents the median of the corresponding distribution

**Weak revenue mobilization is a critical impediment to sustainable development and poverty reduction and puts fiscal sustainability at risk.** Nigeria's extremely low revenues undermine the government's ability to finance necessary expenditures in critical areas such as health, education, and security. For instance, the Federal Government expenditures on health and education were respectively 0.3 and 0.5 percent of GDP in 2019, far behind most other African countries and much below international standards (see the section on expenditures). This causes a vicious cycle of underinvestment, poor human development outcomes and low incomes. Low revenues also threaten fiscal sustainability. Although Nigeria's public debt (around 33 percent of GDP in 2021) is not high by international standards, it is growing rapidly, and low levels of revenue affect liquidity indicators. Before COVID-19 the Federal Government was spending more than 60 percent of its revenues to service public debt, and this ratio increased to over 90 percent in 2020.

**Despite initiating some reforms pre-pandemic, the government has not been able to move the needle on revenue generation.**[12] The tradition of annual Finance Acts accompanying the Federal Government budget was revived in 2019. These Acts are a vehicle for tax reform and have brought in useful measures such as increasing the VAT rate from 5 to 7.5 percent in 2020, enabling taxation of international digital transactions, introducing excises on telecom services, and a levy on electronic money transfers. Despite these efforts and the launch of the strategic revenue growth initiative (SRGI) in 2019 (BOX 2.1**Error! Reference source not found.**), Nigeria's revenue mobilization system suffers from several deficiencies, including a restricted tax base on VAT (due to a suboptimal VAT system) in combination with a very low rate, extensive use of tax expenditures (including incentives), one of the lowest excise duty rates in the region, weak tax administration, and a high cost of compliance, among others.

BOX 2.1. Strategic Revenue Growth Initiative (SRGI)

**The SRGI was launched in 2019, with the ambitious goal of achieving a revenue-to-GDP target of 15 percent by 2023.** Oil and non-oil revenues were proposed to reach 6 and 9 percent of GDP, respectively. The SRGI is a multi-agency initiative led by the Federal Minister of Finance, with 47 proposed actions across three thematic areas: (i) achieve sustainability in revenue generation; (ii) identify new and enhance the enforcement of existing revenue streams; and (iii) achieve cohesion in the revenue ecosystem (people and tools). The SRGI outlined a broad set of initiatives, through several program portfolios assigned to revenue-generating MDAs for implementation.

**Despite some successes, the SRGI is not on track to meet its revenue targets**. The revenue-to-GDP ratio stood at only 7.1 percent of GDP in 2021, well below its 15 percent target. In addition to the COVID-19 pandemic which was not expected at the time of the SRGI design, several internal factors and shortcomings withing the SRGI framework have hampered its implementation. These include: (i) the inadequate tracking and monitoring of the various initiatives and sub-initiatives, (ii) the middle layer of the governance structure (joint team) was not activated, which resulted in a slow pace of implementation, (iii) the performance monitoring and management frameworks (including the key performance indicators) were not fully adopted by the various MDAs, and (iv) a lack of coordination with states, which govern personal income taxes.

**This section is structured as follows.** It starts by describing the structure and dynamics of oil revenues in Nigeria as well as the accompanying fiscal regime and governance set-up. It continues by estimating the non-oil revenue tax potential and examines why Nigeria's non-oil tax revenues are persistently low.

## Oil and gas revenues

### Oil price volatility, increasing production challenges and opaque deductions at the source have undermined oil revenues

**Oil revenues have historically accounted for the largest share of Nigeria's public revenues, but they have been declining over time.** Between 2010 and 2014, the oil and gas sector generated about 47 percent of government revenues, but this share declined significantly thereafter to an average of 36.6 percent in 2015–2020. This drop, which reflects production declines and the twin oil price shock of 2015–2016 and 2020, had a serious adverse impact on the government's budget.[13] With the exception of the so-called joint venture (JV) cash calls (which are included in the deductions through 2017 in the figure below but are excluded thereafter), the costs of oil and gas production account for the difference between total gross oil revenue and the

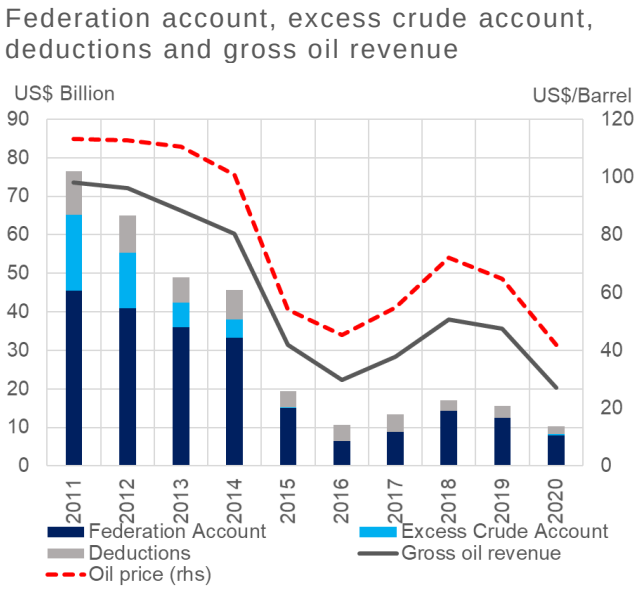
[12] In this chapter, the term government normally refers to General Government, which includes the federal Ggvernment, the state governments, and government-owned enterprises.
[13] In previous episodes of steep revenue falls, Nigeria weathered the shocks to varying degrees by drawing down the oil revenue savings accumulated in the ECA. By 2015–16, however, these savings had been largely depleted, offering little cushion.

sum of: the amounts transferred to the Federation Account, the Excess Crude Account, and deductions explained below (FIGURE 2.3).

**Oil and gas production has historically been disaggregated into five categories, dominated by JVs and production sharing contracts (PSCs).** The five categories are the following (FIGURE 2. 4):

- **JVs** are established between the Federation, represented by the NNPC, and JV partners. The Federation holds a majority stake in each JV operation. Costs—called JV cash calls—and revenues are shared among the JV partners in proportion to their equity shares. The JV cash calls were set by the government until 2017. In 2018, the Federation notionally "exited" JV cash calls, whereby the NNPC would determine the costs to be paid without having to obtain authorization from the National Assembly. However, these payments to cover costs continue to be referred to as JV cash calls.
- **PSCs, in which the Federation holds no cost-bearing interest, are signed by the NNPC on behalf of the Federation.** First signed in 1993, every PSC specifies that fiscal payments specific to oil production be made in kind by providing crude oil to the NNPC. Further, gas in all PSCs belongs to the NNPC, which has not monetized gas to date, andhence PSCs have generated only oil revenue for the Federation until now.

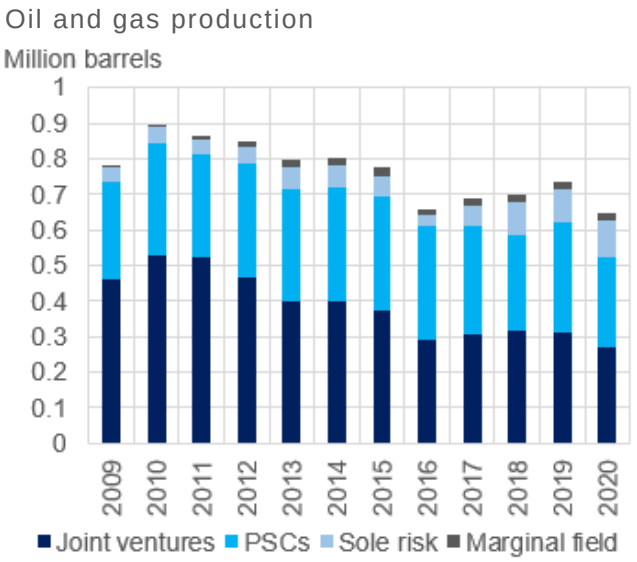
FIGURE 2.3. Evolution of the government's upstream oil and gas revenues




Sources: OAGF and Nigeria Extractive Industries Transparency Initiative (NEITI).
Note: Revenue figures in gray comprise oil and gas revenues. Gross oil revenue is estimated by multiplying the total oil production in each year by the annual average price of Bonny Light crude oil. The OAGF reporting of revenue flows does not use the same basis across years for deductions, as explained below.

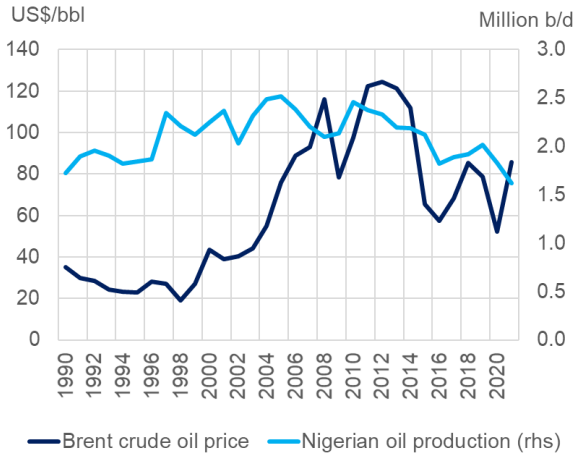
- **Sole risk** operators are those who produce oil and gas at their expense and pay royalties, taxes, and other government fees. The Federation is only indirectly involved through the NNPC's subsidiary, the Nigerian Petroleum Development Company (NPDC), which is meant to operate like any commercial company with no special treatment.
- **Marginal fields** are those with low production volumes that have been declared marginal by the government prior to January 1, 2021. The fiscal terms applicable to marginal fields are more favorable to investors than those for sole risk operators with higher production.
- **Service contracts** no longer exist**.** There were two of them until 2019, when they expired.

FIGURE 2. 4. JVs and PSCs have dominated oil and gas production in Nigeria




Source: NEITI oil and gas industry reports from various years.
Note: Very small production in service contract areas is not shown.

FIGURE 2.5. Oil production has steadily declined over the past decade




Sources: NNPC, Nigerian Upstream Petroleum Regulatory Commission, and World Bank Commodity Prices

**Over the past decade Nigeria's oil and gas production has declined.** After rising above 2 million barrels per day (b/d) in 1997, oil production fluctuated between 2 and 2.5 million b/d before falling below 2 million b/d in 2016 due to an unusually high number of attacks on oil production infrastructure that year. After recovering modestly, production in 2021 fell to the lowest level since 1988 (FIGURE 2.5). Several factors, explained below, have contributed to under-production over the past few years.

**Attacks on oil production infrastructure, work stoppages, and disturbances in oil-producing communities have led to the suspension of oil production on numerous occasions.** In the second quarter of 2016, five oil terminals were under force majeure (*Platts Commodity News* 2016).[14] Among the worst events was a series of attacks in 2016 on the Trans-Forcados Pipeline, one of the main export routes typically exporting 200,000–250,000 b/d.[15] These attacks halted exports for most of the period between February 2016 and June 2017. In September 2017, the NNPC reported that vandalism had affected two pipelines on 42 occasions that year (*Sweet Crude Reports* 2017).[16] Moreover, the NNPC reports submitted to the to FAAC, disclosed since January 2020, highlight various incidents that have disrupted oil and gas production: pipeline leaks, equipment failure, work stoppages for non-payment, community protests for unpaid compensation and other issues, and vandalism.[17]

**Oil production in Nigeria suffers from high procurement costs.** Costs are high because contract approval has historically been complicated and opaque. All contracts of US$1 million or more require approval by the Nigerian Content Development and Monitoring Board. Even smaller contracts in JVs and PSCs require approval by the NNPC's National Petroleum Investment Management Services (NAPIMS). Contract approval has been known to take years and that alone increases costs. Moreover, multi-year contracts have been restricted, potentially discouraging

[14] *Platts Commodity News.* 2016. "OIL Q2: Nigeria shaken by renewed militancy, force majeures but poised to firm lead producer role over Angola." July 1, 2016.
[15] The first bombing in February 2016 forced a declaration of force majeure, followed by an attack in June 2016 and another in November 2016.
[16] Sweet Crude Reports. 2017. "Two pipelines vandalized 42 times this year – Baru." September 15, 2017.
[17] The reports show that disruptions have cut oil production by about 100,000 b/d in 2020 and 175,000 b/d in 2021.

development of local capacity. For these reasons the Nigeria National Petroleum Policy, published in the official gazette in December 2017, called for a "fundamental overhaul" of the procurement process to strengthen "efficiency, transparency and cost control."

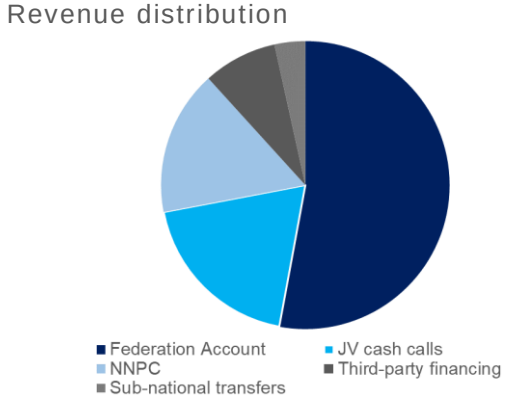
**The NNPC's failure to pay for the Federation's share of costs in JV operations has been a significant contributor to declining oil production.** The Federation, through the NNPC, is supposed to pay 55 percent (in JVs with Shell) or 60 percent (in all other JVs) of production costs and receive the corresponding share of total revenue. However, the Federation has failed to pay its full share and owed, as of March 2022, US$0.97 billion of arrears for oil production costs prior to 2016. It began accumulating arrears again in 2020. The arrears grew in 2021 and 2022, as oil revenues were diverted to finance the growing subsidy for petrol. According to the NNPC's monthly submissions to FAAC, payments made to cover the Federation's share of costs had fallen short of the budgeted amount by US$2.9 billion in 2021. The combined impact of payment arrears and continuing disruptions to oil production in onshore fields has prompted experienced oil companies to exit onshore oil production.

**More generally, the lack of payment discipline has threatened Nigeria's ability to produce oil and gas and supply electricity.** Chronic power shortages, which force business and households to spend on back-up power generators running on petrol and diesel, are caused in part by the failure of power generation companies to pay gas producers, deterring delivery of natural gas to the power sector. Similarly, the NNPC's failure to fully cover the Federation's share of production costs has resulted in declining oil and gas production in JV operations. The only market in which there is full payment discipline is that for liquefied natural gas (LNG), in which Nigeria LNG Limited—where the Federation through NNPC has a 49-percent stake—is active. Improving payment discipline is essential for Nigeria's energy security and economic development.

## The Federation has received none of what is collected by the NNPC in 2022

**In 2019, the Federation Account received about half of the oil and gas revenue recorded by the OAGF**. Out of a total US$34 billion, only US$18 billion (53.3 percent) was transferred to the Federation Account. The rest was allocated as follows: 27 percent was spent on JV cash calls and third-party financing of the federation's costs, another 16 percent was retained (deducted) by the NNPC, and the remaining 3 percent comprised payments to sub-national entities, more than half of which was to the Niger Delta Development Commission in accordance with the law establishing this commission (FIGURE 2.6).

FIGURE 2.6. The federation received about half of what was recorded in terms of oil and gas revenues

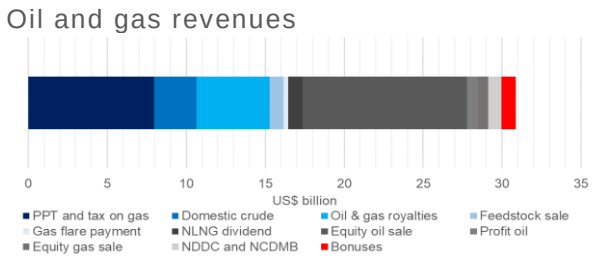



Source NEITI

**A comparison of revenues reported by the Nigeria Extractive Industries Transparency Initiative (NEITI) and the Office of the OAGF for 2019 shows a large difference.** This difference arises presumably because deductions are made at the source before revenues are transferred to the Federation Account. A precise comparison is also not straightforward because the categorization of revenue streams is not the same (FIGURE 2.7 and FIGURE 2.8). Taking identical revenue streams, NEITI's numbers are typically, but not always, higher. An example is the sum of Petroleum Profit Tax (PPT) and tax on gas, which amounted to

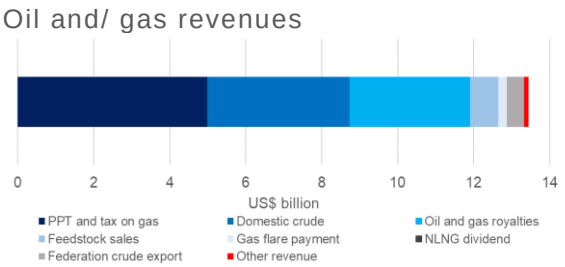
US$8 billion according to NEITI but US$5 billion according to the OAGF. Oil and gas royalties were US$4.6 billion according to NEITI, compared to US$3.2 billion recorded by the OAGF. Particularly striking is the Federation's crude sale excluding the domestic crude allocation assigned to the NNPC: US$10.4 billion reported by NEITI against US$0.45 billion reported by the OAGF. However, NEITI reported less for domestic crude allocation than the OAGF.

FIGURE 2.7. NEITI reporting of oil and gas revenues in 2019 before deductions, US$ billion




Source : NEITI.

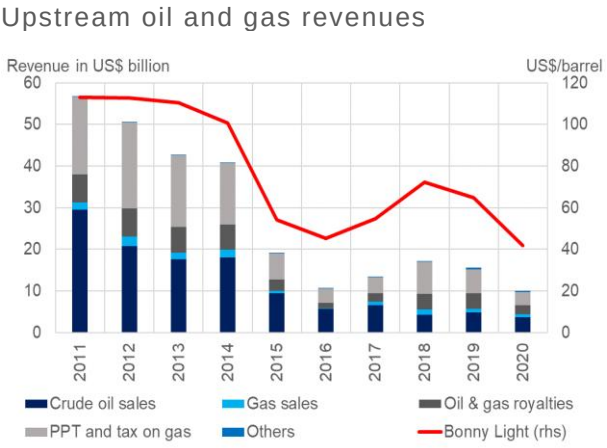
FIGURE 2.8. OAGF reporting of oil and gas revenues in 2019, US$ billion




Source: OAGF.
Note: The revenues shown are before first-line charges are deducted, making them comparable to the revenue streams reported by NEITI. Naira is converted to U.S. dollars at a rate of 379.

**Although the lack of disaggregation makes it difficult to interpret the OAGF numbers, upstream oil and gas revenues before first-line charges deductions move broadly in line with the price of oil (see FIGURE 2.9).** It is not possible to determine from the OAGF data what the Federation's share of profit oil was or how much profit it made from JVs. A reporting template more in line with the fiscal framework would make revenue streams more transparent and easier to analyze. In terms of revenues, royalties are affected only by the price of oil and production volume. For all other revenues, they are affected also by costs and how they are accounted for—some costs are depreciated over five years, and there are additional allowances from costs incurred years earlier in the form of investment tax allowances or credits.

FIGURE 2.9. OAGF recording of upstream oil and gas revenues before deductions, in US$




Source: OAGF

## The governance of revenue generation in the oil and gas sector has been historically complex

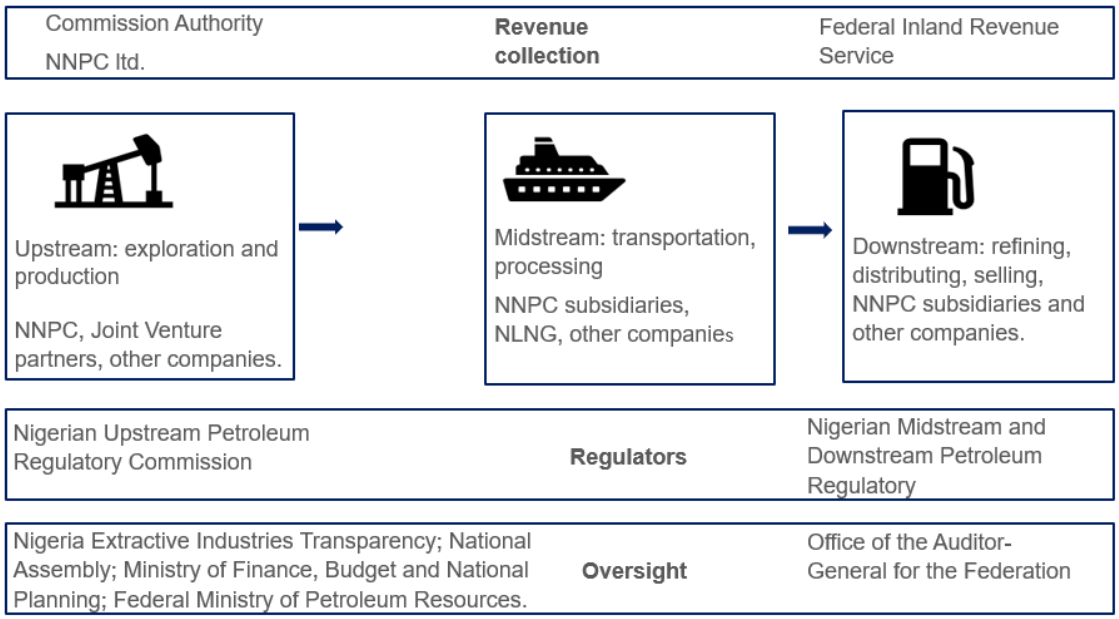
**The Nigerian oil and gas sector is composed of numerous players and institutions.** The sector can be divided into three segments (FIGURE 2.10). In the upstream segment, several companies are involved in the exploration and production of oil and gas. Gas takes the form of associated gas (produced with crude oil) and non-associated gas (produced on its own). Natural gas, in turn, has varying amounts of natural gas liquid, some of which is sold as liquefied petroleum gas for cooking purposes. In the midstream segment, companies store, treat, and transport oil and gas. Among them is the NLNG Limited, which collects and liquefies natural gas for export. Finally, in the downstream segment, there are various companies including refiners, bottling plants for liquefied petroleum gas, filling stations, and trucking companies.

**Several entities are responsible for collecting and administering oil revenues.** FIRS collects taxes, the policy for which is set by the Ministry of Finance, Budget, and National Planning. Royalties, bonuses, license fees and fines are collected by the Nigerian Upstream Petroleum Regulatory Commission (the Commission hereinafter) and the Nigerian Midstream and Downstream Petroleum Regulatory Authority (the Authority hereinafter). The NNPC, to be newly incorporated as the Nigerian National Petroleum Company Limited (NNPC Ltd), remains the fiscal agent in production-sharing, profit-sharing, and risk-service contracts. Although not shown in FIGURE 2.10, the Niger Delta Development Commission charges a 3-percent fee on capital and operating expenditures for economic development of the Niger Delta region and the Nigerian Content Development and Monitoring Board (NCDMB) charges a 1-percent fee on all contracts to promote local content development.

**From a governance perspective, two institutions regulate the sector, and two others monitor it.** The National Assembly passes laws for the sector, with the most significant piece of legislation being the Petroleum Industry Act (PIA), which was enacted on August 16, 2021 (Nigeria 2021). The President of Nigeria appoints the boards of the Commission, the Authority, and the NNPC Ltd, and can suspend or remove them for cause. In terms of accountability and monitoring, NEITI—supported by the NEITI Act of 2007—and the Office of the Auditor-General for the Federation (OAuGF) independently examine financial and physical flows in the sector.

**The NNPC is active across the oil and gas supply chain.** It has many subsidiaries, including three companies focusing on natural gas, three refining and petrochemical companies, and three companies focusing on petroleum products. The NNPC's major subsidiaries are listed in TABLE 2. 1. In the midstream and downstream gas sectors, the Nigerian Gas Company (NGC), the Nigerian Gas and Marketing Company (NGMC), and the Nigerian Gas Processing and Transmission Company (NGPTC) are all subsidiaries of NNPC. There are three refining subsidiaries, as well as the Products Marketing Company (PPMC), the Nigerian Pipelines and Storage Company (NPSC), and NNPC Retail Limited. None of the refineries have produced refined products since mid-2019. All nine subsidiaries are wholly owned by the NNPC. A commercially successful venture is NLNG Limited, which produces LNG and natural gas liquids for export and in which NNPC has a 49-percent share.

FIGURE 2.10. The oil and gas sector is composed of various players and institutions




Source: World Bank

TABLE 2. 1. NNPC's ownership of entities operating in oil and gas

| Entity | Role |
|---|---|
| NAPIMS | A corporate service unit of the NNPC. NAPIMS is responsible for overseeing the NNPC's JVs and all PSCs. NAPIMS approves the annual budget in each licence area falling under the JVs and PSCs. NAPIMS does not operate any oil field. |
| NPDC | A wholly owned subsidiary of the NNPC, the NPDC is an upstream oil and gas producer with its own oil and gas assets purchased from the Federation. |
| Kaduna, Port Harcourt, and Warri Refining and Petrochemical Companies Limited | Wholly owned subsidiaries of the NNPC, they operate more like tolling refineries, as they are paid a fee for processing crude for the NNPC. They are entitled to receive 455,000 daily barrels of crude oil, corresponding to the combined installed capacity of the three refineries, referred to as domestic crude in the rest of this report. Despite several major maintenance and overhaul projects over the years, they stopped producing refined products in mid-2019, making Nigeria entirely dependent on refined product imports. |
| NGC, NGMC, and NGPTC | Wholly owned subsidiaries of the NNPC, they treat, transport, and sell natural gas. The NNPC owns and operates the bulk of the gas pipeline network in Nigeria. |
| PPMC, NPSC, and NNPC Retail Limited | Wholly owned subsidiaries of the NNPC, they operate pipelines for crude oil and refined products, storage tanks, and filling stations. |
| Nigeria Liquefied Natural Gas Limited (NLNG) | The NNPC owns 49% of NLNG, which processes natural gas to produce LNG and natural gas liquids for export and transfers dividends to the Federation through the NNPC. |

Source: NNPC.

**Historically, there were three fiscal regimes in the oil and gas industry, of which two remain today**. Service contracts ended in 2019, leaving (i) tax and royalty and (ii) PSCs as the two remaining fiscal regimes. As the name implies, oil and gas producers pay taxes and royalties under the tax-and-royalty regime (FIGURE 2.11). Those operating under this regime include JVs, sole risk operators, and marginal field operators. In the context of PSCs, production-sharing contractors also pay taxes and royalties, but in addition share so-called profit oil with the

Federation (FIGURE 2.12).[18] Because production-sharing contractors are not allowed to sell gas, there is no profit gas in PSCs in Nigeria, unlike in PSCs in other countries. PSCs specify that the NNPC "lift" the tax oil, royalty oil, and profit oil that contractors must pay in kind to the Federation—meaning the NNPC takes oil, the amount of which is equivalent to these fiscal payments, and sells it to generate cash for the Federation.

**The consensus among industry analysts is that the choice between tax-and-royalty and production-sharing systems is primarily politically motivated.** PSCs can be viewed as giving governments greater control over petroleum resources, because title to petroleum is not transferred to the investor at the wellhead and the government owns the installations built by investors (Bindemann 1999). However, in both cases, the investor conducts petroleum operations at its sole risk and expense, and if no commercial discovery is made, the investor is not reimbursed by the government for any of the work undertaken. Importantly, the same financial end-result can essentially be achieved by the government in either system in terms of risk and revenue sharing.

**Because PSCs in Nigeria were originally introduced for higher-risk investments in deep water, their fiscal terms have been more favorable to investors than tax-and-royalty terms for onshore fields.** PSCs were first signed in 1993 for deep water exploration and production, which at the time had no historical precedent in Nigeria and was also limited in the rest of the world.[19] To compensate for the high risk and attract investment, fiscal terms in the 1993 PSCs were generous. The main features of the two fiscal regimes are shown in FIGURE 2.11 and FIGURE 2.12. In both cases, royalties are independent of costs or profitability. All other payments depend on costs, profitability, or both. It is important to note that the retained company profits in FIGURE 2.11 include the profits due to the Federation for its production of equity oil in the JVs. As such, they belong to the Federation Account.

FIGURE 2.11. Financial flows in the tax-and-royalty regime in Nigeria

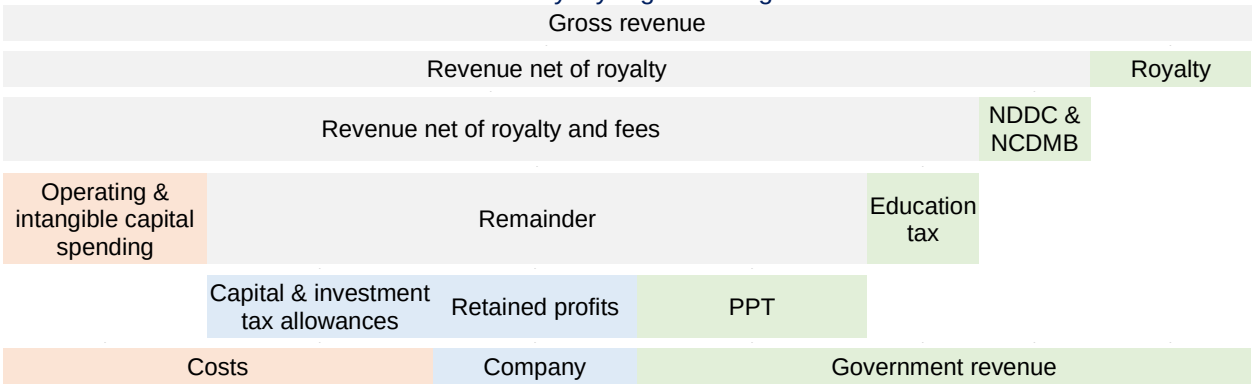



FIGURE 2.12. Simplified financial flows in the PSCs in Nigeria before the PIA

[18] There are more differences between the two fiscal regimes. A PSC is a contract concluded between a state entity (which may be the state itself or a state authority or the national oil company) and a resource extraction company (or companies), called contractor, under which the contractor is granted the right to explore for and produce hydrocarbons within a specified area and for a specific period. The contractor assumes all exploration risks and costs in exchange for a share of hydrocarbons produced from the contract area. The ownership of such share of production passes from the state to the contractor at the delivery point or export point as defined in the contract. In the tax-and-royalty regime, the license holder gains title to oil and gas extracted from the ground.

[19] As an example, offshore oil production in the United States increased by a mere 5 percent from 1980 to 1990. See https://coastalreview.org/2015/06/a-very-brief-history-of-offshore-drilling/.

| Gross revenue | | | |
|---|---|---|---|
| Cost oil | Profit oil | | Royalty, NDDC & NCDMB, PPT and education tax |
| | Company | Federation | |
| Costs | Company | Federation | |

Sources: Government and industry sources.

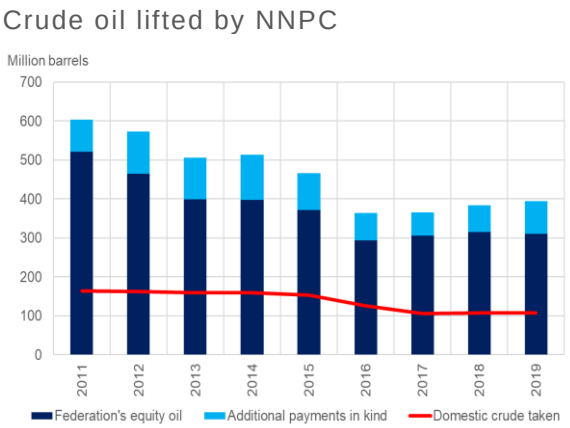
Note: The figures are for illustrative purposes only and the size of each box is not intended to represent the size of each fiscal payment or actual costs or profits retained. For example, typically the education tax is much smaller than PPT. NNDC = Niger Delta Development Commission; NCDMB = Nigerian Content Development and Monitoring Board.

**All taxes are collected by FIRS and all other material fiscal payments, with two exceptions, are to be deposited into designated CBN accounts with the Federation Account as the beneficiary.** Two material payments that fall outside of this revenue flow are the percentages charged on production costs and contracts for the Niger Delta region and local content development, respectively. For the remaining fiscal payments, there are three minor exceptions—the fees for bid processing, data released, and evaluation reports, for which the beneficiary is not the Federation Account.[20] Contrary to what happens with non-oil tax revenues, FIRS is not paid a fee for collecting oil and gas revenue. This may have diminished the agency's incentive to calculate and collect fully what is due from the oil sector.

**Deductions have been taken at the source of income by the NNPC from oil and gas revenues paid in kind**. For in-kind payments, the NNPC lifts crude oil and gas. Instead of transferring the proceeds of the sale of crude oil and natural gas to the Federation Account or to cover JV cash calls, the NNPC has used them to purchase petrol for sale at prices below cost as well as carry out projects, some of which are outside of upstream oil and gas activities and even outside of the oil sector altogether, such as renewable energy. When its refineries were still operating, the NNPC would sell crude oil to the domestic refineries but with a three-month grace period for payment, in contrast to one month given to all other crude oil purchasers.

**Payments in kind are largely for oil and gas produced in the Federation's equity assets in JVs and for oil produced in the fields governed by PSCs.** The Federation owns 55 percent or 60 percent of the assets in the JVs, all of which are operated by companies (JV partners) other than the NNPC. NAPIMS has historically represented the government in the oversight and management of operations and in collecting government revenues. FIGURE 2.13 shows the total oil production in JV operations (shown as the Federation's equity oil) and additional oil lifted by the NNPC for in-kind fiscal payments of other companies.

FIGURE 2.13. Breakdown of crude oil lifted by the NNPC




Sources: NNPC and NEITI

**The basis for deductions reported by the OAGF has changed over the years**. The JV cash calls, the largest component, were included in the OAGF reporting through 2017, after which they are no longer shown as part of the Federation's gross revenues because of the "exit" from JV cash calls at the end of 2017. Further, gas projects were first recorded in 2016 and the Department of Petroleum Resources—a predecessor to the Commission and the Authority established by the PIA—began retaining a 4-percent collection fee upon authorization

[20] https://www.nuprc.gov.ng/revenue-accounts/.

from President Jonathan in October 2014,[21] seemingly in contravention of article 80 of the Constitution.

**Public disclosure of the presentations made by the NNPC to FAAC at its monthly meetings has provided more information on the deductions.** The NNPC committed to enhancing disclosure and transparency in 2015, when it began publishing monthly financial and operations reports. In an important step for increased transparency, the NNPC for the first time in its corporate history published in 2020 its 2018 and 2019 audited financial statements. This was followed by the publication of the 2020 financial statements in September 2021. The NNPC also began publishing data to support NEITI and monthly presentations to FAAC. The latter enumerate various deductions:

(i) Petrol under-recovery, which is effectively the petrol subsidy and termed "NNPC value shortfall" after March 2020

(ii) Government priority projects comprising domestic gas development, gas infrastructure, frontier exploration, renewable energy development, new LNG project (Brass LNG), refinery rehabilitation, and a pipeline to Morocco

(iii) Nigerian Export Supervision Scheme fee

(iv) Pipeline operations, repairs, and maintenance

(v) Strategic stock holding costs

(vi) Crude oil and refined product losses.

**The NNPC accumulated large payment arrears for JV cash calls in the 2010s, which are being paid back using revenues from new oil production.** Over the years, the NNPC fell behind in paying JV cash calls. The magnitude of cash call arrears before 2016 has not been publicly disclosed but may have amounted to more than US$6.5 billion (*Petroleum Intelligence Weekly* 2017). In the negotiation settlement with the JV partners, the Ministry of Petroleum Resources managed to reduce the amount owed to US$4.7 billion and set up a mechanism to pay back the arrears from identified "incremental" projects, those in which investments are made to increase oil production. As of March 2022, US$3.7 billion had been paid back, leaving US$1 billion to be repaid. The clearance of cash call arrears has reduced and will continue to reduce transfers to the Federation Account.

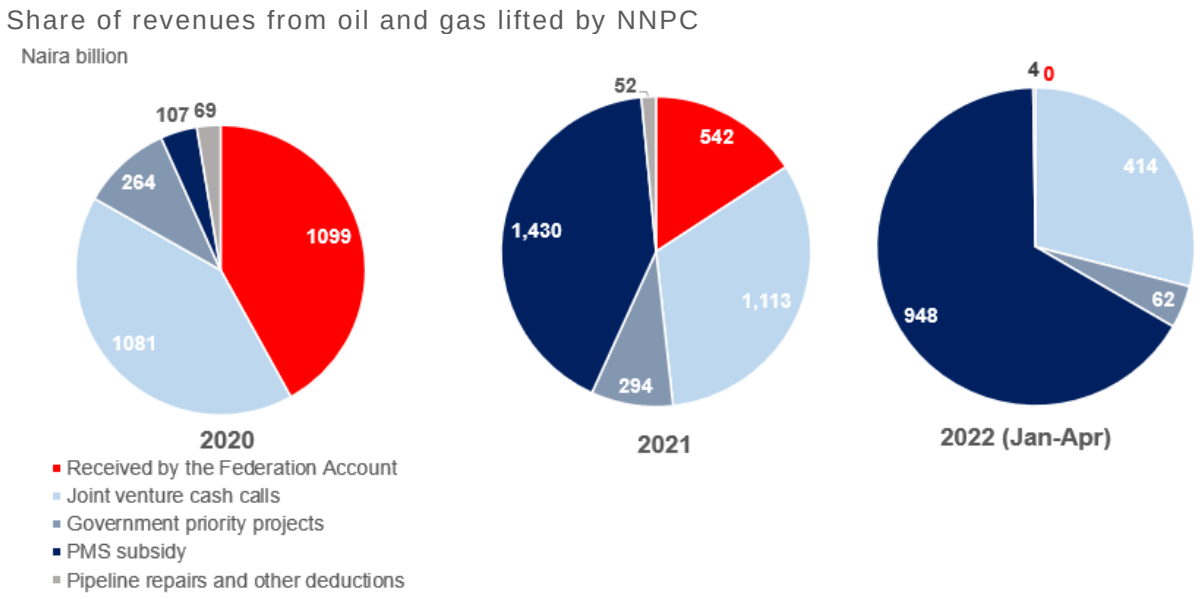
**On certain occasions in the past, funds approved for JV cash calls were diverted, amplifying the arrears.** As an example, the annual report of the Auditor-General for the Federation for 2015 (OAuGF 2017) found that the NNPC had asked the CBN to pay US$289,202,382 not to an official government account but in cash—despite the government's e-payment policy and the enormous sum involved—to the Director-General of the National Intelligence Agency, and without producing a written approval to do so. The transaction cost totaled US$292,094,406 after including the 1 percent fee charged by the CBN. The same report also found that no documentation was provided to account for ₦2.5 billion disbursed reportedly to buy 13 houseboats. The annual oil and gas industry audit reports of NEITI have documented other expenditures charged to the JV cash calls. One is the management fee charged by NAPIMS, amounting to as much as US$365 million in 2016, the year in which the oil price collapsed and markedly higher than US$276 million in 2013 when the oil price was more than double. The Ministry of Petroleum Resources in the National Petroleum Policy (MoPR 2017) described NAPIMS' management cost of "over $200 million a year" as being "significantly higher than it ought to be" and "unjustifiable." Avoiding these expenditures that have raised questions would presumably have substantially reduced, or even eliminated, JV cash call payment arrears prior to 2016.

[21] The PIA makes no reference to the 4-percent fee and instead refers in section (2) (c) to the "cost of collection" as one source of income for the Commission.

**The growing petrol subsidy in 2021 impaired the ability of the NNPC to pay the Federation's share of costs in JV operations, accruing new JV cash call arrears and reducing oil production.** Against the planned JV cash call payments, the actual amounts paid to JV partners had fallen 44 percent short in 2021, possibly adding an additional US$2 billion or even more to JV cash call arrears. Unable to shoulder the funding shortfall, JV partners cut back on investments, contributing to declining oil production even as the world oil price soared. Ironically, the higher the price of oil, the higher the petrol subsidy's burden, and the lower the NNPC's ability to pay the JV cash calls, resulting in lower oil production and creating a vicious downward cycle.

**In 2021, less than one-fifth of oil and gas lifted by the NNPC was eventually transferred to the Federation Account**. The petrol subsidy accounted for 42 percent of oil and gas lifted by the NNPC, by far the largest component (FIGURE 2.14). The share of the Federation was about half, of which two-thirds was invested in oil and gas production. What is more alarming is the outturn in 2022, whereby the petrol subsidy captured the two-thirds of the revenues collected by the NNPC during the first four months, not leaving enough to cover costs and leaving nothing for the Federation Account.

FIGURE 2.14. Breakdown of revenues from oil and gas lifted by the NNPC, billion naira




Sources: NNPC.

## The 2021 Petroleum Industry Act substantially changed the institutional set-up of the oil and gas sector

**After more than two decades in the making, the PIA was enacted on August 16, 2021**. Initiated by the Oil and Gas Sector Reform Implementation Committee that had been set up by President Obasanjo in 2000, various drafts of the Petroleum Industry Bill underwent many stages of reviews and consultations. These consultations included the Gazette Bill of December 2008, the Government Memorandum, the Petroleum Industry Bill 2009, the Inter-Agency Team Memorandum of 2010, and the Petroleum Industry Bill 2012. The PIA, which aims to reform Nigeria's oil and gas sector, is composed of four main chapters: (i) governance and institutions, (ii) administration, (iii) host community development, and (iv) the petroleum industry fiscal framework.

**The PIA transferred many powers and responsibilities—previously assigned to the Minister of Petroleum Resources—to two newly established regulators:** (i) the Commission for oil and gas exploration and production and (ii) the Authority for activities downstream of oil and

gas production. The Minister of Petroleum Resources is in charge of policy formulation and plays an important role in international relations but, unlike in most other countries, is no longer tasked with issuing regulations or conducting licensing rounds.

**In contrast to internationally accepted good practice, the PIA excludes all ministers and vests in the Commission the exclusive authority to decide how fiscal payments are to be made or when and how to conduct licensing rounds.** Given the size of the petroleum revenue for the Federation, it would be beneficial if important decisions—such as when to conduct a licensing round, the amount of oil reserves to bid out, and what terms to offer—were not left to the discretion of the Commission. Good international practice suggests that all relevant ministries, which in Nigeria would include petroleum, finance, environment, and justice, should be involved in such process, including contributing as appropriate to the preparation of the licensing round guidelines, the model license, model lease, and model contract, and be consulted in the negotiation of the terms and conditions in their respective areas of responsibility.

**The PIA also restructured the NNPC into the Nigerian National Petroleum Company Limited, which continues to play pseudo-regulatory functions.** According to section 64 (b) of the PIA, the NNPC Ltd, and not the Commission, signs all production-sharing, profit-sharing, and risk-service contracts on behalf of the Federation. More generally, the NNPC Ltd appears in every contractual arrangement, arguably making its status even less commercially oriented and more favored than today. While the NNPC Ltd should operate strictly on a commercial basis, the PIA grants it a special status. It can retain 30 percent of profit oil and profit gas in production-sharing, profit-sharing, and risk-service contracts for exploration in inland and northern basins. Contractors in current and all future PSCs are denied the right to commercialize natural gas, the right that is granted only to the NNPC Ltd.

**In addition to FIRS, the Commission acts as a fiscal agent in upstream oil and gas and can, in turn, outsource its fiscal agent function to the NNPC Ltd.** The Federal Inland Revenue Service (Establishment) Act, 2007, had earlier assigned the responsibility of collecting all oil and gas revenues (taxes, royalties, signature bonuses, gas flaring penalties, rents, and all fees in the oil industry) to FIRS in the First Schedule, although this provision of the FIRS Act has never been implemented, and the Department of Petroleum Resources—the previous regulator—continued to collect payments other than taxes. The PIA now officially assigns revenue collection in the upstream petroleum sector to the Commission, superseding the FIRS Act. As a result, the Commission can decide at its discretion whether royalties should be paid in cash or in kind. In the latter case, the Commission can designate the NNPC Ltd as the collection agency.

**Consolidation of revenue collection in one agency simplifies the tracing of revenue flows and is hence preferred.** For fiscal payment calculations, taxes are much more complicated to administer than royalties, which effectively behave as turn-over taxes. There is therefore no reason why FIRS cannot be tasked with collecting all revenues because an agency that collects upstream oil and gas taxes would have all the information needed to calculate and collect royalties, profit oil, profit share, and bonuses. And yet instead of consolidating fiscal revenue collection in a single agency, the PIA assigns some revenue collection to the Commission and others to the NNPC Ltd.

**The most transparent revenue collection mechanism requires all payments to be made in cash for immediate transfer to the Federation Account.** The PSCs operational in Nigeria today require the NNPC to collect taxes, royalties, and profit oil in kind. In almost all other countries, taxes are paid in cash, not in kind, whereas royalties may be paid in kind or in cash in PSCs and profit oil is taken in kind. Even under production- and profit-sharing contracts, there is nothing to stop cash payments of profit oil or profit share. Switching entirely to cash payments will not only make revenue flows more transparent, but also avoid altogether various lawsuits against the NNPC for “over-lifting” crude oil for these payments over the years. According to the 2020 financial

statement of NAPIMS, U.S. courts in three cases have ordered the NNPC to pay a total of US$4.1 billion plus interest, all of which are still pending.

## The PIA introduced provisions that affect the Federation's revenues and expenditures, as well as prices paid by consumers

**NNPC Ltd will inherit many liabilities**. Arguably the largest impact in naira terms is the requirement to capitalize NNPC Ltd in an amount "not less than its financial requirements to effectively discharge its commercial role and deal with its obligations and liabilities", as stipulated in section 54 of the PIA. The Minister of Petroleum Resources is to transfer the NNPC's liabilities to NNPC Ltd within 18 months from the effectiveness date of the PIA, which would be February 16, 2023. These liabilities run into possibly tens of billions of dollars. Among them are: (i) JV cash call arrears (pre-2016, as well as those accrued in 2020 and 2021) of possibly more than US$3 billion, (ii) US$ 1.04 billion for exploration obtained from the African Export-Import Bank,[22] (iii) the recent acquisition of a 20-percent stake in the Dangote Petroleum Refinery for US$2.76 billion (Reuters 2021), (iv) US$4.2 billion of payments to production sharing contractors ordered by U.S. courts after arbitration proceedings,[23] (v) US$2.8 billion for the Ajaokuta-Kaduna-Kano natural gas pipeline, (vi) settlement of the NPDC's FIRS dues (vii) settlement of NAPIMS' and the NPDC's outstanding flare payments, and (viii) refinery rehabilitation costs of about US$2.5 billion.

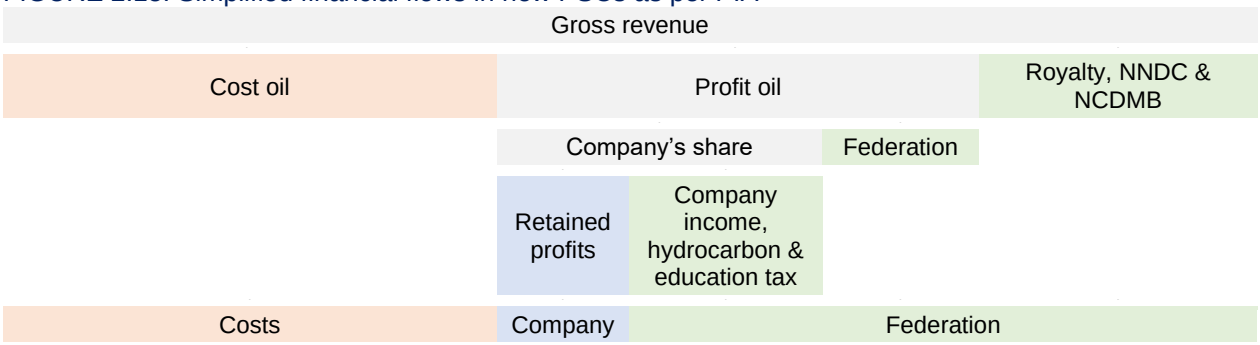
**NNPC Ltd, rather than the Commission, is the concessionaire for all production-sharing, profit-sharing, and risk-service contracts.** Currently the Federation's share of profit oil belongs to the Federation, but as per the PIA, it appears that it may be considered to belong to NNPC Ltd (section 64(c) refers to "profit oil or profit gas payable to the concessionaire" and section 9(4) refers to "NNPC Limited's profit oil and profit gas"). Profit oil can run into billions of dollars a year and the new fiscal framework in the PIA is designed to increase its magnitude, as explained below.

**The new fiscal structure in the PIA aims at increasing profit oil at the expense of taxes**. Pre-PIA, profit oil was shared after all taxes were paid (FIGURE 2.12), but post-PIA profit oil is shared first before taxes are paid (FIGURE 2.15). Everything else being equal, the effect will be to increase the Federation's share of profit oil and decrease taxes. The PIA also replaces the PPT with a hydrocarbon tax and the company income tax of 30 percent applied to all companies in Nigeria. These changes would have no effect on government income if both profit oil and taxes belonged fully to the government, as in other countries. All taxes ought to be transferred to the Federation Account in full, but because of 64(c) and 9(4) in the PIA, the ownership of profit oil is less clear.

**The PIA requires 30 percent of the (potentially larger) profit oil to be earmarked for exploration in frontier basins.** These are areas with no oil and gas production, including Anambra, Dahomey, Bida, Sokoto, Chad, and Benue. The allocation is a significant increase from the September 2020 PIB, which stipulated that 10 percent of acreage rental fees be used for this purpose. According to 2019 data from NEITI, 10 percent of rents amounted to US$270,000, which is clearly insufficient, while 30 percent of profit oil is equivalent to US$213 million. The NNPC's submissions to FAAC show that in the first 11 months of 2021, NNPC spent US$73 million on frontier exploration.

[22] https://www.afreximbank.com/afreximbank-signs-us1-04-billion-deal-with-nnpc-at-iatf2021/.
[23] NAPIMS 2020 financial statement at https://nnpcgroup.com/pages/afs2020.aspx.

FIGURE 2.15. Simplified financial flows in new PSCs as per PIA




Source: PIA.

**There is an unusual clause in the PIA which permits NNPC Ltd to take up to a 60-percent stake in a license under the tax-and-royalty regime at any time after the license is granted.** In the rest of the world, such a clause may be found in PSCs—although not to the tune of 60 percent and only up to the point of field development—but not in the tax-and-royalty regime. Adding to the confusion is the language appearing in section 85 that captures concepts specific to PSCs, which could deter virtually all new applications for a license in the tax-and-royalty regime (currently comprising JVs, sole risk, and marginal fields). If all future investments are to be in PSCs, an automatic earmarking of 30 percent of profit oil for frontier exploration will have an even greater adverse effect on government revenues.

**The PIA establishes a new Midstream and Downstream Gas Infrastructure Fund (MDGIF) with earmarked funding.** The objective of the MDGIF is "to make equity investments of Government owned participating or shareholder interests" in gas infrastructure to promote private investment by risk-sharing, increase domestic gas consumption, and reduce gas flaring. For the foreseeable future, government agencies that will be able to tap into the MDGIF will be limited to NNPC subsidiaries operating in midstream and downstream gas sector. The funding sources for the MDGIF include a 0.5-percent fee on the wholesale prices of petroleum products and natural gas sold in Nigeria, and flare payments.

**The PIA directs flare gas payments of about US$500 million annually away from the Federation Account and into the MDGIF.** Gas flaring occurs when gas produced in association with oil production is flared (burned) for lack of commercially viable alternatives. Nigeria has endorsed the *Zero Routine Flaring by 2030* initiative,[24] but the 2021 Nationally Determined Contribution[25] to the Paris Agreement lists the deadline of 2030 as a conditional contribution. The Flare Gas (Prevention of Waste and Pollution) Regulations in 2018 increased payments for flaring dramatically, from about US$0.03 per thousand cubic feet of gas flared before July 2018 to US$2 per thousand cubic feet in a license area with oil production of 10,000 b/d or more, and to US$0.5 elsewhere. The 2018 regulations have increased the total annual flare payments due to about US$500 million, which will no longer be transferred to the Federation Account and will instead be deposited into the MDGIF. This will result in an immediate loss of an otherwise fairly stable source of income to the government in the near term.

**The funding of the Authority includes a levy on petroleum products sold in Nigeria**. The levy is 0.5 percent of the wholesale prices of all petroleum products sold. While the earmarking of funds for a regulatory body can help secure financial autonomy, the advisability of such a mechanism may be questioned on account of its seemingly arbitrary quantum, its inconsistency with parliamentary budgeting and appropriation process, and significant revenue volatility caused by world oil price and exchange rate fluctuations. No equivalent funding mechanism is provided

[24] https://www.worldbank.org/en/programs/zero-routine-flaring-by-2030.
[25] https://www4.unfccc.int/sites/NDCStaging/pages/Party.aspx?party=NGA.

for the Commission, which further raises questions about the appropriateness of this provision for the Authority.

## Oil savings rules broadly functioned until 2012, but since then savings have been depleted and not replenished

**Following the transfer into the federation account, some oil and gas revenues have historically been set aside as savings in an Excess Crude Account (ECA) at the central bank.** The ECA was established in 2004 to save oil revenue windfalls for future generations and to construct a buffer against revenue shocks. On a monthly basis, all excess oil revenues were supposed to accrue in this savings account. Excess oil revenues were defined as actual gross oil revenues in excess of budgeted oil revenues. Budgeted oil revenues were based on a conservative benchmark (reference) oil price (an indicator the public follows closely) in an effort to build-up oil revenue savings.

**The ECA was a way of implementing an Oil Price-Based Fiscal Rule (OPBFR) as part of a package of fiscal reforms commencing in 2003–04.** The OPBFR was Nigeria's way of implementing a counter-cyclical fiscal policy by delinking public expenditure from current oil revenues, so that when oil prices were high, Nigeria could accumulate fiscal savings from which to draw during periods of low oil prices. Savings of excess oil revenues in the ECA began in 2004 when oil prices averaged about US$33 per barrel and Nigeria adopted a budget benchmark oil price of US$25 per barrel. In 2008, the average oil price was US$97 per barrel and the benchmark price was US$59. By the end of 2008, almost US$20 billion had accumulated in the ECA.

**The savings of excess oil revenues in the ECA became mired in political controversy, prompting the federal government to institutionalize the practice in 2007.** The Federal Fiscal Responsibility Act (FRA) of 2007 states that, when the reference commodity price rises above the predetermined level, the resulting excess proceeds shall be saved in a separate account which shall form part of the respective Governments' Consolidated Revenue Fund to be maintained at the CBN by each government (federal or state). The FRA also provided that no government in the Federation shall have access to the excess proceeds unless the reference commodity price falls below the predetermined level for a period of three consecutive months. The FRA also instituted a Fiscal Responsibility Commission to enforce the provisions of the Act, including the OPBFR.

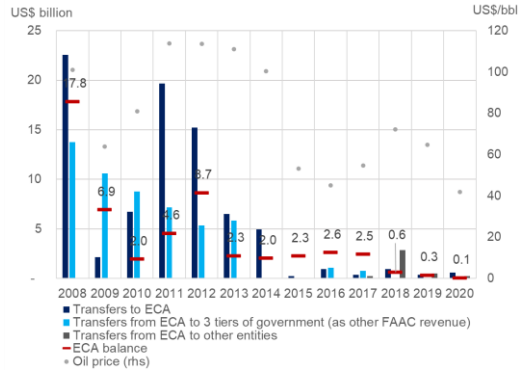
**Historically, transfers to the ECA from the net federation account were sizeable (FIGURE 2.16).** During periods of high oil price, like in 2008 and 2011, savings in the ECA were as large as US$20 billion. Substantial ECA savings were a useful buffer against the fiscal downturn arising from the steep decline in oil prices during the global financial crisis of 2008-09. Thus, outflows have also been systemically sizeable, limiting the build-up of buffers.

**More recently, several factors limited the build-up and led to the depletion of ECA savings:**

- **First, over-ambitious oil production targets** (FIGURE 2.17) limiting 'surplus' revenues despite a conservative oil price benchmark (FIGURE 2.18), which in turn limit 'excess' oil revenues accrual into the savings account (FIGURE 2.19). This has increasingly been the case since the 2015 oil price shock.
- Second, transfers from the ECA to the government within the same year in response to largely non-oil revenue underperformance, which in turn stemmed from ambitious revenue targets without measures to underpin non-oil revenue improvement.
- **Third, and most recently, the relatively small (in historical terms) ECA savings have been depleted by transfers,** not for sharing across the three tiers of government, but for discretionary spending, including military equipment purchases and Paris Club Refund to state governments in 2018.

FIGURE 2.16. Oil and Gas savings in the Excess Crude Account diminished over time

Excess Crude Account (ECA) and oil price

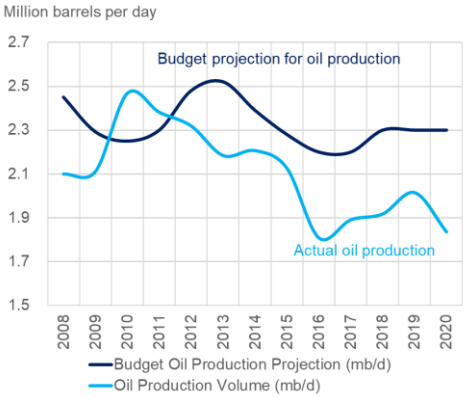



Source: OAGF

Note: Transfers to other entities include: in 2017, US$250 million transfer to NSIA. In 2018: US$496 million approved by the President as advance payment for the purchase of Super Tucano aircraft and US$380.5 million for procurement of critical equipment for the Nigerian Army, Navy, and Defense Intelligence Agency; and US$2 billion Paris Club Refund to states. In 2019: various consultancy fees, additional Paris Club Refunds to states, and other minor flows. In 2020: US$250 million transfer to NSIA.

FIGURE 2.17. Overly ambitious oil production forecasts…

Oil production

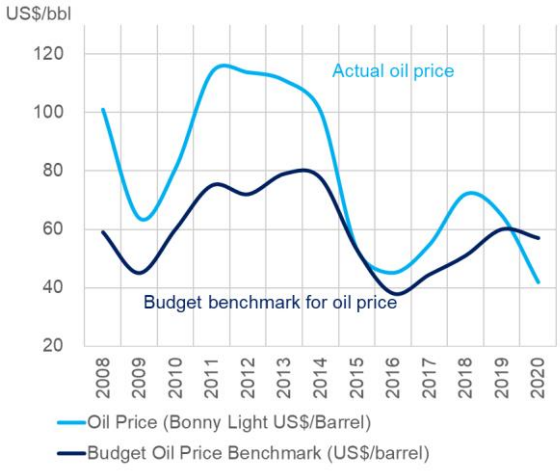



Source: Federal Government Budgets and NNPC reports

Note: 2020 benchmark as in the original Federal Government Budget; the amended budget revised the oil benchmark from US$57/bbl to US$28/bbl

FIGURE 2.18. … despite conservative budgeted oil prices …

Oil price

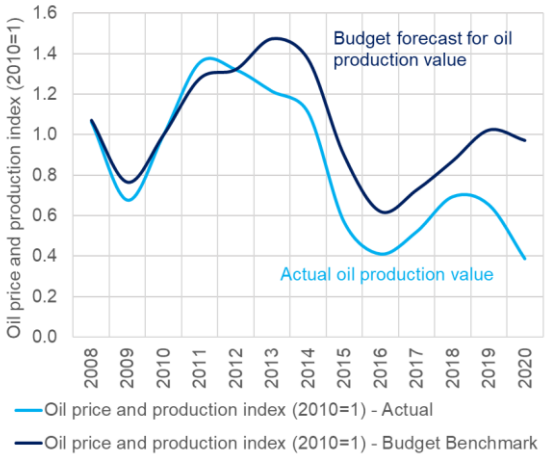



Source: Federal Government Budget and NBS.

Note: 2020 benchmark as in the original Federal Government Budget; the amended budget revised the oil benchmark from US$57/bbl to US$28/ bbl

FIGURE 2.19. … result in over-ambitious forecast of the total value of oil production

Oil price and production index (2010=1)




Source: Federal Government Budget and NBS

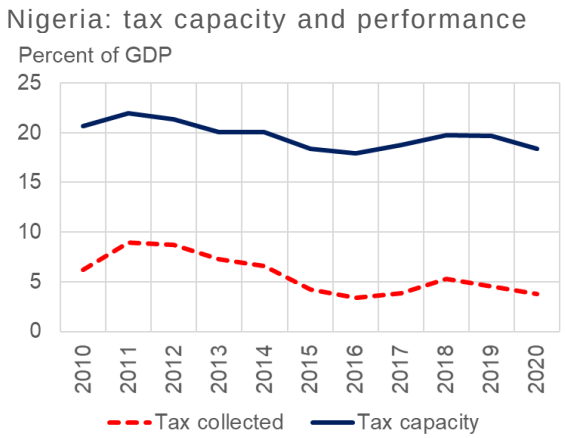
Note: 2020 benchmark as in the original Federal Government Budget; the amended budget revised the oil benchmark from US$57/bbl to US$28/bbl.

## Stagnant non-oil revenues failed to create a buffer to volatile oil revenues

**Nigeria's non-oil revenue mobilization is among the lowest globally.** Prior to COVID-19, the median non-oil tax-to-GDP ratio of Nigeria was only 4.5 percent in 2017-2019, positioning the country as the 167th out of 175. As a result, the tax gap in Nigeria is estimated at 14-15 percent of GDP (FIGURE 2.20). In fact, all key tax inflows are significantly below their potential (FIGURE 2.21 and FIGURE 2.22), with VAT revenues hovering between 0.8 and 1 percent of GDP, corporate taxes at only 1 percent of GDP and customs and excise duties varying between 0.4 and 0.6 percent of GDP. Other independent sources of non-oil revenue amount to about 1 percent of GDP. These include state owned enterprise surpluses, PIT collected at the state level, and local government-collected fees and charges. Overall, low revenue inflows across all tax components mean that Nigeria is far below the 12.75 percent of GDP tipping point those countries need to collect, in order to carry out their most basic functions and finance development programs.[26]

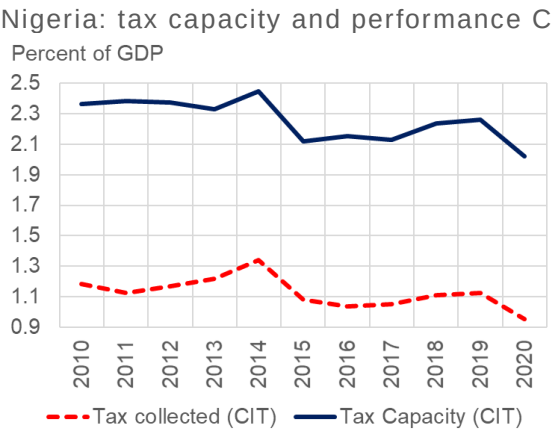
**A dismal revenue collection rate reflects poor tax efforts.** One reason why tax revenue in Nigeria is low is the limited effort—defined as the actual tax rate (revenue collected) as a percentage of taxable capacity—to develop a contemporary, simple and efficient tax policy (FIGURE 2.23). This reflects deficiencies such as a very narrow base for income tax, a suboptimal VAT system combined with a very low rate, extensive use of tax expenditures (including incentives), some of the lowest excise duty rates in the region, low revenue generation at the subnational level, weak tax administration, and a high cost of tax compliance.

FIGURE 2.20. Nigeria suffers from a very large tax gap…




Sources: IMF, Government Revenue Dataset and World Bank estimates

FIGURE 2.21. … stemming from a gap across many taxes, including CIT…

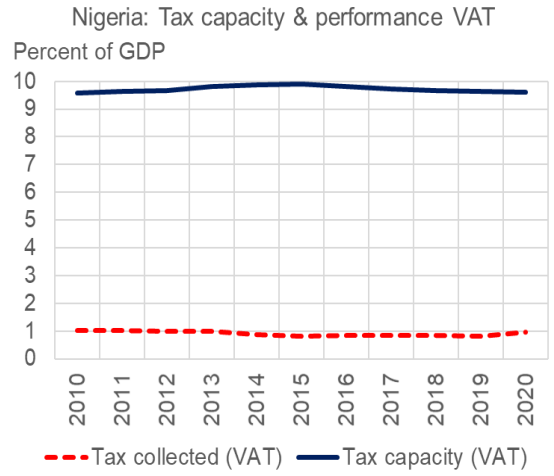



Sources: IMF, Government Revenue Dataset and World Bank estimates

[26]Tax Capacity and Growth: Is there a Tipping Point?, IMF, 2016.

FIGURE 2.22. … and VAT

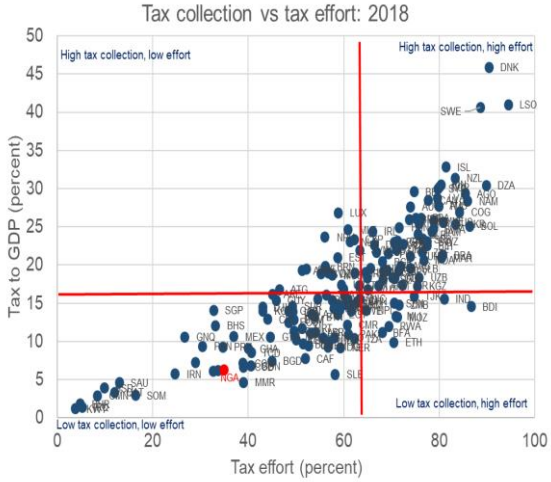
Nigeria: Tax capacity and VAT performance




Sources: IMF, Government Revenue Dataset and World Bank estimates

FIGURE 2.23. Nigeria's low tax collection is related to a low tax effort

Tax collection vs tax effort: 2018




Sources: IMF, Government Revenue Dataset and World Bank estimates

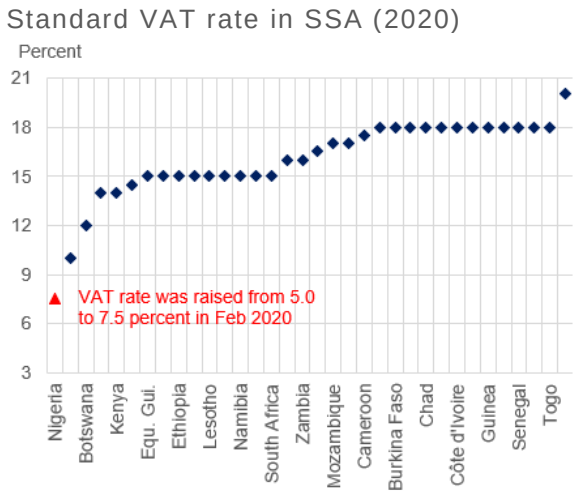
## Low rates combined with inefficiencies in administration undermine tax revenues

**Nigeria's VAT revenue are among the lowest in the world.** They accounted for 0.9 percent of GDP in 2019, far below the regional average of 8 percent of GDP. The low VAT-to-GDP ratio can be attributed to two factors. First, and despite and increase from 5 percent to 7.5 percent in 2020, the standard VAT rate in Nigeria remains by far the lowest in SSA (FIGURE 2.24). Second, the VAT C-efficiency[27] ratio has been trending downwards over the past decade and trails all peer countries for which recent data is available (**Error! Reference source not found.**FIGURE 2.25 and FIGURE 2.26). Poor VAT efficiency reflects exemptions on a large number of goods (e.g. food, pharmaceuticals, education) and weak administrative performance.

**The current excise tax base and rates are also narrow and can be increased substantially.** At 0.04 percent of GDP, Nigeria's excise taxes are among the lowest globally. This stems from low excise rates. For instance, Nigeria's excise rate of 20 percent on tobacco and alcohol products (beer, wine and spirits) is less than half the median of its African peers (FIGURE 2.27). In addition to the health benefits from higher excise taxes on goods such as tobacco and alcohol, increasing excise taxes can provide a stable non-oil revenue stream for the government. This can be achieved by converting ad-valorem taxes to specific rates (indexed to inflation) and further increasing the rates on tobacco and alcohol, institute specific charges to environmentally damaging goods (e.g., plastic bags, bottles), and increasing the excise on liquid fuels (e.g., motoring charge on petrol and diesel fuel).

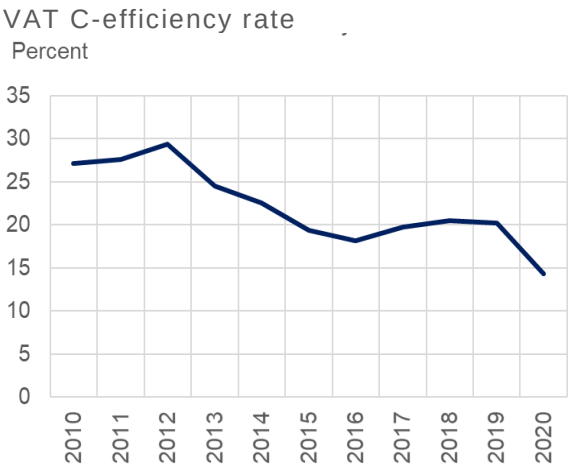
[27] The VAT c-efficiency captures the ratio of actual VAT revenues to the product of the standard rate and final consumption. The c-efficiency measure may equally be applied on other revenue sources, such as CIT.

FIGURE 2.24. The VAT rate in Nigeria is the lowest in SSA



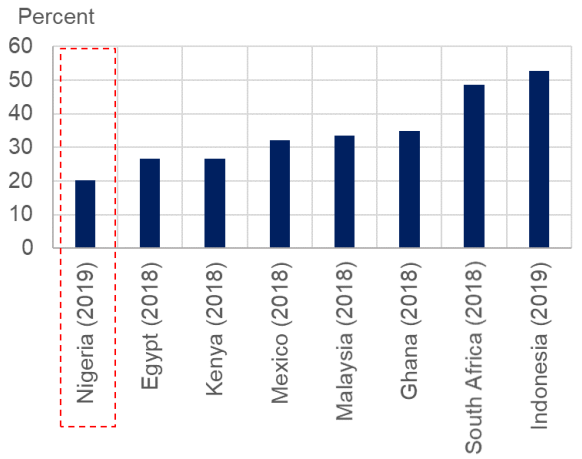

Sources: MFMod, OAUGF, Deloitte (2020)

FIGURE 2.25. The VAT efficiency has deteriorated over time…



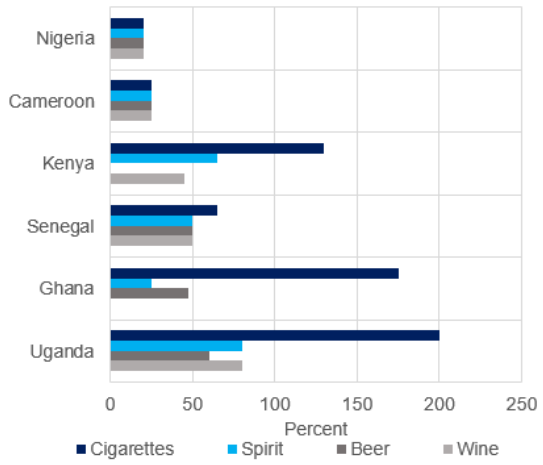

Sources: MFMod, OAUGF, Deloitte (2020)

FIGURE 2.26. … and is the lowest across peers




Sources: MFMod, OAUGF, Deloitte (2020)

FIGURE 2.27. There is ample space to raise excise rates for alcohol and cigarettes




Source: PWC Worldwide Tax Summaries

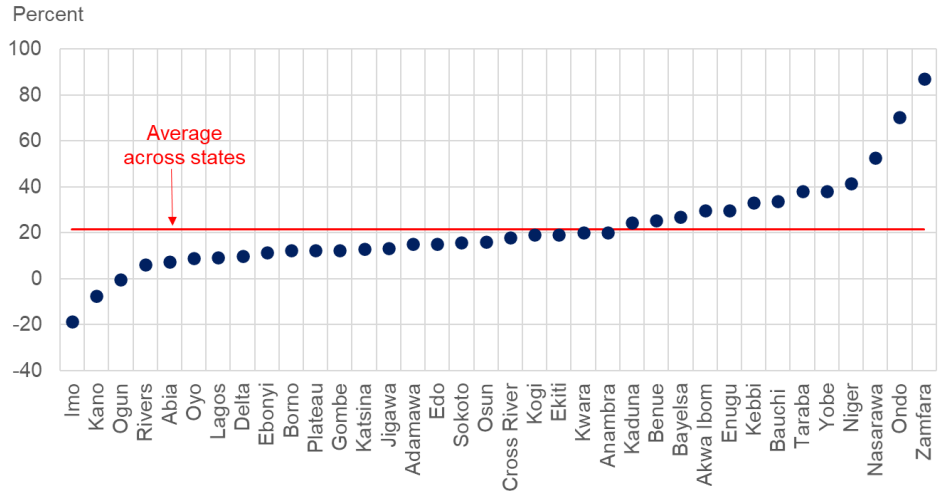
**Corporate Income Tax (CIT) collections remain one of the lowest in the world, at 0.9 percent of GDP**. CIT reforms can seal loopholes without raising the tax burden on compliant corporate entities. The addition of an anti-fragmentation rule in the Corporate Income Tax Act (CITA) would prevent medium and large companies from fragmenting business activity to take advantage of the exemption for small companies with turnover below ₦25 million. Secondly, the definition of dividends could be revised to include "disguised" dividends, to prevent companies from funneling corporate profits to shareholders without paying taxes. These among other CIT reforms have the potential to raise revenue by 0.7 percent of GDP.

**At the sub-national level, the states' Internally Generated Revenues (IGR) have been limited to less than 1 percent of GDP, but efforts have been made recently to shore up these resources.** States have been facing serious fiscal pressure since 2015, as statutory transfers from the FAAC declined significantly while recurrent spending pressure remained high. As a result, capital spending was compressed and total state debt doubled between 2014 and

2016, necessitating two federal government financial assistance packages. In response, states enacted several policy reforms which led to an annual average increase in IGR of 21.6 percent between 2016 and 2019 (compared to an average inflation of 13.9 percent). However, there is significant deviation among states in IGR effort and performance, with some states registering very high IGR growth while others suffer from a decline in IGR collection (FIGURE 2.28).

FIGURE 2.28. The is a large variation in IGR growth across states

CAGR IGR (2016-2019)




Sources: S-DSA-DMS reports prepared and published by states.

## The regulatory environment for tax policy is weak

**There are fundamental weaknesses in the design of the "backbone" taxes (CIT, VAT, and PIT).** The laws implementing these taxes are dated and not particularly detailed, with gaps in legislation giving rise to planning opportunities for taxpayers. There has been a tendency to use subsidiary legislation to fill in some of the gaps. Ideally, these tax laws would be modernized, simplified and consolidated to ensure that they are technically coherent and consistent in their application. This is particularly relevant for the PIT and CIT.

**There are deficiencies in the basic international tax rules for both CIT and PIT.** As an import-dependent country, it is vital to have comprehensive and robust source rules defining Nigeria's jurisdiction to tax non-residents. The effective application of source rules requires detailed and modern definitions of key income classes subject to non-resident withholding tax, particularly dividends, interest, royalties, and technical and management fees. Nigeria uses the concept of "fixed base" for taxing non-residents on business income. While this concept operates in a similar manner to the internationally accepted concept of "permanent establishment" (PE), it is narrower and has not kept up to date with ongoing global reforms of the PE concept. Further, there are no clear rules for attributing profits to a fixed base, with reliance placed on a deemed taxable income rule that may be excluded under tax treaties.

**Not all Base Erosion Profit Shifting (BEPS) actions are equally important for Nigeria; therefore, BEPS implementation should be based on Nigeria's priorities.** As a member of the BEPS Inclusive Framework, Nigeria would benefit from implementing the BEPS minimum standards.[28] Beyond this, there is flexibility to base BEPS implementation on Nigeria's priorities,

[28] These are BEPS Action 5 (review and removal of harmful tax concessions), Action 6 (inclusion of the principal purposes test to counter abuse of treaty practices, Action 13 (Country-by-Country Reporting) and Action 14 (Reform of mutual agreement procedure under tax treaties).

to which end a BEPS implementation plan can be developed and executed. For example, BEPS Action 4 (which addresses base erosion through financing transactions) was implemented as part of the 2019 FA reforms, but the legislation was hampered by technical deficiencies.

**The CITA and PITA need regulatory amendments to fix loopholes and reduce potential tax evasion.** The FA 2019 introduced an exemption for small businesses and a lower tax rate for medium-sized businesses. To prevent taxpayers breaking up a business activity among related persons so that a lower tax rate (including a zero rate) applies, it is important that anti-fragmentation rules are included. In addition, the minimum CIT based on turnover should apply only to profitable companies. This can be achieved by basing the application of the tax on financial accounting profits rather than taxable profits. Finally, the list of exempt income amounts in section 23 of the CITA and Schedule 3 to the PITA would benefit from being reviewed.

**The VAT Act (VATA) is very brief and does not include many of the basic rules that are central to a properly functioning VAT system.** This includes time of supply, value of supply, place of supply rules, and rules dealing with mixed supplies and adjustment events requiring the issue of credit and debit notes. While some of these rules may be partly dealt with in circulars and the like, it is important that all core principles are incorporated in the VATA. In addition, there is a range of transactions whose VAT treatment normally requires specific rules (such as second-hand goods), but these are lacking in the VATA.

**Businesses are denied input tax credits on capital investments, such as plant and machinery.** This means that businesses incur unrecoverable VAT on capital goods. A properly functioning VAT system allows credits for VAT paid on all inputs to ensure that the burden of VAT falls on consumption. The denial of input tax credits means that VAT operates as a tax on investment and can discourage businesses from upgrading their capital equipment. This may also limit the attractiveness of CIT measures aimed at encouraging capital investment, such as accelerated depreciation. Furthermore, a properly functioning input tax credit mechanism requires VAT documentation rules (VAT invoices, debit and credit notes) to support input tax credits.

## Reforming tax expenditures, incentives, and concessions can deliver significant revenue gains

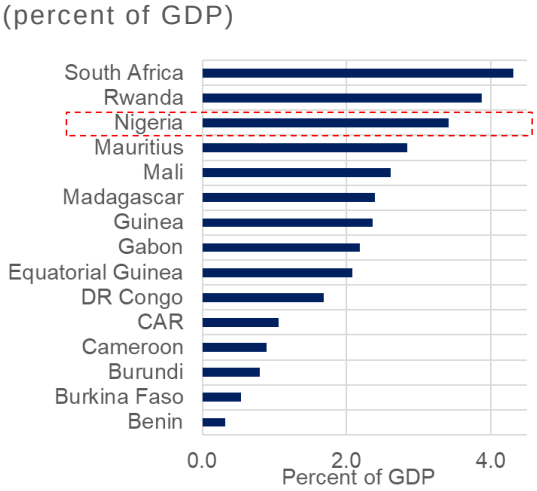
**Nigeria's tax expenditures, including incentives, are not governed by a coherent set of laws, with overlaps occurring across several institutions.** While the preparation of a Tax Expenditure Statement (TES) is required under the Fiscal Responsibility Act (FRA, 2007), these were never computed or published before 2020 (see next paragraph). Several agencies have the power to grant tax incentives, including the Technical Services Department (TSD) of the FMFBNP, the Nigeria Investment Promotion Commission, and the Nigeria Export Promotion Zone Authority, all of which enjoy significant discretion over tax expenditure design and application. Good practice suggests that tax expenditures be provided solely through tax laws, awarded by the Minister of Finance after appropriate consultations, and administered by Nigeria's tax authorities (i.e., FIRS and the state tax agencies). Good country practice also advises a regular application of cost-benefit assessments and sunset clauses in medium-term fiscal projections and the fiscal rules framework. Yet, Nigeria's tax expenditures are not governed by a coherent body of laws, rules and procedures, and it is not clear to what extent these incentives are aligned with each other or support specific policy objectives, such as attracting FDI.

**As a first step to design an effective fiscal management strategy, Nigeria started publishing its tax expenditures on a regular basis.** The FMFBNP issued a circular on April 30, 2020, requiring that relevant ministries, departments, and agencies submit annual tax-expenditure statements. These statements will inform the preparation of the annual Medium-Term Expenditure Framework and Fiscal Strategy Paper. The circular mandates that all agencies empowered to grant tax incentives report on those incentives in a consistent format in each fiscal

year starting in 2019. The circular also mandates the creation of a Tax Expenditures Committee to consolidate the reports into a comprehensive statement. This Committee started operating in May 2020 and is chaired by the Director General of the Budget Office of the Federation (BOF).

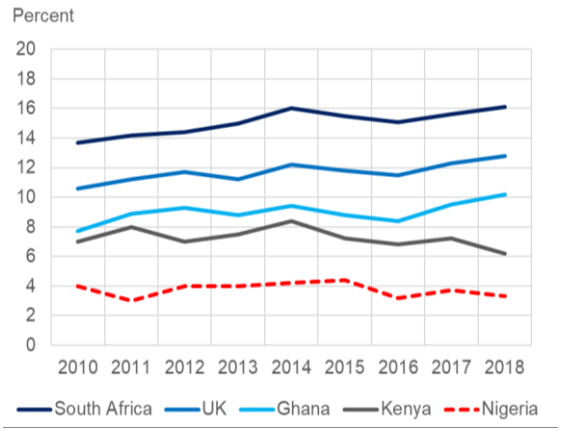
**Tax expenditures impose a large cost in terms of foregone revenues.** Although foregone revenues are difficult to compare across countries, they are very high in Nigeria at ₦5.8 trillion (3.7 percent of GDP). This rate is one of the highest among SSA countries for which estimates are available (FIGURE 2.29). Revisiting high tax expenditures in the hopes of reducing inefficient ones could increase government resources.

FIGURE 2.29. Nigeria has one of the highest rates of forgone revenues as a ratio of GDP in SSA




Sources: Global Tax Expenditures Database (GTED) and MTEF 2022–2024

FIGURE 2.30. The efficiency of CIT collection is very low in Nigeria compared to peers




Sources: MTEF 2022–2024

**VAT revenues account for the bulk of forgone revenues, largely due to a significant compliance gap.** In 2020, if all commodities in the VAT system were fully taxable, Nigeria could have generated about ₦6 trillion from the existing tax structure. This compares to only ₦1.8 trillion collected that year. Thus, the estimated VAT revenue foregone was ₦4.3 trillion, of which 21 percent results from exemptions set out in the legislation, while the remaining 79 percent corresponds to the compliance gap. This large compliance gap could reflect difficulties in bringing the informal sector and underground economic activity into the VAT value chain, well as wider problems in tax administration.

**Corporate Income Taxes and Petroleum Profit Tax are also subject to exemptions.** Nigeria forewent ₦457 billion (0.3 percent of GDP) through CIT concessions and incentives in 2020. These largely stemmed from financial and non-oil manufacturing Large Tax Offices (LTOs) which accounted for 15.8 and 65.1 percent of total CIT exemptions, respectively. These concessions arose almost entirely (96 percent) from exemption of profits under section 23 of CITA. In addition to being subject to large exemptions, the collection of CIT in Nigeria is low compared to peers (FIGURE 2.30). About ₦307 billion (0.2 percent of GDP) of Petroleum Profit Tax (PPT) was foregone in 2020. Most of these tax expenditures (89 percent) were granted through the Investment Tax Credit, while the rest were granted under the Petroleum Investment Allowance and Investment Tax Allowance. This excluded possible incentives subsumed into normal expenses and allowances such as under Modified Carry Agreements.

**Custom exemptions are also sizeable.** They are estimated at ₦780 billion in 2020, a relatively large amount compared to collected custom revenues of ₦932 billion (MTEF, 2022–2024). In terms of decomposition, about 39 percent of total tax relief on imported goods relates to

exemptions on import duties, 28 percent on waivers regarding the Common External Tarif Levy (CETL), and 23 percent on tax relief granted on VAT. China accounted for about two thirds of custom relief.

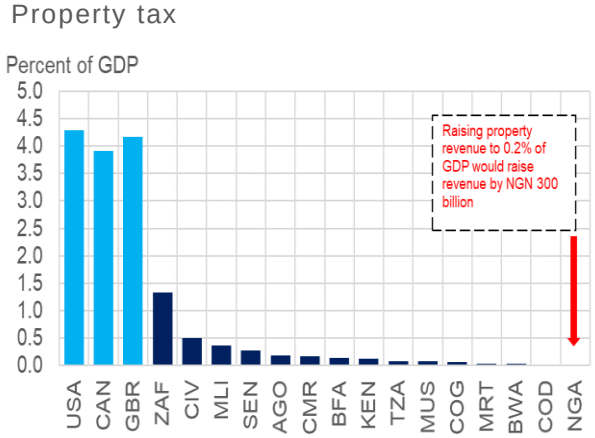
## In addition to federally collected revenue improvements, several options can boost revenue collection at the state and local government levels

**Measures are possible to improve revenue collection at state and local levels, while respecting political and constitutional boundaries.** A significant part of the fiscal challenge in Nigeria stems from the distributed tax administration competences between the federal and state levels. This is a common challenge in most federal states, and touches on political and constitutional issues that are beyond the scope of a purely technical work program. However, it is possible to make improvements that will materially impact on the overall fiscal position.

**Personal income tax collection is below regional peers and can be improved.** Tax rates range from 7 to 24 percent and are in line with international comparators. However, evasion is a major problem. Certain classes of taxpayers escape the income tax net in whole or in part. A key part of these are High Net Worth Individuals (HNWIs), who have conspicuous consumption patterns, yet return low or no income subject to PIT. Incomes from businesses and property are under-reported, especially by unincorporated businesses. Further, there is a large informal sector, where small-scale traders and other businesses do not report income at all.

**States could prioritize these two groups for PIT compliance enforcement.** While there could be other areas to pursue, such as expatriates paid split salaries, and undervaluation of employee benefits under the PAYE system, the 'informal sector taxation' and the HNWI have the most revenue potential. There are data limitations on the incomes of HNWIs. However, tax law defines income very broadly, which HNWIs tend to under-report. While common sources of indirect data on income or wealth are difficult to access, solutions can be found.

FIGURE 2.31. Nigeria's property tax collection is the lowest among SSA peers




Sources: IMF World Revenue and Longitudinal Data

**Revenue collection from property tax is less than optimal.** The recurrent immovable property tax is a stable source of revenue for subnational and local governments all over the world. In advanced countries such as the US, Canada, and the UK, as much as 3 percent of national GDP annually is collected through this tax instrument. This tax also generates significant revenues in some sub-Saharan African countries, notably in South Africa where it raises over 1 percent of national GDP. There is no data available for Nigeria from the IMF, but based on information collected from the states, property taxes are estimated at 0.01 percent of GDP, which is significantly lower than comparable countries (FIGURE 2.31)

## Tax morale is low, leading to non-compliance

**The sentiment that citizens and firms should pay a fair share of taxes and that tax evasion or avoidance is wrong is not widespread in Nigeria.** In fact, support for the government's right to collect taxes has declined by 17 percentage points in the country between 2011 and 2020, one

of the worst changes among 15 SSA countries (FIGURE 2.32). This is mainly due to opacity of the tax administration and policy, negative experience when interacting with tax officials, weak accountability on the use of taxes and general government revenues, incidences of double taxation from overlapping mandates across tax jurisdictions, and an overall lack of trust in the tax authorities, regimes, and government. This breakdown in the social contract between citizens and the government is a major factor behind high levels of tax non-compliance among Nigerians.

**Nigerian firms consider the tax system not well suited to generating sustainable revenues or supporting the development of a modern economy.** According to the World Bank Enterprise Survey in 2014, close to 26 percent of firms in Nigeria expected to provide gifts when meeting with tax officials, compared to 17.6 percent in SSA. In addition, in another survey on firms conducted by Compliance Professionals Plc in 2019, the majority of taxpaying firms reported having issues with the tax system, and asserted that their input or consideration of their feedback in policy formulation would bring about a more harmonious and workable tax environment. In the view of respondents, the tax administration is focused on short-term revenue collection, rather than generating sustainable revenues for development and engendering an enabling economy.

**On the household side, tax morale is also extremely low.** A 2018 Nigerian Economic Summit Group Survey (NESGS 2019) of 16,000 households shows that less than 20 percent of households reported paying income tax in the previous year, with only 7–8 percent reporting having paid property taxes[29]. Effectively, the average tax paid per household is very low, as the average income tax paid by the less than 20 percent that reported having paid it was under ₦23,000 per year. This is about 10 percent of the annualized minimum wage of ₦216,000 per year. Moreover, less than 17 percent of those surveyed said that not paying tax is "wrong and punishable ", while more than 20 percent said that not paying is "not wrong at all".

**Three systemic reasons can explain the low tax morale among both firms and households:**

- **First, there is limited knowledge of and little readily available information about the tax system.** In addition, there is little effort within the tax administration to engage with the taxpayers, with only 12 percent of the population reporting having received any kind of communication from the government on tax (the NESG Nigeria Tax & Subsidy Perception Dataset, 2019).[30] As a result, there is low understanding and weak implementation of the Nigerian tax policy and inadequate clarity about the prevailing tax laws, resulting in widespread ignorance, confusion and frustration about different taxes.
- **Second, the tax collection system is often inefficient, opaque, and corrupt.** The negative experience reported by both individuals and firms when dealing with the tax system and with tax officials creates apathy even among those willing to pay taxes. Even where technology has been adopted, there is dissatisfaction with the e-filing platform and the processes for filing returns. While certain types of tax are regarded as efficient and professionally administered (e.g. PAYE and VAT), many other types of tax require personal interaction with state or local tax officials. Over a third of respondents in the 2018 NESGS said they were often or always asked for bribes by tax officials, with the experience varying significantly across regions. Where tax is finally collected, there is a tedious dispute resolution and appeal process, cases of double/multiple taxation and irregular tax administration practices.
- Third, most households and small firms point to a broken social contract, and to low trust in a government which shows little transparency or accountability in its use of taxes. The level of satisfaction with local services among Nigerians is very low. Around half of Nigerians surveyed say they are dissatisfied or very dissatisfied with the services

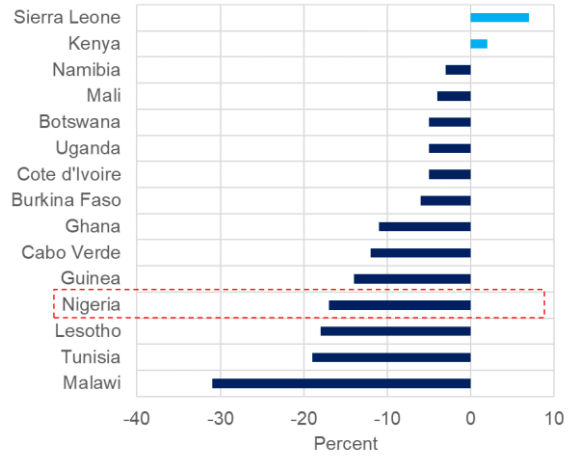
[29] McCulloch, Neil, Tom Moerenhout and Joonseok Yang (2021) "Building a Social Contract? Understanding Tax Morale in Nigeria", The Journal of Development Studies, 57:2, 226-243, DOI: 10.1080/00220388.2020.1797688 https://www.tandfonline.com/doi/full/10.1080/00220388.2020.1797688

[30] https://www.ictd.ac/dataset/nesg-nigeria-tax-subsidy-perception-dataset/.

they receive, particularly electricity, security, and road maintenance (NESG, 2019). Moreover, only 34 percent of Nigerians— the second lowest percentage in SSA— thought that the government uses taxes for the well-being of citizens (FIGURE 2.33). More generally, the link between taxation and service delivery appears broken. In most states, people believe that services have worsened over the last three years while taxes have gone up. Low trust from firms is compounded by a high frequency of tax audit visits from various MDAs, as well as ambiguity and uncertainty in the rules governing the administration of tax incentives and other tax expenditures. Over three-quarters of respondents said they trusted tax officials very little, if at all.

FIGURE 2.32. Support for the government's right to collect taxes has declined significantly

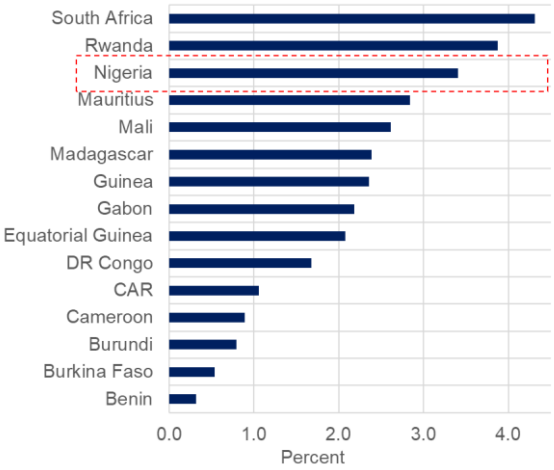
Changes in support for government to collect taxes (2011-2020)




Source: Afro Barometer (2021)

FIGURE 2.33. As trust in government's use of taxes is low

Respondents who agree that government uses taxes for well-being of citizens




Source: Afro Barometer (2021)

**Low tax morale partly affects compliance rates in the registration, filing and payment of major taxes.** There are around 57 million Nigerians who are economically active,[31] but it is estimated[32] that for corporate income tax, less than 6 percent of 1 million registered taxpayers are active (i.e., filing taxes). For personal income tax, only 2 percent of 761,000 registered taxpayers (mostly formal sector employees) are active. Estimates on payment compliance for VAT vary between 15 percent and 40 percent.

[31] This assumes a population of 190 million Nigerians; 54.3 percent aged between 15-64; 52.65 percent youth unemployment; 18.8 percent unemployment; and 21.2 percent underemployment (NESG 2019).
[32] International Survey of Revenue Administration. IMF, 2018.

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# PUBLIC SPENDING

# 3.1 General government spending: Too low to serve citizen's needs and equip them for a productive future

## Nigeria's overall public spending is among the lowest in the world and has declined over time

**Nigeria's development outcomes are among the lowest globally, indicating a great need for public spending.** Nigeria ranked 169th out of 174 countries on the Human Capital Index in 2020: school enrolment rates for primary and secondary education have remained flat over the past decade, at around 60 percent and 47 percent, respectively; over 36 percent of children under 5 years of age are stunted; and an average Nigerian can only expect to live up to 55 years, less than the Sub-Saharan African average of more than 61 years.[33] Infrastructure quality is also low, as Nigeria was ranked 132nd out of 137 countries on infrastructure in the Global Competitive Index in 2018. Nigeria's physical infrastructure gap is set to reach an estimated US$3 trillion over the next 30 years[34].

FIGURE 3.1. Very low revenues translate into…

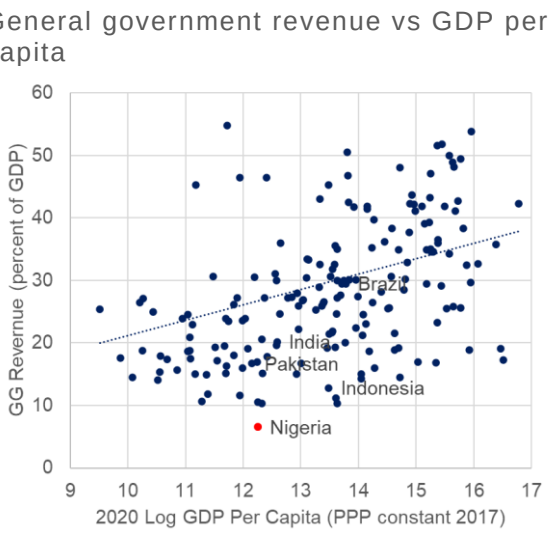
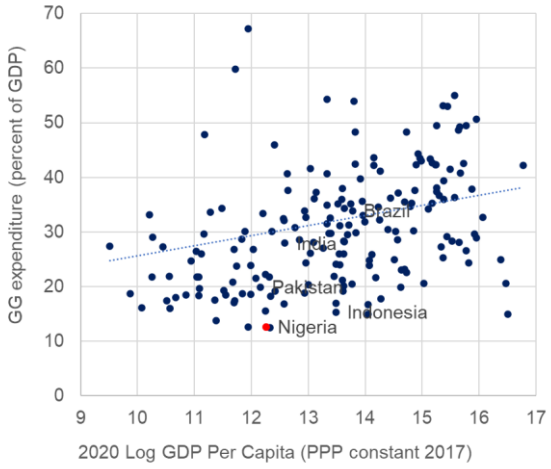



FIGURE 3.2. …very low levels of public expenditures




Sources: WDI and IMF

**Yet, at around 12 percent of GDP between 2016 and 2020, Nigeria features one of the lowest levels of public spending in the world—too low to meet its development needs and objectives.** Relative to structurally comparable countries (FIGURE 3.1 and FIGURE 3.2), Nigeria's spending levels in per capita terms were already the lowest before the 2015–2016 crisis, when they plummeted in parallel with collapsing oil revenues. Even when considering GDP per capita or regional circumstances, expenditure is strikingly low. Nigeria's public spending falls well below the average of the SSA region (17.2 percent of GDP) and that of countries with similar income

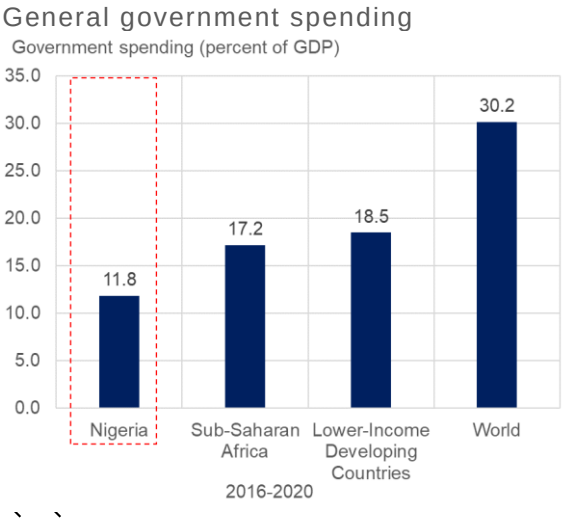
[33] DHS 2018, WDI 2019.
[34] Nigeria Integrated Infrastructure Master Plan

levels (18.5 percent of GDP) (FIGURE 3.3). To achieve its Sustainable Development Goals by 2030 and improve the quality of its citizens' lives, Nigeria needs to spend more, by at least 6 percentage points of GDP annually.

**Considering Nigeria's large and growing population, public spending is particularly low in per capita terms, and not only relative to the size of the country's economy.** With its population surpassing 200 million, Nigeria's national budget of nearly US$50 billion translates into a per person allocation of US$220[35] annually across federal and state governments. This is significantly lower than in comparator countries: for example, the Indonesian government in 2020 spent US$716 per capita, and the South African government spent approximately US$1,833 per capita.[36] In addition, most of the Nigerian resource envelope is devoted to keeping the government's administrative functions going, and the resulting per capita spending on human capital and infrastructure is low.

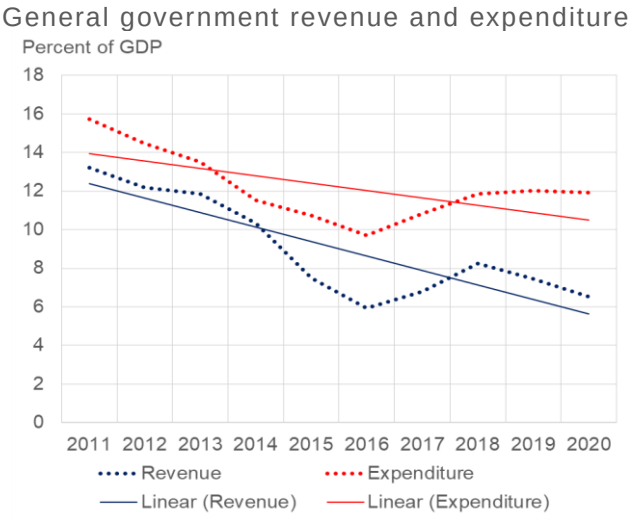
**Furthermore, total government spending has been declining over the past decade, driven by falling revenues.** General government expenditures decreased from 15.9 percent of GDP in 2011 to an estimated 11.9 percent in 2020 (FIGURE 3.4). The fall in oil prices and production that took place in 2015–2016 had a significant impact on the Nigerian economy and drastically reduced public revenues. This sharp fall in overall revenues constrained the fiscal space and put downward pressure on public expenditures.

FIGURE 3.3. Expenditure in Nigeria and comparable countries (percent of GDP)




Source: WEO.

FIGURE 3.4. Nigeria's General government revenue and expenditure (percent of GDP)




Sources: OAFG and BoF.

**Widening public deficits have helped stabilize the decline in expenditure, but at a high cost.** With declining revenues, deficits have increased during the last decade to help finance spending needs. The deficits rose from 1.7 percent of GDP in 2013 to above 5 percent of GDP by 2020 (FIGURE 3.5). The public and publicly guaranteed debt stock doubled during the decade, from 9.6 percent of GDP in 2010 to 36 percent of GDP in 2020[37]. Accompanied by rising effective interest rates, partly due to increasing monetization of the deficits, debt servicing costs have

[35] In current (2021) US$-equivalents, derived from naira values converted using the official exchange rate prevalent during the preparation of this report (₦410/US$). These values are budgeted, not actual spending.
[36] World Development Indicators (2021) and IMF Fiscal Monitor (October 2021).
[37] This figure includes public guarantees in addition to the public debt stock

placed increasing pressure on public spending—by 2020, interest payments consumed a fifth (20 percent) of general government actual spending, squeezing public investment in particular (FIGURE 3.6).

FIGURE 3.5. increasing deficits helped stabilized government spending but at a cost of accumulating public debt…

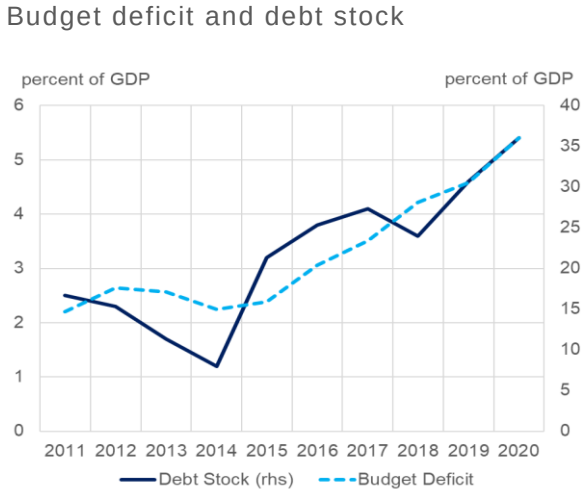
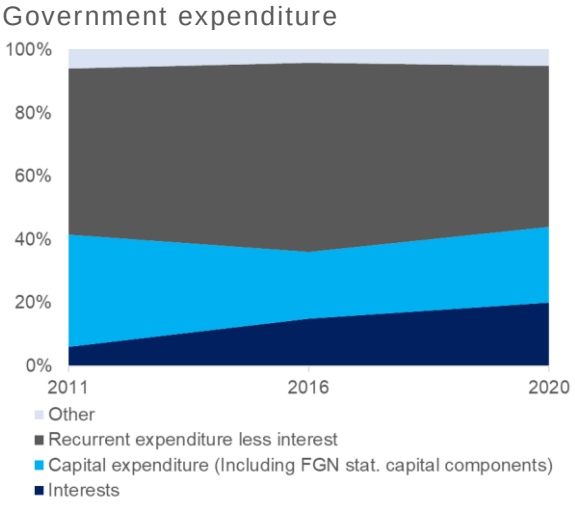



FIGURE 3.6. …with growing debt servicing cost squeezing the budget envelope for investment and service delivery




Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates

## Public expenditure is primarily used for running the government administration

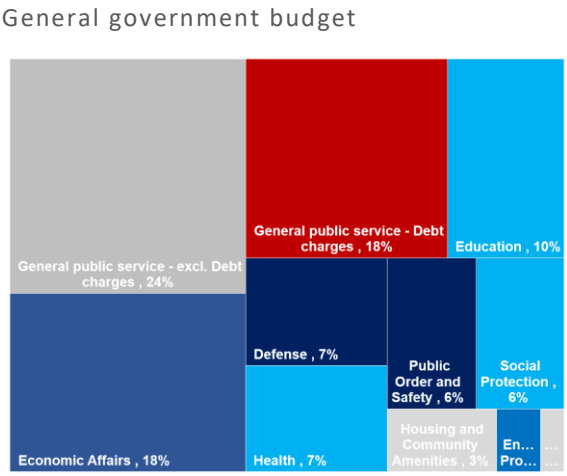
**Most of the national budget[38] is allocated to administrative functions**. The single largest allocation in the general government budget in 2021—equivalent to 42 percent of the budget, or 4.9 percent of GDP—was devoted to general government functions, which include general government administrative functions (24 percent of total budget, 2.8 percent of GDP), as well as debt servicing (18 percent, 2.1 percent of GDP) (FIGURE 3.7 and FIGURE 3.8). After accounting for allocations to economic affairs[39] (18 percent of total budget, 2.2 percent of GDP), public order and safety (6 percent, 0.7 percent of GDP) and defense (7 percent, 0.8 percent of GDP),[40] the budget envelope for key social spending is very limited. In 2021, 10.1 percent of the national budget (1.2 percent of GDP) was allocated to education, 6.6 percent (0.8 percent of GDP) to health, and 5.8 percent (0.7 percent of GDP) to social protection.

- General public services (excluding debt charges) is the single largest component of spending at both the federal and state levels. As public debt is primarily contracted by the federal government, debt servicing is primarily reflected in the federal government budget.

[38] Proxied by the federal and 36 state budgets.
[39] Economic affairs captures spending on core infrastructure (transport, communications); state support to mining, manufacturing and construction; spending on agriculture; and general economic, commercial and labor affairs.
[40] Combined spending on defense and public order and safety is equivalent to 13 percent of federal government spending, in part reflecting the high incidence of conflicts in Nigeria (insurgency in the North-East, farmer-herder disputes in the middle belt, and oil-related conflicts in the South).

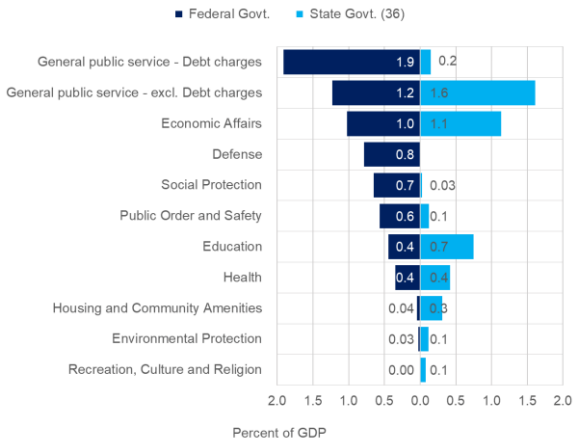
- Economic affairs, which captures broad investments in agriculture and key infrastructure, is split between tiers of government, highlighting the need for cross-tier coordination (for example, on planning federal vs. state roads to avoid duplication).

FIGURE 3.7. General government (federal and state) budgets across sector across government functions (percent of total national budget) 2021




Source: World Bank estimates using Federal Government and 36 State Government Budget 2021
Note: Estimates exclude FCT, Local Governments, FG GOEs, and Extrabudgetary Funds receiving Federation Account Allocations.

FIGURE 3.8. Federal and state budgets across sector across government functions – budgeted amounts (percent of GDP) 2021




Source: World Bank estimates using Federal Government and 36 State Government Budget 2021
Note: Estimates exclude FCT, Local Governments, FG GOEs, and Extrabudgetary Funds receiving Federation Account Allocations.

- As defense is a sole responsibility of the federal government, no budget allocations are made for it at the state level. Similarly, social protection is primarily a federal responsibility, which is reflected in budget allocations.
- Key social spending responsibilities, including health and education, are split between the federal and subnational governments, as reflected by their spending allocations. State governments dominate in education spending, as they have the key responsibility for basic and secondary education (the latter of which is shared with the federal government); federal allocations focus on tertiary education and national coordination funds. Health responsibilities and spending are similarly shared.

## Social spending is too low to close gaps in human capital

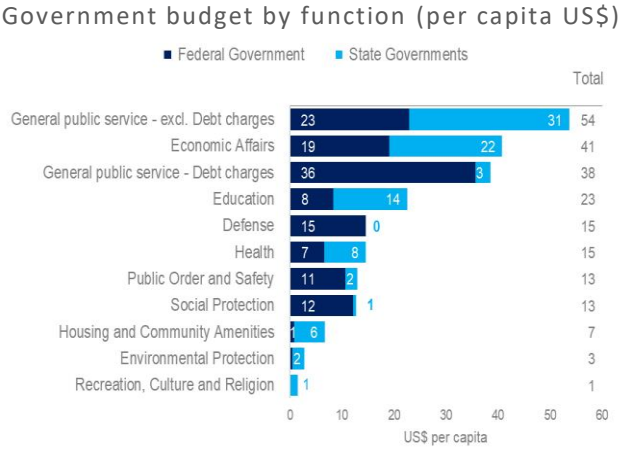
**Nigeria's social spending is insufficient (both in absolute terms and as a share of budgetary resources) to ensure human capital growth and convergence with other middle-income economies.** The social sectors (health, education, social protection) receive only allocated about a quarter of the national budget. In 2021, an average Nigerian could have expected to receive up to US$15 worth of public health services per year[41]—at a time when the country was battling the COVID-19 pandemic (FIGURE 3.9). This allocation includes all capital investments, salaries for healthcare personnel, and procurement of medicines and vaccines. In Indonesia, the comparable figure is US$55 per person annually—more than three times as much as in Nigeria. As a result, more than 70 percent of Nigeria's health expenditure is out-of-pocket

[41] As proxied by allocations across federal and state government budgets.

(more than twice as much as in Indonesia), potentially excluding many of the poor from accessing even basic health services. The budgetary allocation to education is similarly low, equivalent to US$23 per person per year. (FIGURE 3.9FIGURE 3.9). The subnational governments—particularly, the states—are on the front line of basic service delivery; beyond the low averages, there is substantial variation across states in social spending and social development outcomes.

**Nigeria's spending on any specific social function is significantly lower than the corresponding allocations by its peers.** FIGURE 3.10 and FIGURE 3.11 show general government spending allocations for Nigeria compared with those of two structural peers: Indonesia (a large, lower-middle income oil exporter like Nigeria) and South Africa (an upper-middle income country and Nigeria's regional peer). Figures are reported as a percentage of national GDP and as a percentage of general government spending, respectively.[42] Nigeria's allocation to education from the general government budget (equivalent to 1.2 percent of GDP) is less than half that of Indonesia's (2.9 percent of GDP) and less than a sixth of South Africa's. Similarly, Nigeria's public expenditures on health (0.8 percent of GDP) are much lower than Indonesia's (1.3 percent of GDP) and South Africa's (5.1 percent of GDP).

FIGURE 3.9. Federal and state budgets 2021 across government functions – budgeted amounts per person (US$ dollars per person)




Source: World Bank estimates using Federal Government and 36 State Government Budget 2021
Note: Estimates exclude FCT, Local Governments, and Extrabudgetary Funds receiving Federation Account Allocations.

[42] Nigerian estimates are based on budgeted figures due to a lack of actual spending data. Figures for Indonesia and South Africa reflect actual spending.

FIGURE 3.10. General government expenditure by functional classification, 2015-2019 (as a share of GDP)

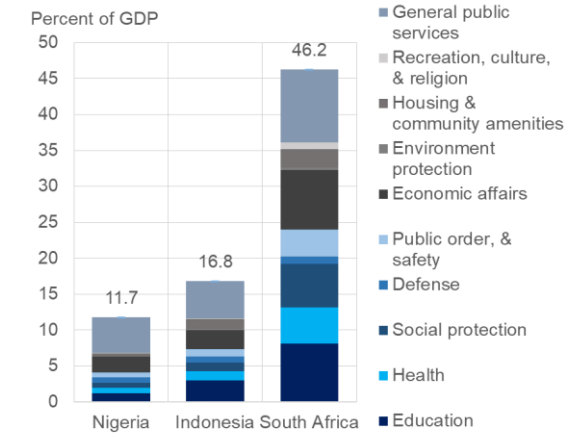
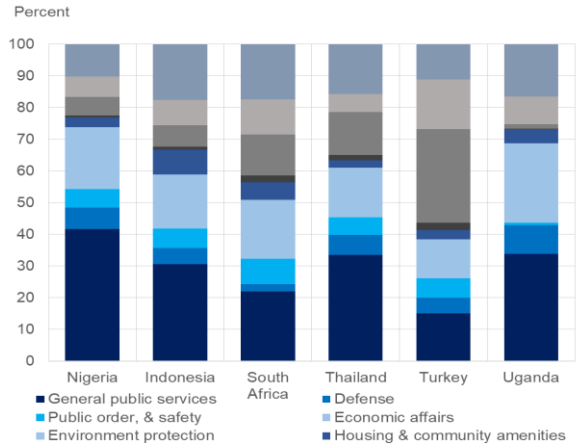



FIGURE 3.11. General government expenditure by functional classification, 2015-2019 (as a share of total)




Sources: For Nigeria, World Bank estimates using Federal Government and 36 State Government Budget 2021. For Indonesia and South Africa, IMF GFS database (2015-2019).
Note: Nigerian estimates exclude FCT, Local Governments, FG GOEs, and Extrabudgetary Funds receiving Federation Account Allocations. Nigerian estimates are based on budgeted figures due to lack of actual spending data availability; Indonesia and South Africa figures reflect actual spending.

TABLE 3.1. Nigeria General Government budget allocation (2021)

| General Government budget allocation | percent of GDP | In Naira billion | US$ billion | percent of total GG Budget |
|---|---|---|---|---|
| General Public Service | 4.9% | 8,523 | $20.8 | 41.7% |
| General public service - Debt charges | 2.1% | 3,587 | $8.7 | 17.6% |
| General public service - excl. Debt charges | 2.8% | 4,936 | $12.0 | 24.2% |
| Defense | 0.8% | 1,363 | $3.3 | 6.7% |
| Public Order and Safety | 0.7% | 1,200 | $2.9 | 5.9% |
| Economic Affairs | 2.2% | 3,757 | $9.2 | 18.4% |
| Environmental Protection | 0.1% | 247 | $0.6 | 1.2% |
| Housing and Community Amenities | 0.4% | 615 | $1.5 | 3.0% |
| Health | **0.8%** | 1,341 | $3.3 | 6.6% |
| Education | **1.2%** | 2,073 | $5.1 | 10.1% |
| Social Protection | **0.7%** | 1,183 | $2.9 | 5.8% |
| Recreation, Culture and Religion | 0.1% | 135 | $0.3 | 0.7% |
| **Grand Total** | **11.7%** | **20,437** | **$49.8** | **100%** |

Source: World Bank estimates using Federal Government and 36 State Government Budget 2021
Note: Estimates exclude FCT, Local Governments, FG GOEs, and Extrabudgetary Funds receiving Federation Account Allocations. Data reflects budgeted amounts; actual execution amounts not available for 2021 at the time of production of this report.

BOX 3.1. First National Budget Estimates

NIGERIA'S FIRST NATIONAL BUDGET ESTIMATES

**This PFR presents the first national budget estimates across functions and tiers of government in Nigeria.** While estimates of aggregate general government spending have been available for the last decade (see World Bank and IMF macro monitoring publications), thanks to data on government spending by economic classification, the composition of spending across government functions remained unavailable. Challenges at both the federal and subnational levels prevented this analysis:

- Federal government budgets have been broadly aligned with the National Chart of Accounts (NCOA), allowing a classification of budget allocations across core government functions—as defined in the UN Classification of the Functions of Government (COFOG).[43] However, until recently, actual spending figures (budget execution) for these compositions have not been available. Since 2018, the Office of the Accountant General has been publishing actual spending figures for the federal government, providing insight into actual spending composition at the federal level.
- The budgets of the 36 states and the Federal Capital Territory followed different formats and were not aligned with the NCOA, preventing a holistic understanding of spending composition at the subnational level. In 2021, in fulfillment of the SFTAS program requirements, the state governments aligned their budgets with the NCOA. This allowed the World Bank team to systematically map the budget allocations of all 36 state governments to their Ministries, Departments and Agencies across COFOG-consistent functional categories, thus establishing national budget allocations across government functions.

**The 2021 NCOA-aligned federal and state government budgets were leveraged to produce estimates of national budget allocations.** Although these estimates remain an approximation—local governments (10% of general government spending), extrabudgetary funds receiving FAAC allocation (5%), and the FCT are still excluded—this is the first time that data advances and Public Financial Management improvements make such estimates possible (TABLE 3.1). An additional caveat is that these estimates pertain to budgeted amounts, but budget implementation issues remain.

## Nigeria's public expenditures are heavily skewed towards recurrent spending, especially personnel costs and debt servicing

**Nigeria's public expenditures are heavily skewed towards recurrent spending**. Between 2011 and 2020, about 70 percent of total government spending was recurrent (FIGURE 3.12 and FIGURE 3.13). Most of it, on average 56 percent, was non-debt spending, to cover salaries (on average 30 percent of government resources), overhead costs, and some budgetary transfers. Recurrent debt expenditures averaged 13 percent of total government spending over the decade.

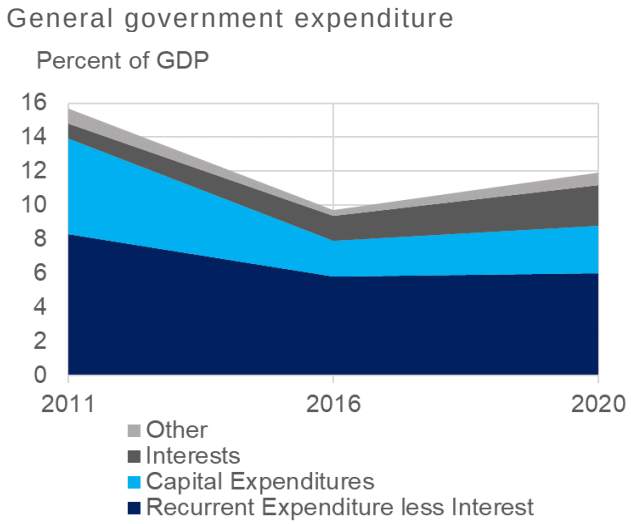
**The evolutions of the fiscal deficit and debt stock in a high-inflation context have brought about a marked increase in recurrent debt expenditures.** Interest costs of servicing the public debt went from 0.9 percent of GDP at the beginning of the decade (and 6 percent of total expenditure) to 2.4 percent of GDP (or 20 percent of total spending) in 2020.

**Recurrent non-debt expenditures—spending on personnel and overheads—relative to GDP have declined since the early 2010s, in parallel with the overall decline in public spending**. Personnel costs decreased relative to GDP as the federal government capped the wage bill, introduced and implemented International Public Sector Accounting Standards (IPSAS), and took steps to remove ghost workers from the payroll. Nevertheless, set against

[43] As defined in the UN Classification of the Functions of Government (COFOG).

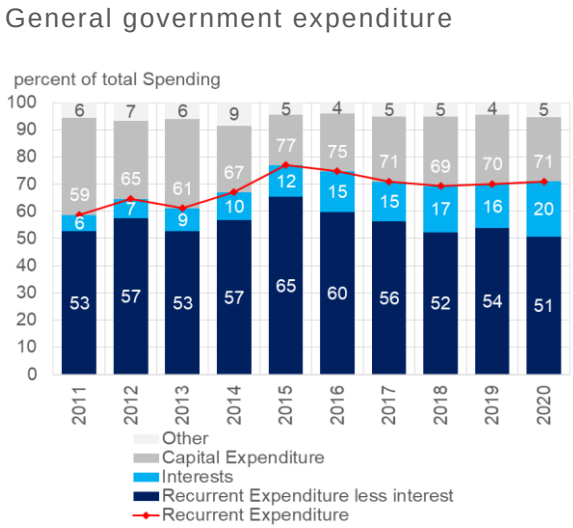
lower total spending, the civil servant compensation envelope absorbed a higher share of total expenditures, rising from 28 percent of total expenditures in 2011 to 33 percent in 2020.

FIGURE 3.12. General government expenditure by economic classification (percent of GDP)




Source: OAGF

FIGURE 3.13. General government expenditure by economic classification (percent of total)




Source: OAGF

**Relative to comparable countries, Nigeria's general government spending on personnel is lower in proportion to GDP but consumes a greater share of government resources.** The personnel costs of the Nigerian general government averaged 3.9 percent of GDP during 2015–2019 (FIGURE 3.14 and FIGURE 3.15). This was broadly comparable to Mexico, whose public salaries consumed the equivalent of 3.4 percent of GDP, but significantly below other comparable countries such as Indonesia or South Africa (5.4 and 12 percent of GDP, respectively). However, the burden of personnel costs on total expenditure in Nigeria was the highest among its peer countries, standing at an average of 36 percent during 2015–2019—slightly above South Africa and Indonesia, but significantly higher than in Kenya, Egypt, and Mexico.

FIGURE 3.14. GG personnel spending (percent of GDP) compared to other countries (average of 2015-2019)

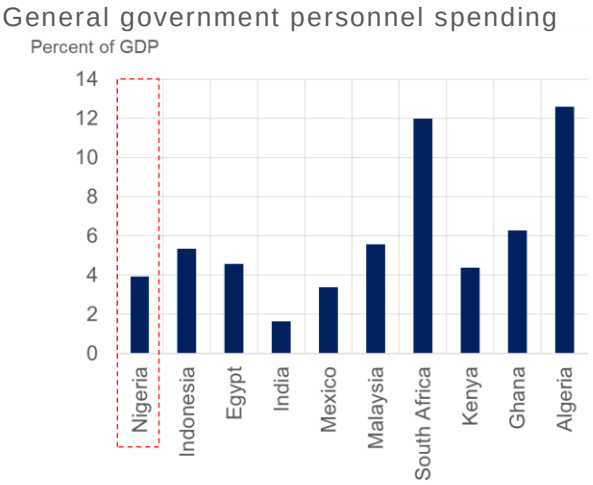
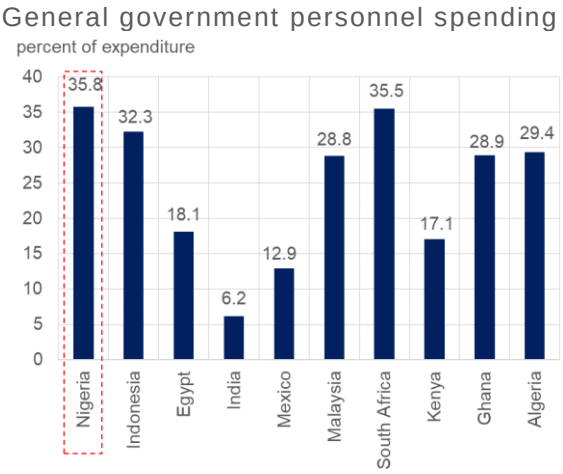



FIGURE 3.15. GG personnel spending (percent of expenditure) compared to other countries [average of 2015-2019]




Source: IMF article IV reports for selected countries.

**The increase in minimum wage in 2019 is expected to have had an impact on the government's personnel expenditure, especially at the subnational level.** In Nigeria, the minimum wage is not indexed to inflation but is negotiated every few years, often just before national elections. This can lead to sizeable periodic jumps in the public wage bill, as a significant portion of the civil service is paid the minimum wage or close to it. As Nigeria has limited revenues, this dynamic can also lead to personnel costs consuming a higher proportion of total expenditure and to wage compression between the higher and lower grades in the civil service, since the government has limited fiscal space to increase salaries and allowances for the higher grades.

BOX 3.2. Nigeria's minimum wage and possible impact on public wage bill

NIGERIA'S MINIMUM WAGE AND ITS IMPACT ON PUBLIC WAGE BILL

**The 2019 increase has brought the annual minimum wage to ₦360,000 (US$1,104), or the equivalent of about 50 percent of GDP per capita** (FIGURE B3.1). While in current US$ terms the Nigerian minimum wage is about 40 percent lower than the average for comparator countries (US$1,816), it tends to be higher in proportion to living standards.

**The minimum wage sets the floor for federal public sector pay, but the average public salary is 3.3 times higher**. According to the Consolidated Public Service Salary Structure issued by the National Salaries, Incomes and Wages Commission in 2019, the minimum federal civil service salary is set to the minimum wage. The median civil service annual wage (as per the pay matrix, not based on actual remuneration) is ₦886,020 (US$2,718 per year), 2.5 times higher than the minimum wage and 1.2 times higher than GDP per capita (FIGURE B3.2). The median salary is close to Grade 7 salary, which is the lowest grade for the professional administrative segment of the civil service. In a single–earner household scenario, this would be sufficient to bring a family of five above the poverty line (US$2,108), but not to afford them the consumption standards of the average household. There is a wide range in the federal civil service pay scale. The highest salary established by the 2019 pay scale is ₦6,215,435 a year (US$19,066), nearly 17 times higher than minimum wage and about seven times the median public sector salary[44].

[44] Consolidated Public Service Salary Structure (CONPASS) per annum effective from 18th April 2019. This uses the federal government pay scale matrix as the basis for the calculation; state governments have their own salary scales. Actual public service salary payment data is not available. The salary data excludes other benefits.

**The minimum wage increase has had varying degrees of impact on salary envelopes across government tiers.** The Budget Office of the Federation estimated its immediate impact on the federal budget bill in 2020 to be limited, as most federal civil servants already received salaries above the new minimum wage.[45] However, the increase has posed a greater challenge at the state level. For example, Kaduna state government—one of the best performing state governments in Nigeria on fiscal management—has increased its personnel spending envelope by 30 percent in its amended 2020 budget, relative to the original 2020 budget which was passed before accounting for the rise in the minimum wage. With inflation (particularly on food) accelerating in 2020–2021, political pressure to further increase the minimum wage has been building up.

FIGURE B3.1. Nigeria's minimum wage compared to other countries (% of GDP per capita, 2019 average, annual values' labels also report values in current US$)

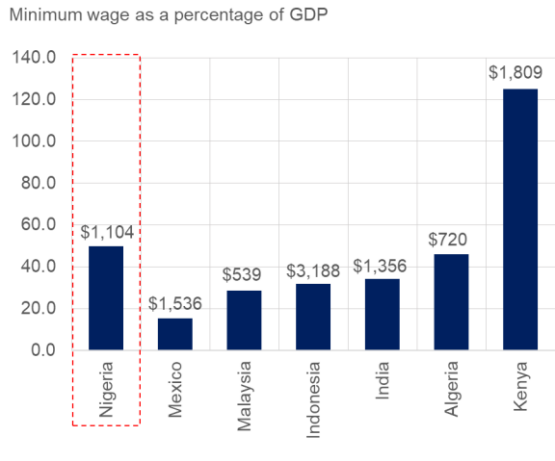
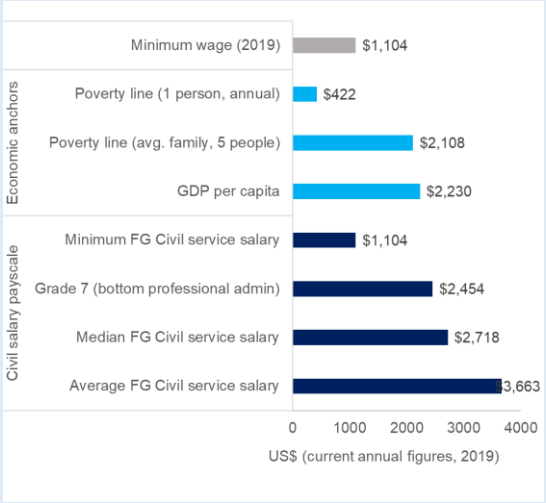



FIGURE B3.2. Nigeria's (annual) minimum wage compared to living standards, poverty line and civil service payscale




Source: World Bank estimates using *National Bureau of Statistics, National Salaries, Incomes, and Wages Commission,* http://www.salaryexplorer.com/salary-survey.php?loc=158&loctype=1

## Declining resources and rigid costs for personnel and debt servicing have squeezed public investment

**The decline of public expenditure, and the changes in its structure, have been characterized by the reduction of capital investments—the least prioritized spending category.[46]** Personnel expenditure and interest payments remain non-discretionary items, which the governments—federal and state—have limited room to adjust in the short term. Despite increases in the minimum wage, recurrent non-debt spending has remained broadly stable, thanks to improving basic Public Financial Management practices; however, the rising interest bill

[45] Source: Kaduna State Government Explanatory Note for the Revised 2020 Budget Assumptions/Projections and Expenditures (part of 2020 Amended Budget Documentation): "The increase of Personnel Cost from N36.3 billion to N47.3 billion is as a result of the review of the Personnel Cost to capture the Thirty Thousand Naira (₦30,000) Minimum Wage."

[46] This section is based on actual general government (all tiers) spending data and on estimates by economic classification, while the previous section was based on budgeted amounts by functional classification at the national level, as proxied by federal and state government budgets. This difference explains certain discrepancies in absolute figures and percentage shares across these sections.

has squeezed the fiscal room for capital investments. Capital expenditures collapsed from over 4 percent of GDP in 2011 to as low as 2 percent of GDP at the height of the 2015–2016 fiscal crisis, recovering only slightly to 2.8 percent of GDP in 2020 (FIGURE 3.16 and FIGURE 3.17). This represents a reduction of almost 50 percent in capital expenditures-to-GDP since 2011, while interest payments have doubled over the same period. Public investment also declined as a share of total expenditure, from 36 percent in 2011 to 24 percent in 2020.

FIGURE 3.16. General government expenditure by economic classification in 2011 (as percent of GDP and percent of total)

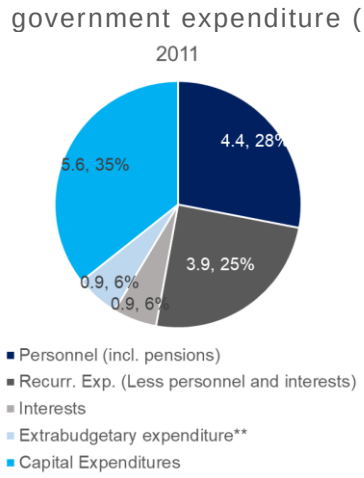
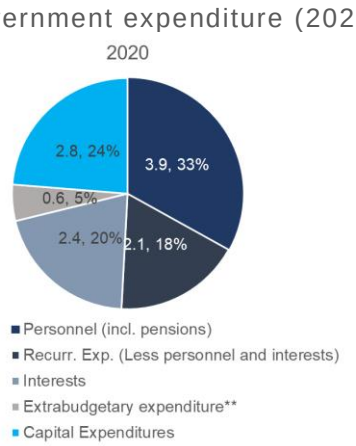



FIGURE 3.17. General government expenditure by economic classification in 2020




Sources: World Bank using OAGF, DMO, CBN, State Audited Financial Statements and other official figures.
Note: 2020 data are estimates.

## Nigeria's public investment is insufficient to close the infrastructure gap

**At an average of 2.6 percent of GDP annually, Nigeria's public investment is too low to plug the large and growing infrastructure gap.** Although Nigeria's capital expenditures as a percentage of total expenditure are relatively high compared to peer countries, they are among the lowest in terms of GDP. Compared to structurally similar countries, Nigeria has similar levels of overall investment, at 22.8 percent of GDP in 2015–2020. Yet, Nigeria stands out for the low share of government investment within capital formation. (FIGURE 3.18).

**At current levels of public investment (not including Public Private Partnerships and other private sector investments) it would take 300 years to close Nigeria's infrastructure gap.**[47] The infrastructure gap is set to reach an estimated US$3 trillion by 2050 and closing it would require annual investments of US$100 billion (twice the entire national annual budget), compared to US$11billion in general government capital expenditure in 2020.

**The infrastructure gap, estimated to cost up to 4 percent of GDP growth annually, reduces profitability and discourages private investment, particularly through a lack of reliable power supply and shortcomings in transportation, irrigation, and access to water and sanitation**. Unreliable power supply is arguably the most critical deterrent to private sector development in Nigeria: most households and businesses receive less than five hours of power

[47] This illustration does not take into consideration additional infrastructure gaps potentially arising between 2050 and 2320.

per day, and only 60 percent of Nigerians have access to electricity, well below the average of 86 percent in LMIC. Nigeria's average annual electricity consumption per capita (147 kWh) is around one-fifth of the average for LMIC.[48] There are also major gaps in transportation, irrigation, and water and sanitation. Only 30 percent of roads are paved (compared with 50 percent in LMIC) and only 1 percent of croplands are irrigated. Strikingly, 30 percent of Nigeria's population lacks access to basic drinking water supply, and 56 percent lacks access to basic sanitation service.[49] These shortcomings are starkly evident in the agricultural sector, where annual post-harvest losses are estimated at around 10 percent of the value of domestic production due to inadequate power supply, storage, transportation and irrigation infrastructure.[50] A combination of private- and public-sector investment is required to close these gaps, and a more consistent policy framework will be required to tap this potential.

**Since the 2015–2016 fiscal crisis, capital investments have fallen and remained below the overall deficit levels.** The government, by law (the Fiscal Responsibility Act, 2007), is only permitted to borrow to fund capital investment and human development. In 2011–2014, the deficits were lower than capital investment, indicating that government primarily borrowed to fund public investment. Since the 2015–2016 fiscal crisis, the revenue envelope has no longer been sufficient to fund all recurrent expenditures (FIGURE 3.19). Despite capital investment levels falling, the deficits systemically exceeded capital expenditures. The federal government is the primary driver: as in most federal countries, it carries out the central government's mandated functions to provide national infrastructure, national defense, and public safety.[51] As such, apart from financing the army and security apparatus, the federal government is tasked with plugging much of the national infrastructure gap, to develop connectivity within Nigeria and link it with its key neighbors, trading partners and markets. The federal government contracts the largest portion (about three quarters) of the public debt, and therefore most debt servicing costs.

[48] SE4ALL Global Tracking Framework, https://www.worldbank.org/en/topic/energy/publication/Global-Tracking-Framework-Report

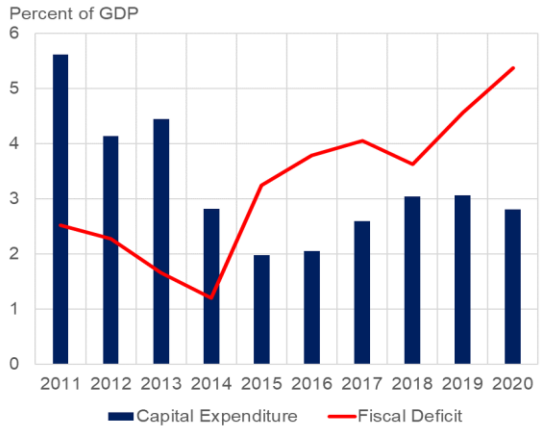
[49] 2019 Federal Ministry of Water Resources Water, Sanitation, Hygiene National Outcome Routine Mapping (WASHNORM 2019)

[50] http://www.fao.org/platform-food-loss-waste/flw-data/en/

[51] The federal government is the sole tier responsible for: defense; shipping; federal trunk roads; aviation; railways; posts, telegraphs and telephones; police and other security services; regulation of labor, interstate commerce, telecommunications; mines and minerals; social security; insurance; national statistical system; national parks; guidelines for minimum education standards at all levels; water resources affecting more than one state.

FIGURE 3.18. Although government should only borrow primarily for capital investment deficits systemically exceed public investment

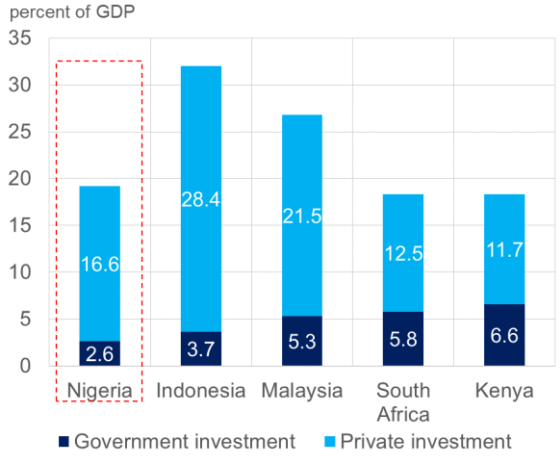
Capital expenditure and fiscal deficit




Sources: OAGF, DMO, CBN and State Audited Financial Statements
NOTES: 2020 data are estimates.

FIGURE 3.19. Nigeria's public investment is low, too low to fill the infrastructure gaps (2016-2019)

Government investment and private investment




Sources: OAGF, DMO, CBN, State Audited Financial Statements and IMF Article IV data.

## The federal government accounts for a large and growing share of general government spending

**The federal government dominates Nigeria's public expenditures, being responsible for over half of general government spending.**[52] In 2020, federal government spending was equivalent to 6.6 percent of GDP and to 55 percent of general government actual spending (11.9 percent of GDP). The 36 State governments and the FCT are estimated to have collectively spent 3.6 percent of GDP, or about 30 percent of general government spending. Collectively, the 774 local governments' public expenditures are estimated at 1.1 percent of GDP (about 9 percent of total government spending). Extrabudgetary funds receiving allocations from the federation (FAAC) revenues have estimated expenditures of 0.6 percent of GDP, equivalent to the remaining 5 percent of general government expenditures (FIGURE 3.20 and FIGURE 3.21).

**Over the last decade, public expenditures have slightly shifted from states and local governments towards the federal government, reflecting the latter's greater ability to finance widening deficits.** During the first part of the decade, the federal government was responsible for 42 percent of expenditure, while state and local governments administered 54 percent of the aggregate spending (38 and 16 percent, respectively). The fall in revenues that took place in 2015–2016, which mostly impacted federation revenues shared through fixed formulae, affected all levels of government. Yet, the federal government had more access to—and a stronger legal basis for—borrowing, both domestically and externally, which enabled it to finance its rising deficits. In the second part of the decade, the federal government increased its share of expenditure to over 50 percent, while state and local governments fell to a combined average of 42 percent (32 and 10 percent respectively).

[52] While the previous section on functional spending estimates used budget data, this section references actual public spending data.

FIGURE 3.20. Expenditures by tier of government as share of GDP…

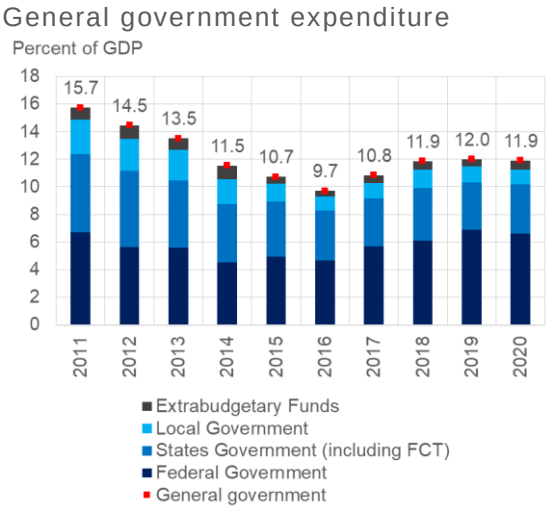
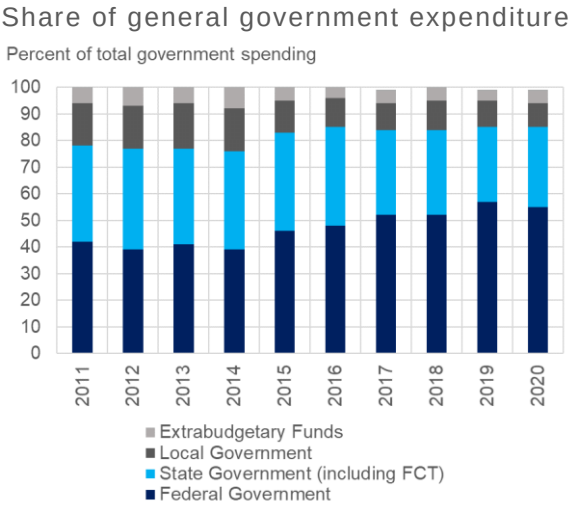



FIGURE 3.21. ...and as percentage of total spending




Sources: OAGF, NBS, and state financial statements.

# 3.2 Federal government spending

## Core government functions and key challenges

### The federal government's mandate focuses on national infrastructure, but its fiscal management leaves little room for effective implementation

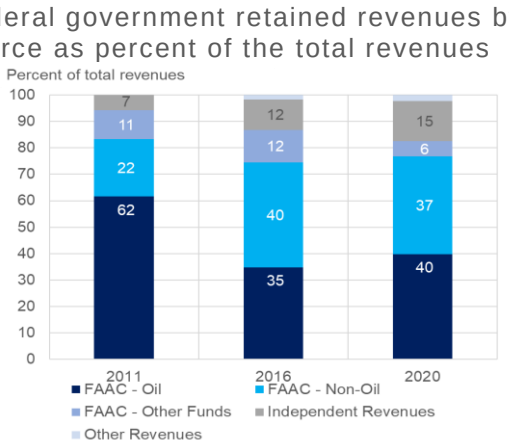
**As in most federal countries, in Nigeria the federal government fulfills the central government's mandated functions of providing national infrastructure, national defense, and public safety.**[53] Apart from financing the army and security apparatus, the federal government is tasked with plugging much of the national infrastructure gap, in order to develop connectivity within Nigeria and link it with its key neighbors, trading partners and markets. This mandate spans aviation, ports, railways, national roads and highways, and other infrastructure core to the country's connectivity. Although core basic service delivery is largely devolved to state and local governments, the federal tier remains responsible for setting minimum education standards, and shares responsibilities in providing health, social welfare services and post-primary education with state governments. Notably, the federal government manages and distributes shared resources for education through the Universal Basis Education Fund, and health services through the Nigeria National Health Insurance Scheme.

**The federal government, as the other tiers of government, is largely dependent on federation revenues; therefore, its revenue decline follows that of federation revenues, with some important differences.** More than 80 percent of the federal government's revenue envelope comes from federally collected and shared revenue pools (oil and non-oil) (FIGURE

[53] The federal government is the sole tier of government responsible for: defense; shipping; federal trunk roads; aviation; railways; posts, telegraphs and telephones; police and other security services; regulation of labor, interstate commerce and telecommunications; mines and minerals; social security; insurance; national statistical system; national parks; guidelines for minimum education standards at all levels; water resources affecting more than one state. Other federal mandates overlap with those of subnational governments.

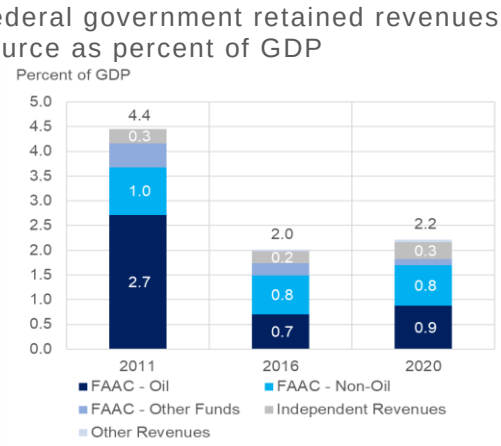
3.22).[54] As federally collected oil and non-oil revenues are shared using a fixed formula, the decline of federal government revenue from these sources has mirrored general government revenue trends, while the federal share of general government revenues has remained relatively stable (FIGURE 3.22 and FIGURE 3.23). However, in one of the few areas where the federal government has made impactful reforms—the VAT regime—it has benefitted the least, as it retains only 14 percent of VAT receipts. Moreover, while state governments have started increasing their independently collected revenues with the support of the SFTAS program, progress at the federal level has been slower on this front. Overall, in the decade between 2011 and 2020, the federal government's revenue envelope halved, from 4.4 percent to 2.2 percent of GDP (FIGURE 3.23).

FIGURE 3.22. Federal government is highly dependent on federally collected (FAAC) revenues.




Sources: OAGF and DMO

FIGURE 3.23. Federal government maintains a stable share in total government revenues, has not been able to significantly increase its independently collected revenues




Sources: OAGF and DMO

**The federal government stabilized its spending at about 6 percent of GDP, despite declining revenues, by substantially increasing deficit funding.** Equivalent to nearly 7 percent of GDP in 2011, federal government expenditures contracted to less than 5 percent of GDP during the oil price shock of 2014–2016 (FIGURE 3.24) Since then, they have been recovering again towards 7 percent of GDP, increasingly fueled by deficit financing (FIGURE 3.25). Supported by its greater ability to raise financing (due to a favorable legislative framework, higher deficit limits, and the option of obtaining direct financing from the central bank) relative to subnational governments, the federal government's share of total government spending has increased over time, from 42 percgroent of total expenditures in 2011 to an estimated 55 percent in 2020.

[54] Revenue collection responsibilities are clearly assigned across the federation and individual tiers of government. The federal government receives 48.5 percent of federally collected (FAAC) revenues and 14 percent of VAT receipts. Additionally, it can collect independent revenues, such as personal income tax from federal employees, and retain a share of operating surpluses of Government-Owned Enterprises (GOEs). Over the last decade federal independent revenues have remained low, at about 0.2–0.3 percent of GDP, contributing a small share (10 percent) of the federal government's total retained revenues.

FIGURE 3.24. FG total expenditures fluctuate with fiscal crises but increases as a share of total government spending…

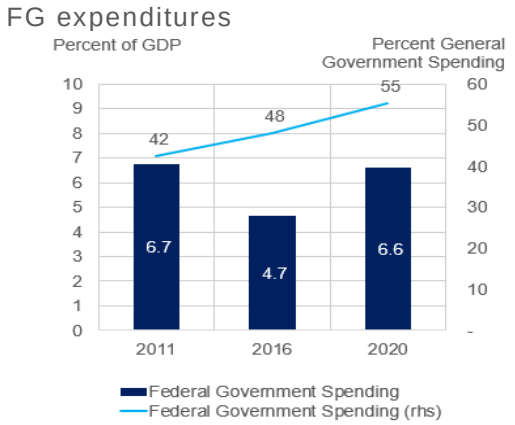
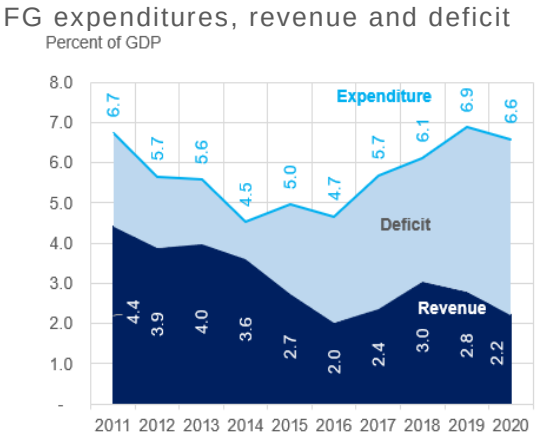



FIGURE 3.25. …while increasing deficits helped stabilize federal government spending levels




Sources: OAGF and DMO,.

Note: Expenditures include off-budget electricity subsidy.

**On the other hand, rising debt and over-reliance on the monetization of the deficit (through financing from the central bank) have rapidly increased interest payments and their burden on public resources.** Federal government deficits increased from an average 1.8 percent of GDP in 2011–2015, to an average 3.5 percent of GDP in 2016–2020, exceeding 4 percent of GDP in 2019–2020. Since 2017, the deficit has systematically exceeded the limit of 3 percent of GDP stipulated in the Fiscal Responsibility Act (FRA, 2007). The federal government debt stock (including estimated cumulative overdrafts from the central bank) has more than doubled, from 10 percent of GDP in 2011 to an estimated 23 percent of GDP in 2020 (FIGURE 3.26). Interest payments have increased accordingly, consuming 33 percent of the federal government's actual annual expenditure, equivalent to more than 60 percent of its retained revenues since 2016—with a new maximum of 98 percent interest-to-revenue ratio recorded during the COVID-19 crisis, due to a collapse in revenue (FIGURE 3.27). As the federal government contracts an increasing share of total government debt, its interest bill accounts for a correspondingly large share of general government interest payments.

FIGURE 3.26. With sustained and widening federal government deficits, the federal government debt stock has more than doubled

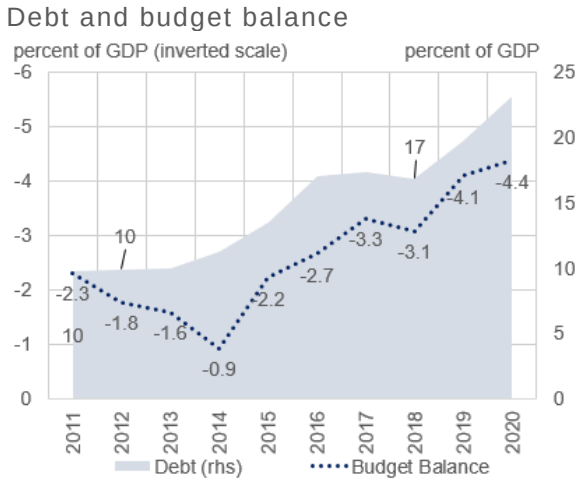
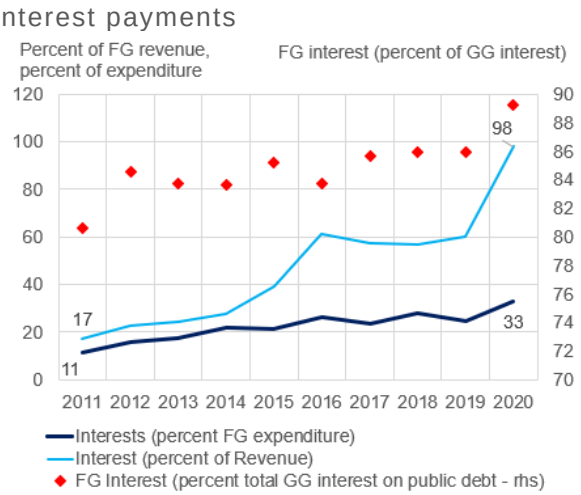



FIGURE 3.27. With debt rising in a high inflation environment, interest payments consume a growing share of federal expenditure and revenues




Source: OAGF, DMO.
Note: Federal Government debt stock includes estimated borrowing from the central bank.

## Spending trends and composition

### Federal government on-budget spending is skewed towards current expenditures, with debt service eroding the limited available fiscal space

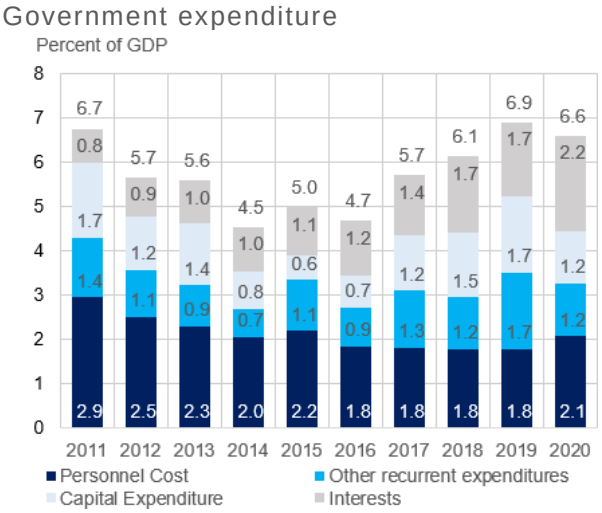
**Over the last decade, the composition of federal government expenditure has increasingly shifted towards recurrent spending, and particularly debt service.** While spending needs are high on both recurrent and infrastructural items, the increasingly limited fiscal space poses a challenge to Nigeria's development by undermining public investment. The federal government's total expenditure level in 2020 was broadly comparable to its 2011 level, but its composition has shifted radically (FIGURE 3.28), with an increasing share of fiscal resources consumed by growing debt service expenditures. This trend greatly diminishes gains from the rationalization of other categories of recurrent expenditure (including personnel), to the point that the share of expenditure allocated to capital investment declined from an already low 25 percent of total spending in 2011, to 18 percent in 2020 (dipping to 11 percent at the height of the fiscal crisis of 2016) (FIGURE 3.29).

**Throughout the last decade, 80 percent of federal government spending was allocated to recurrent expenditures.** The federal government, despite its core infrastructure mandate, devotes more resources to recurrent spending than the general government on average. The federal government dedicates about 30 percent of its total expenditure to debt servicing, and about 50 percent to recurrent non-debt expenditures. The key components of recurrent non-debt spending span personnel costs and overheads.

**Personnel costs have decreased over time, from nearly 3 percent of GDP in 2011 to 1.8 percent in 2017–2019.** Various reforms have contributed to this decline, including the introduction and implementation of International Public Sector Accounting Standards (IPSAS) and a reduction in ghost workers. The 2015–2016 fiscal crisis also played a role, as it revealed personnel

expenditure arrears amounting to 0.7 percent of GDP.[55] As the Fiscal Responsibility Act (2007) prevents the government from borrowing to cover current expenditures, these are settled as part of budgetary expenditure in service-wide votes.[56]

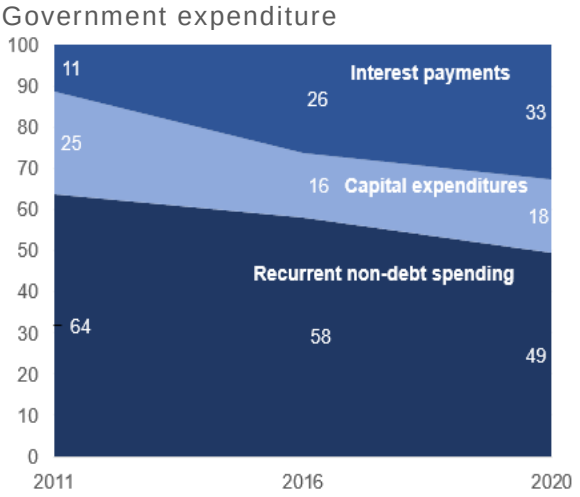
FIGURE 3.28. Federal government expenditures (percentage of GDP) 2011-2020




Sources: Word Bank Calculations using OAGF, DMO, and other authorities' data.

Notes: Expenditures include federal government budgetary expenditures, on and off-budget power sector subsidies; and exclude Government Owned Externprises. Fuel subsidies are not included, as they constitute a deduction from oil revenues and their fiscal burden is shared across tiers of government.

FIGURE 3.29. Spending composition has changed, with increasing debt service



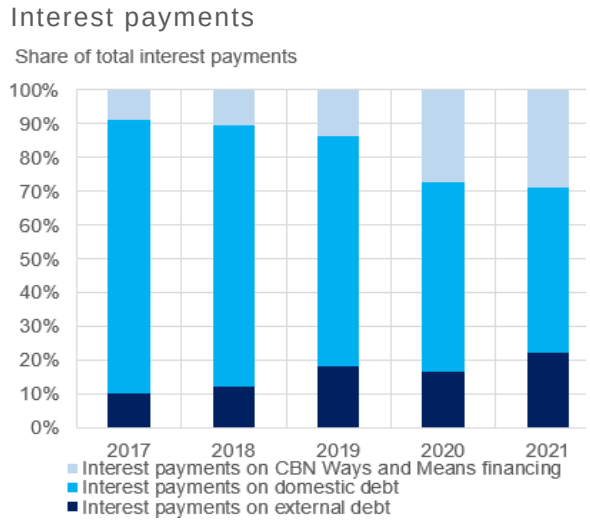

Sources: Word Bank Calculations using OAGF, DMO, and other authorities' data.

**Interest payments consume an increasing share of federal government spending—33 percent in 2020.** An accumulation of debt to finance widening budget deficits, combined with high nominal interest rates, has led to rising interest payments in both absolute and relative terms. Federal government interest payments on domestic and external public debt nearly tripled between 2011 and 2020: in 2011 they amounted to 0.8 percent of GDP, requiring 11 percent of federal government spending (FIGURE 3.30); while in 2020, when they also included interest on the central bank's overdraft facility, they amounted to 2.2 percent of GDP, or 33 percent of actual federal spending. Ways and Means financing from the CBN is amplifying the fiscal costs associated with interest payments, as CBN borrowing is more expensive than other domestic sources of financing and has shorter grace periods (FIGURE 3.31).

**Rising interest payments are squeezing the already limited fiscal space.** Since 2014, interest payments have exceeded federal government capital expenditures; and since 2016, they have consumed more than 50 percent of total federal government retained revenues. In 2020, the federal government's interest-payment-to-revenue rose to 98 percent. Federal government interest payments account for nearly 90 percent of the total general government interest bill.

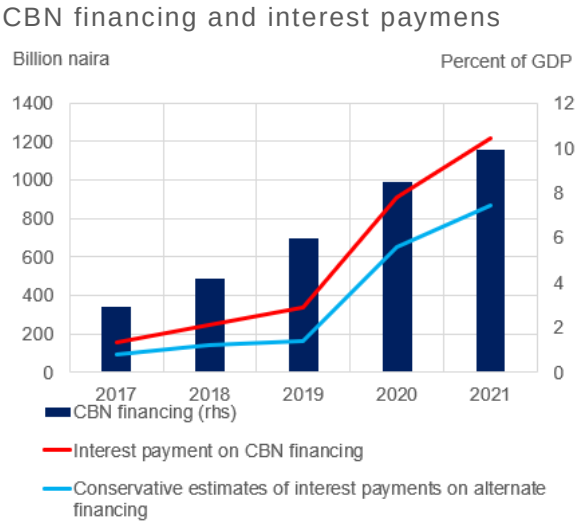
[55] IMF Article IV 2017
[56] Federal Government Budget documents.

FIGURE 3.30. Interest payments have consumed the majority of federal retained revenues, while interest payments on CBN financing have been increasing their share of total interest payments




Sources: CBN and DMO

FIGURE 3.31. CBN financing is growing, with the corresponding interest payments estimated to cost at least 1.5 times as much as other means of domestic financing




Sources: CBN, DMO and World Bank estimates

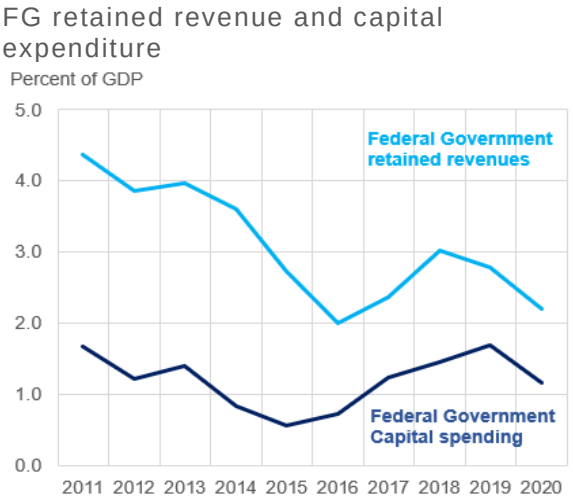
## Federal government investment is very low, compromising the government's ability to close core infrastructure gaps

**Federal government capital expenditures are low—equivalent to an average 1.2 percent of GDP annually over the last decade.** A de facto residual spending item, capital expenditures have fluctuated against a background of dipping revenues (FIGURE 3.32). During the 2015–2016 fiscal crisis, federal capital spending fell to 0.6 percent of GDP. Since 2015, the federal government has committed to allocating 35 percent of its budget to capital investments. Although budget allocations have largely followed this rule, challenges around budget implementation have led to a much lower share of actual spending being attributed to capital projects. Actual capital spending has averaged under 20 percent of total federal government expenditure, as a de facto cash rationing has prioritized recurrent expenditures.

**Since 2014, federal government capital investments have been lower than the deficits, as well as than federal interest payments on existing debt (**FIGURE 3.33**).** As the federal government is meant to only borrow to finance capital expenditure and human development, at concessional terms with low interest rates (per the FRA 2007), an unfortunate fiscal management paradox arises. The federal government is responsible for federal roads and highways, railways, and other infrastructure core to the country's connectivity, but its on-budget capital spending of US$5 billion per year is only equivalent to 5 percent of the annualized investments necessary to plug the country's infrastructure gap.[57]

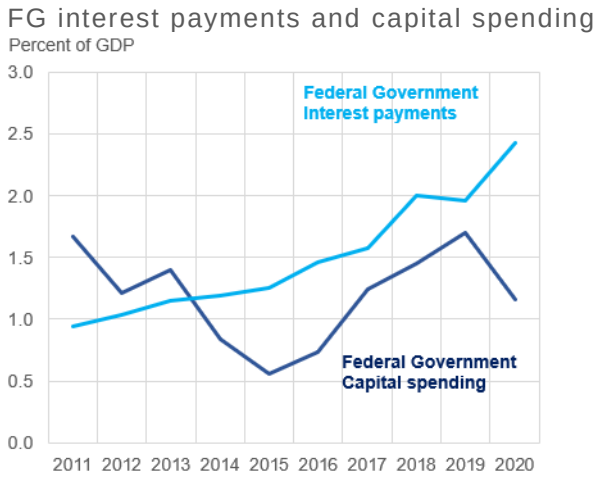
[57] Nigeria's total infrastructure gap is set to reach an estimated US$3 trillion over the next 30 years and addressing it would require annual investment of about U$100 billion. National Integrated Infrastructure Master Plan (prepared by the National Planning Commission) https://nesgroup.org/storage/app/public/policies/National-Intergrated-Infractructure-Master-Plan-2015-2043_compressed_1562697068.pdf

FIGURE 3.32. Federal government capital investments fluctuate in line with retained revenues, despite increasing deficits




Source: OAGF

FIGURE 3.33. Since 2014, federal government capital investments have been lower than federal interest payments on existing debt




Source: OAGF

**Public investment spending is not only low, but of low quality and lacks transparency**. The efficiency score of public investment in Nigeria is 77 percent away from the frontier and well below the scores of peer countries (IMF PIMA 2019)[58]. Furthermore, funding shortfalls and PFM/PIM challenges in capital budget implementation have generated a trend of priority projects being removed from the federal budget framework and diverted to private sector agencies, reducing spending transparency. These off-budget mechanisms have increasingly been applied to core power and roads projects.

## Federal social spending could double if subsidies were eliminated

**Actual federal spending across sectors does not reflect the federal government's mandated priorities.** Most federal resources go towards general government administration and debt service, restricting the space to deliver on core federal mandates (FIGURE 3.34).

- **A third of federal resources are consumed by core administrative functions:** General Public Services (excluding debt service) accounted for 32 percent of federal on-budget spending.
- Debt service—the remaining component of General Public Services—required 24 percent of federal government spending.
- **Combined spending on Defense and Public Order and Safety is equivalent to 18 percent** of federal government spending, reflecting a multiplicity of conflicts in Nigeria (insurgency in the north-east, farmer-herder disputes in the middle belt, and oil-related conflicts in the south). The federal government is solely responsible for all defense spending.
- Economic Affairs—under which much of the necessary infrastructure investment would fall—consumed only 12 percent of federal government resources (0.8 percent of GDP) and is systematically underfunded and deprioritized. Economic Affairs captures spending on core infrastructure (transport, communications; state support to mining, manufacturing and constructions); agriculture; and general economic, commercial, and labor affairs. Economic

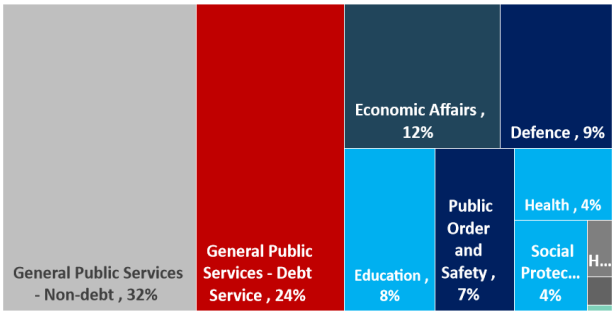
[58] Unpublished technical assistance report to the Federal Government.

Affairs is also among the poorest-performing functions in terms of budget implementation, with about 30–36 percent of planned expenditures executed (actually spent) in 2018–2019.[59]

**Only 12 percent of federal spending is allocated to health and education, and less than 4 percent to social protection**. In 2019, federal government spending on education—primarily tertiary, but also including Universal Basic Education (UBEC) transfers for basic education—received 8 percent of total actual budgetary expenditures, equivalent to 0.5 percent of GDP. Spending on health was equivalent to about half the education allocation: 4 percent of federal government total spending, or 0.3 percent of GDP. Although subnational governments hold the core service delivery mandate on health and education, the federal government nevertheless has an important role to play. It is solely responsible for developing guidelines for minimum education standards at all levels, and together with state governments it is responsible for delivering tertiary and secondary education, as well as health and social welfare expenditures. The federal government does not directly deliver primary education services, but its budgetary expenditures include statutory UBEC transfers to state governments, on matching grant principles. In the context of COVID-19 and other national health emergencies (e.g., the Ebola crisis), the federal government provides resources for vaccinations and other healthcare needs.

FIGURE 3.34. Spending on administrative functions and debt service dominates federal actual spending, leaving little room for infrastructure investment and social spending

Federal Government budgetary expenditures (actual) by function (as percentage of total FG budgetary expenditures), 2019

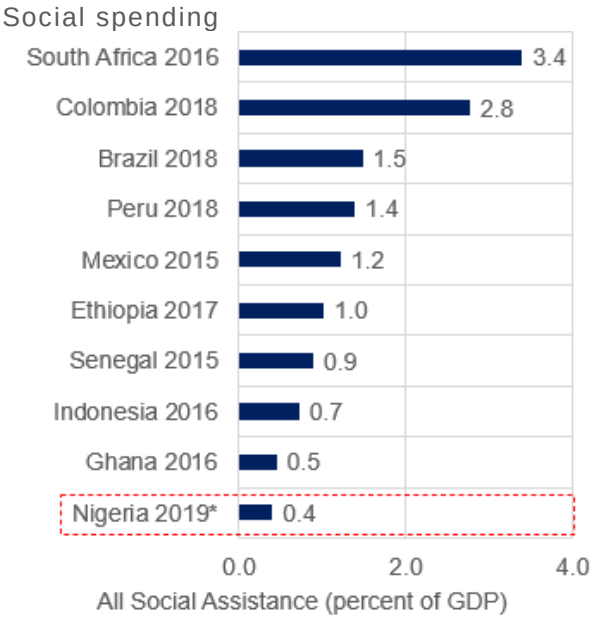



Sources: OAGF and DMO
Note: Unlabeled categories includes: Environmental Protection (0%); Recreation, Culture and Religion (0%)' and Housing and Community Amenities (1%).
Budgetary Expenditures (actuals 2019) collectively add up to 100 percent; Energy subsidies would add another 11 percent of total budgetary resources.

**The federal government holds the core responsibility for social security and insurance, but its spending is low despite great needs.** Even accounting for the Social Investment Program,[60] the allocation for social protection spending by the key tier responsible for it is very low (0.2 percent of GDP). Furthermore, even accounting for social protection spending across all tiers of government, Nigeria has the lowest social Protection spending across selected federal and regional comparators (FIGURE 3.35), despite high poverty rates (FIGURE 3.36). According to the 2018/19 National Living Standards Survey (NLSS), only 1.6 percent of Nigerians lived in a household enrolled in the National Social Safety Net Program, and the coverage of most other social protection programs was even lower.[61]

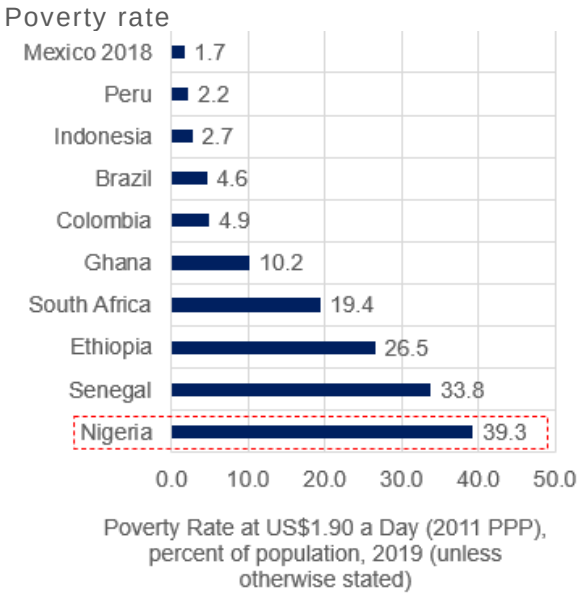
[59] WB calculations based on OAGF data.
[60] The 2019 social protection estimate by the government (OAGF report published on the Open Treasury Portal) includes spending by the National Commission for Refugees, Ministry of Humanitarian Affairs, Disaster Management and Social Development, and the National Emergency Management Agency. This reported number has been complemented to include the Social Investment Program, although only the recurrent component of the latter was traceable in OAGF fiscal reports.
[61] The only exception is the school feeding program: 20.1 percent of school-age children (11 million children) live in households receiving support from this program.

FIGURE 3.35. Government spending (all tiers) on social assistance programs, % of GDP, latest available year




Source: World Bank ASPIRE database, except for Nigeria (World Bank estimate based on OAGF data)

FIGURE 3.36. Poverty rate at $1.90 a Day (2011 PPP), percent of population (2019, unless otherwise stated)



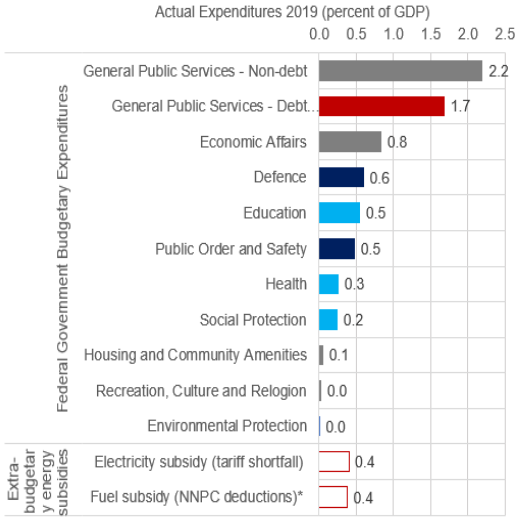

Source: World Bank Macropoverty Outlook

**Off-budget energy subsidies consume a high share of public resources.** Historically, energy subsidies arising from petrol and electricity price caps have not been on-budget, and thus have not been fully captured in government spending data.[62] In 2019, the direct costs of energy subsidies, including for petrol and electricity, were equivalent to about 11 percent of total federal government actual spending (FIGURE 3.37 and FIGURE 3.38), or 0.8 percent GDP. In fact, they were equivalent to federal spending on education and health combined, or nearly three times the federal expenditures on social protection. In 2020, electricity sector reforms were undertaken that resulted in the elimination of the electricity subsidy by early 2022. However, the petrol subsidy remains a growing drain on government resources.

[62] The cost of the electricity subsidy is reflected in the federal government actual spending estimates presented in this report. The cost of fuel subsidies, which are accounted for as a deduction from oil revenues, is not.

FIGURE 3.37. Federal government budgetary expenditures (actual) by function, and extrabudgetary energy subsidies (2019, percent of GDP)

FG expenditure

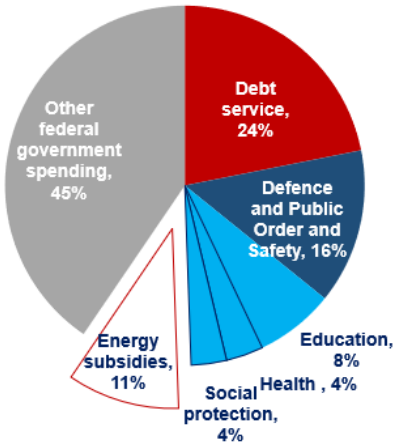



Sources: OAGF, DMO, NNPC, CBN

Notes: Functional classification as reported by the government (OAGF), with two exceptions: debt service and social protection. 1) Debt service is separated from general public service using DMO and OAGF Fiscal Accounts data. Debt service includes domestic and external interest payments, as well as payments on "ways and means" (overdraft form the central bank). 2) The Social Investment Program (recurrent) is reclassified as social protection from general public service. The petrol subsidy amount is as reported in NNPC publications for deductions for subsidy from oil revenues due to the Federation Account; as such, the cost of the subsidy is borne by all tiers of the federation (federal, state, and local governments). The federal share is equivalent to 48.5% of the total amount reflected in the chart for illustrative purposes.

FIGURE 3.38.Eliminating energy subsidies would allow to nearly double social spending: federal government budgetary expenditures (actual) by function, and extrabudgetary energy subsidies (as percentage of total FG budgetary expenditures), 2019

FG expenditure




Sources: OAGF, DMO, NNPC, CBN

Note: "Other federal government spending" includes environmental protection; recreation, culture, and religion; and housing and communicty amenities.

Budgetary expenditures collectively add up to 100 percent. Energy subsidies would add another 11 percent of total budgetary resources.

# 3.3 Subnational (state) government spending

## States' spending levels and funding sources

### States account for 30 percent of Nigeria's general government spending, a share that has been declining over time

**Collectively, Nigeria's 36 state governments accounted for about 30 percent of general government spending in 2019-2020**. Their total collective spending envelope was equivalent to about US$16 billion annually in 2018-2019, or 3.5 percent of national GDP (FIGURE 3.39). States' share of total general government spending has decreased over the last decade, from 37 percent of in 2011 to about 30 percent in 2019-2020 (FIGURE 3.40). In large part, this decline is due to the states' dependence on federally collected revenues. As oil revenues faced repeated price and

production shocks, the amounts transferred to the states decreased. This, combined with the states' limited capacity to borrow compared to the federal government (the states' collective deficit tends not to exceed one percentage point of national GDP), caused their spending to decline.

FIGURE 3.39. SG expenditures as percent of GDP and percent of total GG spending

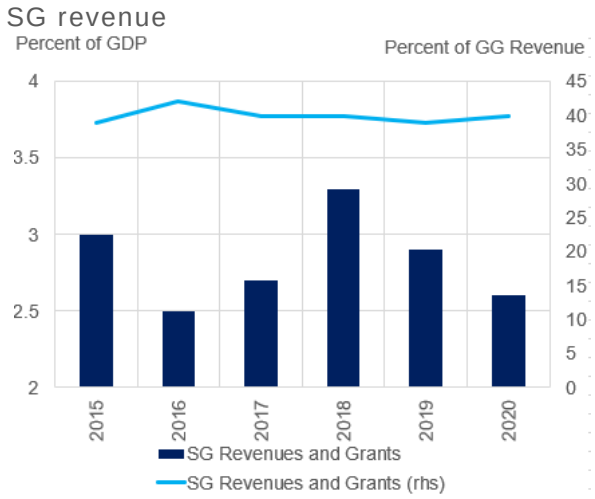
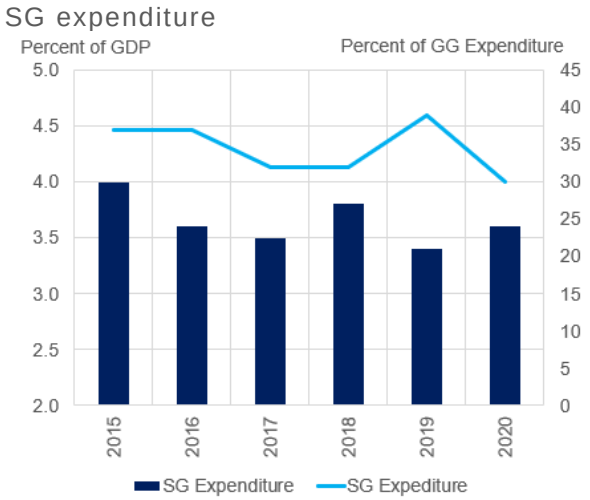



FIGURE 3.40.SG Revenues as percent of GDP and percent of total GG spending




Sources: World Bank estimates based on OAGF, DMO, State Audited Financial Statements, CBN, NBS and other official data.

BOX 3.3. New State Level Data

**NEW STATE LEVEL DATA**

**States are at the forefront of service delivery, but only recently have advances in data availability allowed for evidence-based insights into Nigeria's subnational public spending**. Fiscal data availability has increased across states as they participate in the SFTAS program. This unprecedented boom in subnational data makes it possible to build a systematic overview of the fiscal situation at the state government level, which can help inform policy at both the national and subnational levels:

**Since 2018, the regular publication of Audited State Financial Statements has allowed to understand actual levels of public spending,** which—as is the case for the federal government—can differ significantly from budget plans. Prior expenditure estimates were based on the CBN and DMO data. This data also offers insight into the allocations across recurrent and investment spending at the subnational level.

**Since 2021, the state governments' budgets align with the National Chart of Accounts, providing visibility into the allocation of subnational budgets across government functions systemically across all 36 states**. Furthermore, the corresponding alignment of the states' quarterly budget implementation reports (published from 2021 onwards) is expected to offer insight into the actual spending across functions at the state government level, across all 36 states.

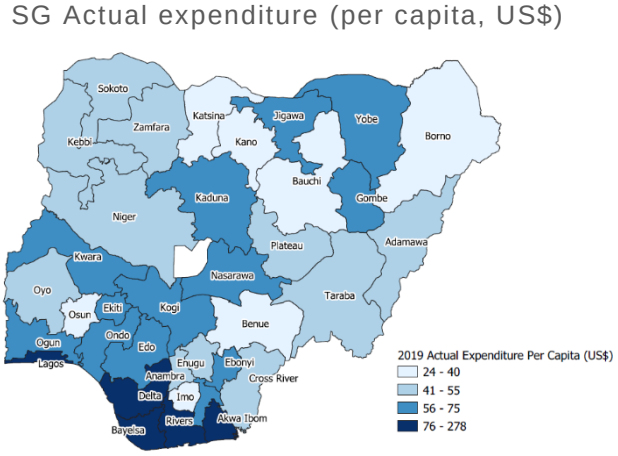
## Overall state spending is low, equivalent to about US$66 per person annually, with substantial regional variations

**States spent on average about US$66 (N21,000) per person per year[63] in 2018-2019**. State spending varies substantially in per capita terms, with oil-producing states in the South-South

[63] Nigeria's population numbers used in this document were established by the national census conducted by the National Population Commission in 2006 and extrapolated by the National Bureau of Statistics (NBS) using constant population growth rate at the state level. The figure excludes interest payments on debt.

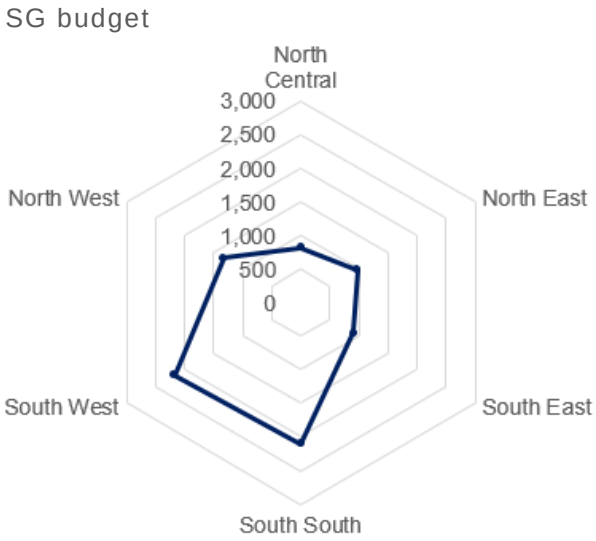
spending nearly three times more than states in the North-West and the North-East, where poverty is highest (FIGURE 3.41).

FIGURE 3.41. State spending varies substantially in per capita terms, with North-East states showcasing some of the lowest spending levels, and oil-producing states in the South-South (and Lagos) reporting the highest levels of actual state government spending per person (2019)




Source: World Bank estimates using 2019 State Audited Financial Statements and NBS population data.

FIGURE 3.42. SG total budgets in 2021 by region show substantial differences, and were highest in the South-West and South-South regions where oil production and economic activity are concentrated

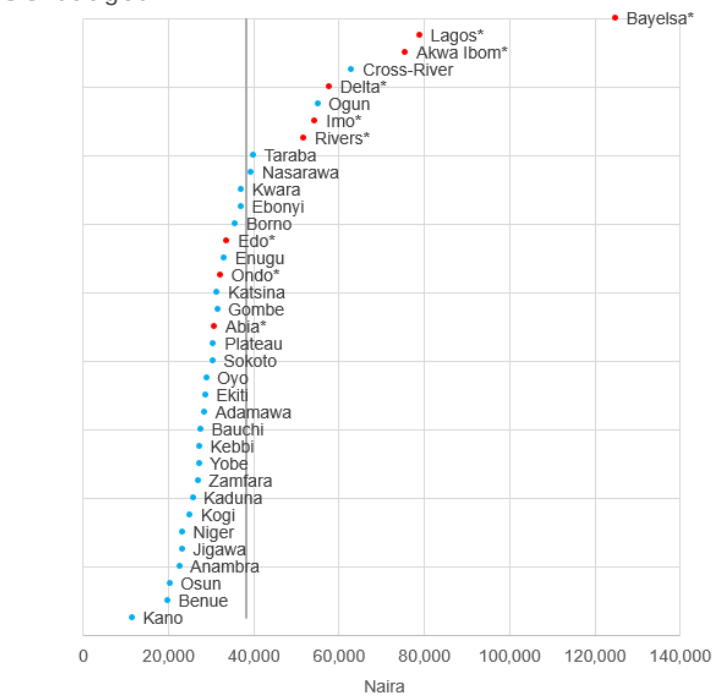



Source: World Bank estimates based on 2021 state budgets

**Budget allocations vary substantially across regions and states, broadly driven by differences in revenue and population.** Across Nigeria's six geopolitical zones, states in the South-South (where the oil-producing states are concentrated)[64] and South-West (where Nigeria's economic powerhouse, Lagos, is located) had the largest state government budgets (FIGURE 3.42). While most state governments remain dependent on federally shared revenues, the oil states' ability to budget and spend more rests on their additional revenues from oil derivation. Lagos state, on the other hand, due to the size of its economy and administrative capacity, collects the highest levels of Internally Generated Revenues (IGR). In addition, Nigeria's Christian-dominated and relatively economically well-off South has lower fertility rates and population, leading to higher budgets not only in absolute, but also per capita terms (FIGURE 3.43).

[64] Oil-producing states are mainly in the South-South (Akwa Ibom, Bayelsa, Delta, Riverss); some are in the South-East (Abia, Imo), and South-West (Ondo and, more recently, Lagos, although the latter's oil production is minimal compared to other states).

FIGURE 3.43. Oil producing states and Lagos tend to have higher per capita budget allocations. (SG Total budget per capita 2021, in naira)




Sources: World Bank estimates based on 2021 state budgets and NBS population data.

## Variation in public spending across states is largely driven by revenue differences

**Due to the state governments' limited ability to borrow, states' spending levels are primarily determined by their revenues.** In turn, since state revenues are dominated by their share of federally collected (FAAC) oil and non-oil revenues, state spending is highly correlated with their share of the FAAC allocation.

**States derive the majority of their revenues (about 70 percent in 2020) from their share of the FAAC oil and non-oil revenues** (FIGURE 3.44) – a share comparable to the federal government (please see previous section). Specifically, the FAAC Gross Statutory Allocation[65]—the states' share of Federation account revenues—accounted for 32 percent of the total state revenue envelope in 2020, representing the single largest revenue component for most states. Moreover, although most oil revenues are allocated through the Gross Statutory Allocation across all tiers of government and all 36 states, oil-producing states receive an additional FAAC Oil Derivation, which amounts to 13 percent of the total federation oil and gas revenues and is shared across the relevant states in proportion with their production. FAAC Other Revenues, mostly deriving from the distribution of savings during episodes of revenue shortfalls, accounted for 5

[65] Collectively, the 36 states receive 26.72 percent of the total net FAAC revenues, based on the vertical sharing formula (see section 1.3 (fiscal federalism)). This pot is shared across states in line with the horizontal sharing formula: 40 percent is shared equally across states, 30 percent is allocated based on state population, 10 percent based on land mass and terrain, 10 percent based on social development factors, and 10 percent in such a way as to reward a state's own independently generated revenue (IGR).

percent of the total state revenue envelope in 2020.[66] Finally, federally collected VAT receipts accounted for 18 percent of the total state revenue envelope in 2019.

**IGR contributed about 30 percent to the states' total revenues in 2018-2020 on average.**[67] States collect IGR mainly from personal income taxes and property taxes. Prior to the COVID-19 shock, IGR collection had been increasing, in part incentivized by the SFTAS program. In 2020, the IGR was estimated to have stagnated in nominal terms—despite double digit inflation—due to economic recession, interruptions to revenue administration, and some tax relief measures. Lagos—the state with the largest economy and advanced revenue policy and administration—collects the most IGR among all states (FIGURE 3.45). States also receive grants and other revenues outside of the IGR classification (about 4 percent of their total revenue and grant envelope in 2018-2020).

FIGURE 3.44. Federally collected revenues account for about 75 percent of states' total revenues and grants: states' total revenue composition (percentage of 36 states' total revenues and grants), 2020

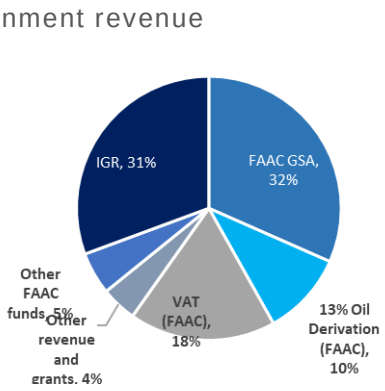
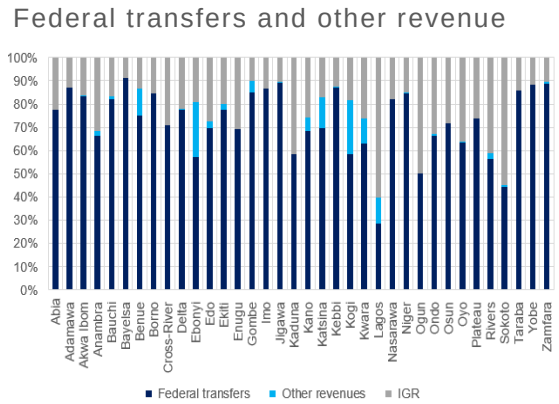



FIGURE 3.45….with substantial differences in revenue composition across states




Sources: State Financial Statements 2019 and NBS.

**Oil revenues and IGR are the key drivers of disparity in public resources and spending across state governments** (FIGURE 3.46). While the distribution of federation revenues to states is based on several factors (population, landmass, social development and IGR efforts), variability in state revenues per capita arises mainly from: i) the oil derivation receipts linked to each state's oil production, and ii) IGR, which depends on both economic activity and administrative capacity at state level.

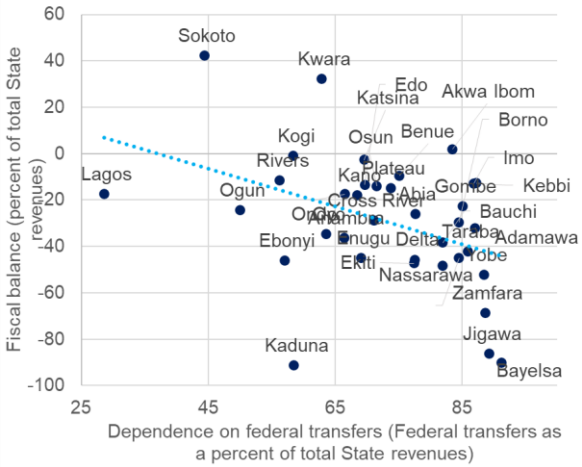
[66] Historically, these primarily included oil-revenue savings, used intra-year to smooth oil revenue sharing. More recently, as oil savings have been depleted, these have included distribution of savings from exchange rate difference, as well as other funds. Since the 2015-2016 fiscal crisis, these other funds have been distributed to allow states to cover salary payments to civil servants. As most savings are related to oil revenues, the formula for sharing these other funds is based on the derivation principle (the 13 percent distributed to oil-producing states), with the net amount distributed using the FAAC Gross Statutory Allocation principles.

[67] Technically outside the Federation Account but still distributed through the Federation Account Allocation Committee, VAT revenues follow a separate formula. States collectively receive 50 percent of the total VAT pot based on the vertical distribution formula. This pot is then shared across the 36 states: 50 percent is distributed equally to all states, 30 percent in proportion to state population, and 20 percent is based on the derivation principle (where the VAT was collected).

**Reliance on FAAC transfers increases the fiscal vulnerability of the states**. Similarly to the federal government, a significant proportion of state spending (49 percent in 2020) is dedicated to personnel expenditure and interest payments, which are non-discretionary. Reliance on transfers, a large proportion of which stems from volatile oil and gas revenues, often makes states more prone to volatility in their resource envelopes. This compromises their ability to adjust their fiscal stance and can lead to fiscal deficits, the accumulation of arrears, or drastic cuts to discretionary spending.

FIGURE 3.46…Higher dependence on federal transfers is associated with poorer fiscal outcomes for states

SG fiscal balance and federal transfers




Source: OAGF, DMO, and World Bank staff estimates

## States' spending composition

### States' budget allocations across functions vary substantially between states, in part reflecting different priorities and needs

**The state government budgets' alignment with the National Chart of Accounts since 2021 enables a first glimpse into how all 36 states allocate budget resources across sectors and functions, although actual spending composition across sectors is not yet available for all states.**

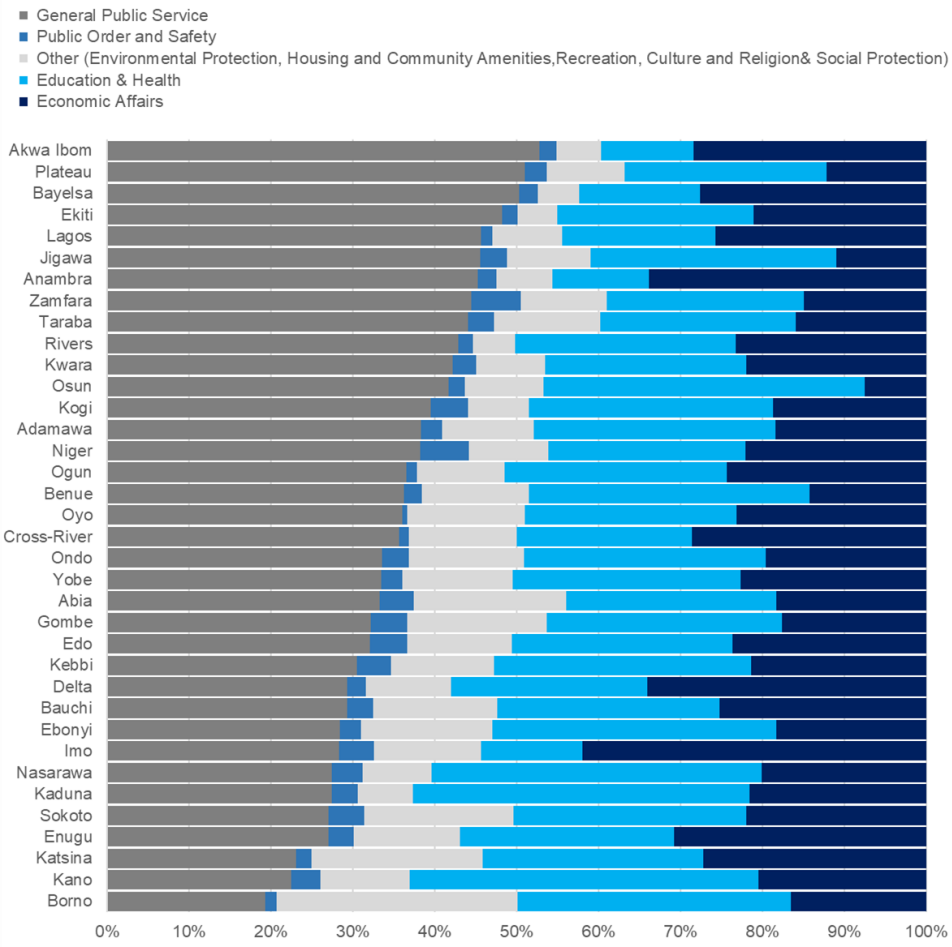
**Like the federal government, states allocate a substantial proportion (37 percent) of their budgets to General Public Service, which encompasses broad government administration and debt service** There is substantial variability in the share of public resources allocated to these administrative functions, ranging from 20 percent in the North, where resources are scarcer and development needs and gaps are greater, to 50 percent in the oil-producing states, where resources are more abundant and basic development needs are less urgent (albeit still high) (FIGURE 3.47). However, relative to the federal government, far less budget is allocated to debt servicing, partly because less debt is accrued at the state level, but also reflecting limitations in the states' capacity to budget for debt service (which, at least for external debt and state bonds, is carried out by the federal government on behalf of the states, funded by deductions at source from each state's gross statutory allocation) (TABLE 3.2).

**The Economic Affairs function was allocated 24 percent of the states' 2021 budgets.** While at the federal level Economic Affairs spending broadly concentrates on infrastructure, at the state level it spans both infrastructure (e.g., state roads and other connectivity) and agricultural development/other expenditures, which partly explains the higher overall allocation of budget resources to Economic Affairs at the state than at the federal level. On this item too, there is substantial variation across states, from under 10 percent of budget resources in Osun, to over 40 percent in Imo (FIGURE 3.47).

**Public Order and Safety on average received** a 3 percent allocation in state budgets. As **Defense** is solely a federal responsibility, it received no formal allocation at the state level. The same applied to **Social Protection.**

**The key basic services that determine Nigeria's human capital—health and education—received on average 25 percent of state government resources**. While the proportion of state allocations exceeded that of the federal government (11 percent of its budget) (TABLE 3.2), the states are at the forefront of delivery of these basic services. Variation across states was again considerable, ranging from just over 10 to over 40 percent of their budgets.

FIGURE 3.47. State governments' 2021 budget composition




Source: World Bank calculations using 36 state government budgets for 2021.

TABLE 3.2. State Government 2021 Budget Allocation Across Functions

| Function | Average SG 2021 budget Allocation per capita (US$) | SG Allocation (% of Total Budget) | Average 2021 SG | *FG budget allocation (% of Total 2021 FG Budget)* |
|---|---|---|---|---|
| General Public Service | 34.5 | 37% | | 45% |
| *Excl. debt* | *34.5* | *37%* | | *27.2%* |
| Economic Affairs | 21.7 | 24% | | 14.6% |
| Education | 14.6 | 16% | | 6.3% |
| Health | 8.0 | 9% | | 5.0% |
| Housing and Community Amenities | 6.2 | 7% | | 0.6% |
| Public Order and Safety | 2.5 | 3% | | 8.1% |
| Environmental Protection | 2.0 | 2% | | 0.4% |
| Recreation, Culture and Religion | 1.5 | 2% | | 0.0% |
| Social Protection | 0.6 | 1% | | 9.3% |
| **Total SG Budgeted Allocation 2021** | **92** | **100%** | | **100%** |

Sources: World Bank calculations using federal and state government budgets for, World Bank nominal exchange rate projections, and NBS population figures (extrapolated using stable state-level growth rates).
Note: Calculations are in current values.

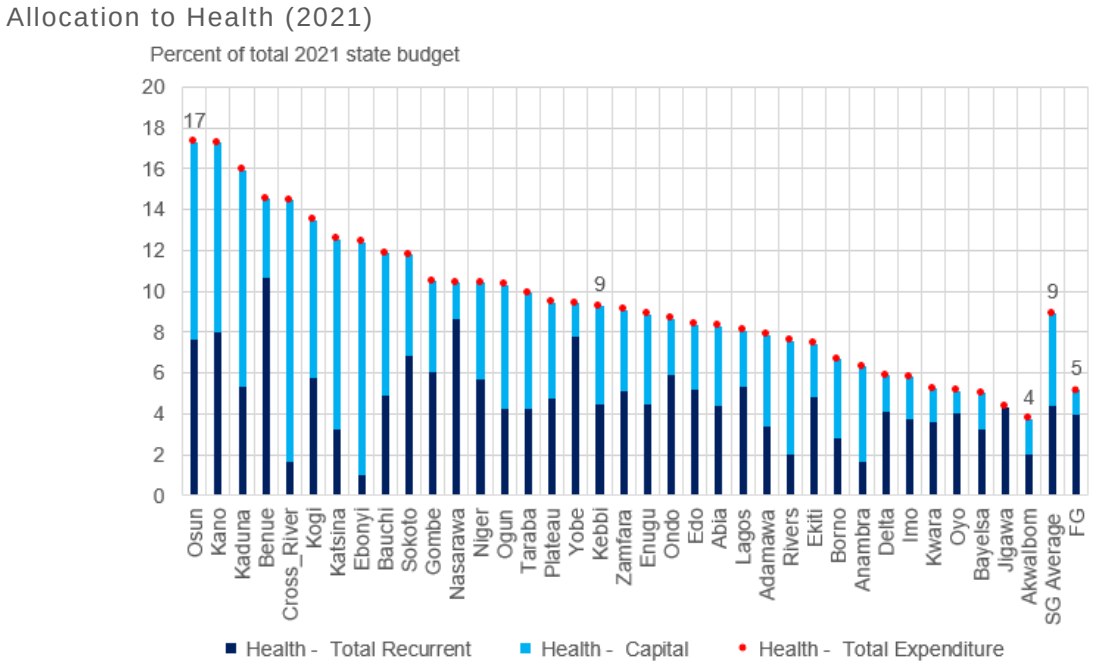
## States are at the forefront of basic service delivery, but their allocations to social sectors are too low to improve livelihoods

**In 2021 most states allocated less than 10 percent of their budgets to health—even in the face of the pandemic—which translates into less than US$8 per person per year**, with up to another US$6 per person coming from the federal government budget. With an average state budget implementation of 50 percent, actual annual state spending on health may be as low as US$4 per person per year. Considering that an average Nigerian is estimated to pay for 75 percent of their total health expenditures out-of-pocket, total average health spending per person may be in the range of US$16-40 per year across primary and advanced health care.

**As in other spending categories, there is a large variation across states in the share of budget allocated to health** (FIGURE 3.48 and FIGURE 3.49). Certain states allocated as little as 4 percent of their budget to health (equivalent to US$2.5 per person per year), others as much as 17 percent (US$22.3 per person per year). There is also considerable variation in the split between the recurrent and capital components of state health allocations, although on average such split was even (49 and 51 percent, respectively).

**State allocations to education were higher than those to health,** as they amounted on average to 16 percent of state budgets– equivalent to about US$15 per person per year, with up to another US$8 per person coming from the federal budget. Certain states allocated as little as 5 percent of their budget to education (US$3 per person per year), others up to 30 percent (US$29.5 per person per year) (FIGURE 3.50 and FIGURE 3.51). In contrast with the fairly even split recorded for health allocations, the states allocated relatively more resources to the recurrent (63 percent) than to the capital (37 percent) component of the education allocation, possibly as a consequence of the large teaching workforce.

FIGURE 3.48. Most states allocated less than 10 percent of their budgets for health—even in the face of the pandemic




Sources: World Bank calculations using federal and state government budgets for 2021, World Bank nominal exchange rate projections, and NBS population figures (extrapolated using stable state-level growth rates).

FIGURE 3.49. There is a large variation across states in the share of their budgets allocated to health…

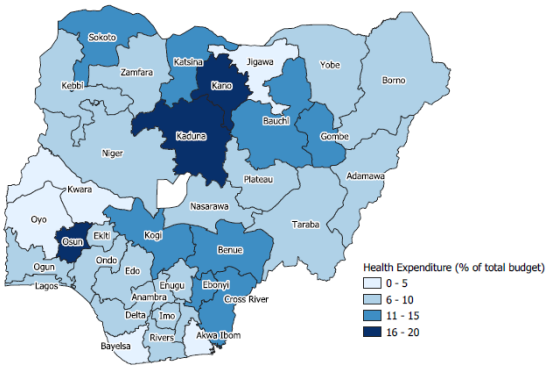
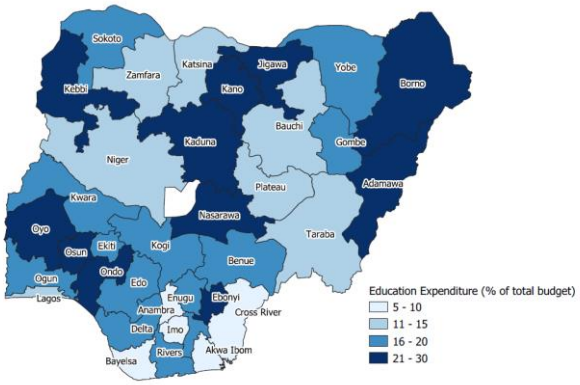



FIGURE 3.50. …and to education

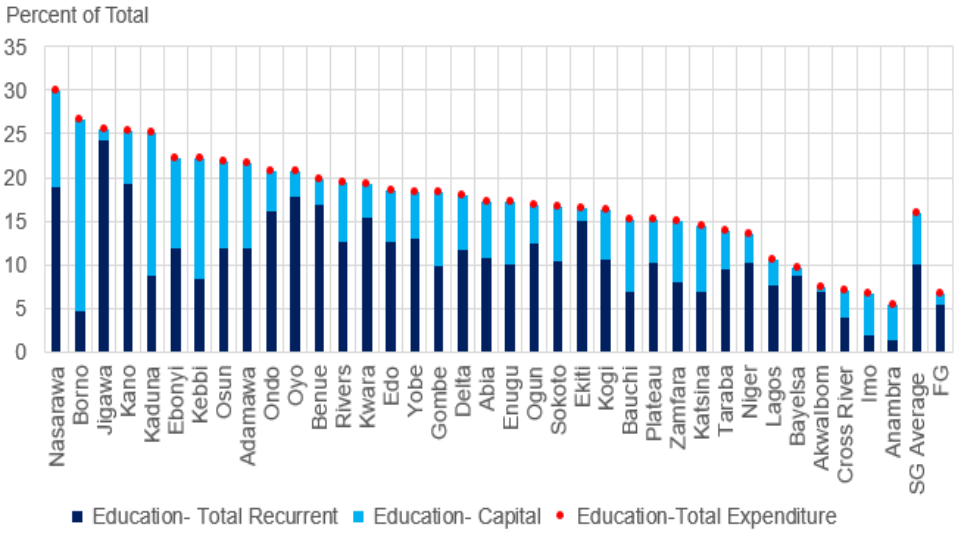



Sources: World Bank calculations using federal and state government budgets for 2021, World Bank nominal exchange rate projections, and NBS population figures (extrapolated using stable state-level growth rates).

**These early estimates indicate that spending allocations for key human development objectives are low in Nigeria and fall short of the country's needs**. The variation recorded across states gives grounds for both optimism (for states where spending is higher) and realism (where it is insufficient). However, these initial estimates may broadly be deemed optimistic, against a background of low budget implementation (50 percent on average) and concerns about spending efficiency.

FIGURE 3.51. There is a large variation in budget allocations to education across states

Allocation to education (percent of total SG 2021 budget).




Sources: World Bank calculations using federal and state government budgets for 2021, World Bank nominal exchange rate projections, and NBS population figures (extrapolated using stable state-level growth rates).

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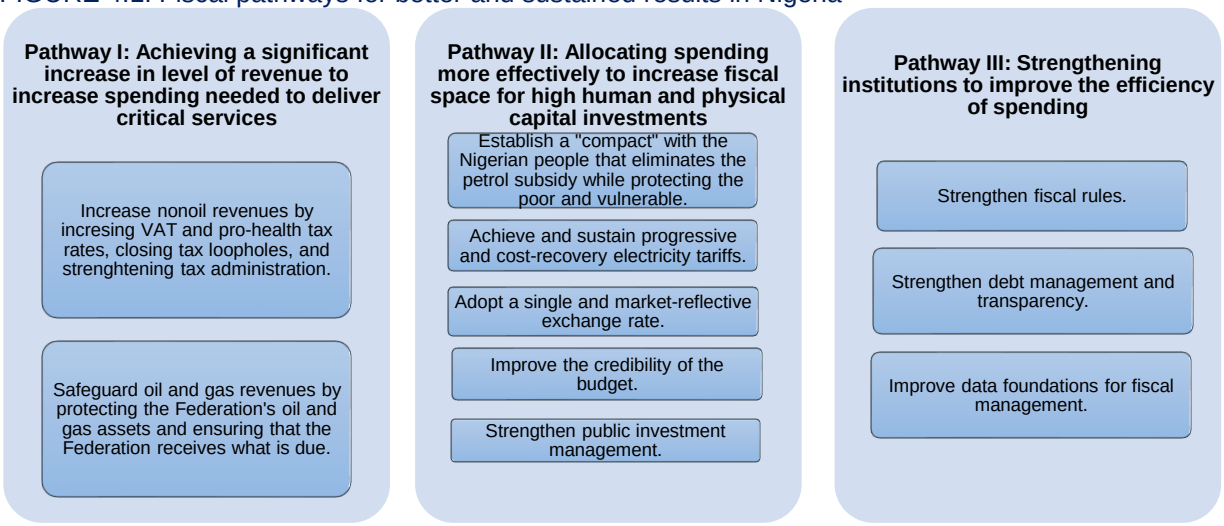
# POLICY RECOMMENDATIONS

## 4.1. Policy options for improving fiscal scenarios for better service delivery

**Putting Nigeria on a sustainable fiscal path with improved service delivery requires a multi-pronged approach anchored around three interlinked and mutually reinforcing pillars (FIGURE 4.1).** For each pillar, we present policy options that are both impactful and technically feasible, most of which can be implemented over the short- to medium-term. The proposed measures would create fiscal space for much-needed investments in human and physical capital while improving the quality of spending. Further details appear in the Annex.

FIGURE 4.1. Fiscal pathways for better and sustained results in Nigeria




Source: Authors.

**First, Nigeria needs to achieve a minimum level of revenue to deliver critical public services.** The top priorities for mobilizing revenues are to (i) gradually increase tax rates, especially the VAT and pro-health excise rates on alcohol, tobacco, and sugary drinks, to bring them in line with international standards; (ii) ensure that all oil and gas fiscal payments are made in cash rather than in kind, and improving the governance of the oil sector, including by ensuring that oil and gas revenues are first transferred to the Federation Account; (iii) address loopholes in the current tax legal framework; and (iv) strengthen tax administration to encourage voluntary compliance, including for example by rationalizing tax incentives to the agriculture, pioneer, and financial sectors. While most of these reforms are the purview of the Federal Government, much can be done at the state level. For instance, states could mobilize property taxes more effectively, and widen the base for personal income taxes.

**Second, better allocating spending would free up fiscal space for the delivery of critical public services.** In the short term, no other reforms are more important than to fully eliminate the petrol, electricity, and exchange rate subsidies, so that all tiers of government would then be able to use part of the savings to invest in much-needed human and physical capital and to protect the poor and vulnerable with targeted programs. Public support for removing these harmful and inefficient subsidies can be gained by the establishment of a “compact” that combines the subsidy removal with the identification of key services and support programs (e.g., time-bound cash transfers for the poor) to be delivered with the savings, and a commitment to adhere to expenditure ceilings for “general administrative expenditures”, which currently absorb a high share of total spending. Furthermore, strengthening budgeting preparation (e.g., more realistic

revenue projections) and monitoring can result in better allocative decisions – across all tiers of government - that enhance the overall efficiency of spending.

**Third, Nigeria can strengthen its fiscal institutions and governance practices to improve accountability mechanisms, reduce costs, and mitigate fiscal risks.** The Fiscal Responsibility Act (2007)[68] sets several good practices—including deficit ceilings and limits to financing from the CBN. Yet, in recent years the Federal Government has not fully adhered to these rules. Given Nigeria's current fiscal situation, there is a need to update the Fiscal Responsibility Act to introduce clauses to improve the adherence to fiscal discipline. This includes the specification of predictable and transparent transfers of oil and gas revenues to the Federation Account, ceilings on budget allocation to general administrative expenditure (e.g., wages), sanctions for breaking the fiscal rules, having a national outlook as part of the medium-term expenditure framework, and defining the fiscal balance holistically by considering the finances of government-owned enterprises. It would also be critical to enhance the use of the National Chart of Accounts and build good data foundations to better monitor fiscal performance. Better targeting of federal transfers to the states would improve the efficiency of said transfers towards critical service delivery areas, where current transfers focus broadly on revenue sharing. Own-revenue powers would also benefit from strengthening, by allocating more potent revenue sources to the states and thereby reducing the vertical fiscal gap. Finally, improving debt management could also help reduce fiscal costs. This can be done by having deficit borrowing plans that are based on costs and other fiscal information, improving cash management practices to eliminate the reliance on CBN borrowing, and including CBN financing as part of the public debt stock.

[68] Many States have recently introduced fiscal legislations, which help put in place some principles of good fiscal management at subnational level.

*The policy options presented below are based on analytical and advisory work conducted by the World Bank, and consistent with the Government of Nigeria's 2021 Economic Sustainability Plan and the 2019 Strategic Revenue Growth Initiative.*

| POLICY OPTION | TIMELINE (ST, MT, LT)* | IMPACT ON FISCAL SUSTAINABILITY (M, H, VH)** |
|---|---|---|
| **PILLAR I: ACHIEVING A SIGNIFICANT INCREASE IN THE LEVEL OF REVENUE TO INCREASE SPENDING NEEDED TO DELIVER CRITICAL PUBLIC SERVICES** | | |
| **Increase non-oil revenues** | | |
| • Increase the **Value Added Tax** rate and improve its collection:<br>• Increase the VAT rate from 7.5 percent closer to the regional Sub-Saharan African average of 15 percent by a 2.5 percentage point increase every two years to control potential inflationary pressures and negative effects on demand.<br>• Re-introduce the VAT on petrol, which was exempted in by the Federal Ministry of Finance.<br>• Allow input tax credits so that the VAT can function as a true consumption tax, and remove the current distortionary VAT exemptions for certain capital goods.<br>• Amend the VAT Act to clarify the charge to tax, e.g., provide a clear time and place of supply rules, and order of charge for VAT on excisable goods so VAT is due on the duty paid value. | MT/LT | VH |
| • Raise **pro-health excise rates** to regional averages:<br>• Gradually increase excise rates on beer and tobacco. For instance, by 2024, the beer excise rate can be increased from ₦35 /liter to a rate equivalent to the ECOWAS excise duty rate of 47.5 percent of the cost of goods, insurance, and freight. For tobacco, by 2024, the excise rate can be increased from ₦ 2.9 /stick to the ECOWAS rate of ₦8.2 /stick.<br>• Gradually increase the excise on non-alcoholic beverages from ₦10 /liter to a rate that ensures a tax incidence of 20 percent ad-valorem.<br>• Gradually increase the excise on non-alcoholic beverages from ₦10 /Liter to a rate to ensure tax incidence of 20 percent ad-valorem by 2024.<br>• Amend legislation to ensure that excise rates increase each year in line with the CPI. | ST/MT | H |
| • Close legal **tax loopholes**:<br>• Issue a regulation that gives the Ministry of Finance the sole responsibility for granting tax expenditures.<br>• Legislate a comprehensive set of "source rules" covering all classes of income. | ST | H |

| POLICY OPTION | TIMELINE (ST, MT, LT)* | IMPACT ON FISCAL SUSTAINABILITY (M, H, VH)** |
|---|---|---|
| • Modernize and strengthen income definitons for non-resident withholding tax.<br>• Align taxation of indirect transfers of immovable property (including mining and petroluem rights) with international norms.<br>• Replace the current "fixed base" concept[69] with the international norm of "permanent establishment".<br>• Update the Nigerian Model double tax treaty in line with the United Nations Model Convention, particularly Articles 12A and 12B.<br>• Include an anti-fragmentation rule to minimize tax evasion practices under the VAT and CIT. | | |
| • Strengthen tax administration:<br>• Rationalize tax expenditures granted to agriculture, pioneer, and financial sectors.<br>• Implement a risk-based selection system for selecting tax cases for audit.<br>• Improve excise tax administration, including the use of improved technology solutions and monitoring tools for excise stamps and physical controls.<br>• Design a comprehensive communication package that explains the benefits of paying taxes.<br>• Leverage technology and big data to expand the tax base and tax net. | MT/LT | M/H |
| **Safeguard oil and gas revenues** | | |
| • Safeguard the Federation's oil and gas assets:<br>• Amend the Petroleum Industry Act to specify that oil and gas assets will belong to the Federation and the ownership will be transferred to the NNPC Ltd. or any other party upon payment of the full market value. | ST | VH |
| • Require that oil and gas fiscal revenues to be transferred first to the Federation Account:<br>• Amend the Petroleum Industry Act and re-insert the language found in the Petroleum Industry Bill sent to the National Assembly in September 2020, requiring the government revenues related to the oil and gas contracts to be paid to the Federation Account and verified by the Commission. | ST | H |

[69] The fixed base provision attributes the right to tax income from independent personal services to the "other" country (i.e., the source country) if the taxpayer has a fixed base available to her in that country and income is attributable to that fixed base.

| POLICY OPTION | TIMELINE (ST, MT, LT)* | IMPACT ON FISCAL SUSTAINABILITY (M, H, VH)** |
|---|---|---|
| • Ensure that all oil and gas fiscal payments be made in cash:<br>• Amend the Petroleum Industry Act to remove references to tax oil, royalty oil, and production sharing contracts, and retain only profit-sharing contracts, thereby ending all in-kind fiscal payments. | ST | VH |
| **PILLAR II: ALLOCATING SPENDING MORE EFFECTIVELY** | | |
| • Establish a "compact" **that eliminates the petrol subsidy** while protecting the poor and vulnerable:<br>• Phase-out the petrol price subsidy over one to three years.<br>• Roll out a large-scale, targeted, and time-limited cash transfer program to mitigate the adverse effect of higher petrol prices on poor and vulnerable households.<br>• Identify, commit, and communicate to the public spending priorities for federal and state trust funds that are financed by savings from the elimination of the petrol subsidy. | ST and MT | VH |
| • Achieve and sustain **cost-reflective electricity tariffs** to fully eliminate the power subsidy:<br>• Maintain regular annual reviews of the Multi-Year-Tariff-Order, to reflect the actual cost of generating and delivering power in commercial tariffs.<br>• Regularly update the Power Sector Financing Plan to identify all potential uses of funds to settle current and historical electricity tariff shortfalls, define budgetary and non-budgetary sources of funds, and prevent any financing gap that may reverse the removal of the subsidy. | ST | H |
| • Adopt a single and market-reflective **exchange rate**:<br>• Unify the current five FX windows into a single window to eliminate the exchange rate subsidy and reduce market distortions.<br>• Communicate a clear exchange-rate management strategy that builds credibility and improves the availability and accessibility of FX. For example, assure a well-defined schedule of regular FX auctions, apply pre-defined exchange-rate bands (with "circuit breakers") to control possible immediate overshooting, and limit CBN FX interventions to episodes of intense market volatility.<br>• Re-establish the FX interbank market and allow commercial banks to trade FX on their behalf, to allow for greater price discovery. | ST | H |
| • Improve budget credibility: | ST/MT | VH |

| POLICY OPTION | TIMELINE (ST, MT, LT)* | IMPACT ON FISCAL SUSTAINABILITY (M, H, VH)** |
|---|---|---|
| • Publish a monthly report that tracks the cumulative (federal and state) budget execution rates relative to the original budget for each revenue and expenditure category.<br>• Publish in budget documents the full set of assumptions articulated by NNPC, FIRS, and Nigeria Customs Service.<br>• Limit the percentage growth to oil production in the budget to 10 percent of the average oil production in the preceding two years.<br>• Adopt a supplemental budget mid-year if there is more than a 10 percent deviation in revenue outturn.<br>• Reduce deviations between budgeted and actual expenditures to less than 15 percent, and impose penalties on ministries, agencies, and departments that surpass this threshold. | | |
| • Strengthen public investment management:<br>• Adopt guidelines for enhancing the appraisal and selection process for public investment projects, including the establishment of a single pipeline of appraised projects to ensure that only high-priority appraised projects are included in the budget.<br>• Publish project costs and multi-annual commitments as part of the budget.<br>• Adopt methodologies for determining maintenance needs and related budget costs. | MT/LT | M |
| **PILLAR III: STRENGTHENING INSTITUTIONS TO IMPROVE THE EFFICIENCY OF SPENDING** | | |
| • Strengthen **fiscal rules**:<br>  • Introduce sanctions (and escape clauses) for breach of fiscal and debt rules specified in the 2007 Fiscal Responsibility Act.<br>  • Consider re-formulating the 3 percent deficit limit in the 2007 Fiscal Responsibility Act with a focus on the non-oil sector to minimize oil-revenue-related fluctuations. | MT | H |
| • Strengthen debt management and transparency:<br>  • Limit the amount of Central Bank financing (Ways and Means) available to the Federal Government to no more than 5 percent of the previous year's collected revenues as per the 2007 CBN Act.<br>  • Issue regulations to prioritize treasury bills to finance fiscal shortfalls over CBN financing. | ST/MT | H |

| POLICY OPTION | TIMELINE (ST, MT, LT)* | IMPACT ON FISCAL SUSTAINABILITY (M, H, VH)** |
|---|---|---|
| • Publish the Annual Borrowing Plan along with the budget.<br>• Restructure the borrowing by the Federal Government through Ways and Means Advances at the CBN and publish the stock of outstanding Federal Government debt to the CBN every quarter. | | |
| • Improve **data foundations** for fiscal management:<br>• Update the Open Treasury Portal with Federal and State in-year budget execution data within 30 days of the end of the quarter/month.<br>• Publish FAAC revenues within 30 days of the end of the month.<br>• Updated oil revenues and payouts are made available on NNPC and NEITI websites every month. | MT | M |

*The timeline horizons are defined as: ST (Short-term, 0-12 months), MT (Medium-term, 1 – 3 years), and LT (Long-term, more than 3 years).
** The impact of fiscal sustainability can be categorized as: M (Moderate, expected reduction in annual consolidated fiscal deficit of <0.3 percent of GDP over the medium term); H (High, expected reduction in annual fiscal deficit of 0.3-0.6 percent of GDP over the medium term); and VH (Very High, expected reduction in annual consolidated fiscal deficit of over 0.6 percent of GDP over the medium term).

# SELECTED DRIVERS OF PERFORMANCE OF NIGERIA'S PUBLIC EXPENDITURE MANAGEMENT

# 5.1 The petrol subsidy

*Summary: The subsidy for petrol is ostensibly designed to ease the burden of petrol costs on the economy, but in practice its benefits overwhelmingly accrue to the wealthy, as the poor purchase only an estimated 3 percent of subsidized petrol. The cost of the subsidy rose from 4 percent of Federation oil and gas revenue captured by the NNPC in 2020 to 42 percent in 2021, an untenable fiscal burden for a country with Nigeria's enormous infrastructure deficit and vast underserved population. Moreover, the petrol subsidy distorts efficiency incentives, promoting its nonessential as well as inefficient use. The subsidy also makes petrol much cheaper in Nigeria than in the neighboring countries, creating enormous financial incentives for smuggling and benefitting criminal syndicates at the expense of the public. Lessons from international experience make it clear that no government action can effectively stop such diversion of a subsidized fuel as long as large price differences remain. Following the expansion of social protection policies during the pandemic, the government has an opportunity to phase out the petrol subsidy while utilizing cash transfers to safeguard the welfare of poor and middle-class households.*

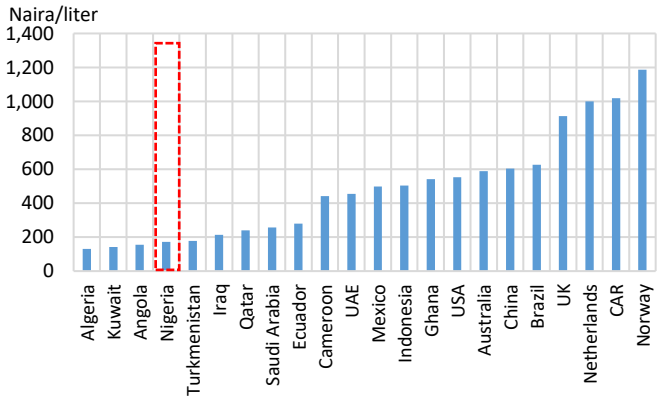
## Nigeria's petrol subsidy is unique

**Nigeria is the only country in the world with a universal price subsidy provided only for petrol.** Universal price subsidies for liquid petroleum products are almost always regressive because the rich consume far more than the poor both directly and indirectly. Petrol subsidies are especially regressive because it is used primarily in light- and medium-duty vehicles, which are rarely owned by the poor, and petrol is also much less of an intermediate good than diesel. In many developing countries petrol is seen as a fuel of the better-off and governments worldwide have typically prioritized eliminating petrol subsidies first. Nigeria has done the opposite, eliminating all subsidies for liquid fuels but retaining the petrol subsidy, and the latter generously so—in June 2022, Nigeria's petrol price ranked the eighth lowest among 170 economies surveyed, averaging ₦593 per liter against ₦165 in Nigeria (FIGURE 5.1).

**Attempts to eliminate the subsidy have repeatedly failed, but the recently enacted PIA effectively mandated the elimination of the subsidy by February 16, 2022.** The government removed the petrol subsidy in January 2012 after months of high global oil prices, but after two weeks of protests the policy was reinstated. The government ended the subsidy again in May 2016, this time as the world oil price had just hit a new low, and the authorities introduced a price band designed to move with international petrol prices. However, the government failed to adjust the price band when the naira depreciated sharply later in 2016, and by 2017 the subsidy had returned. In March 2020, amid another oil-price collapse, the government replaced the subsidy with market-based pricing regulations for petrol.[70] However, the government has frozen the pump price since December 2020 amidst rising international petrol prices. As global oil prices continued to rise, the petrol subsidy returned and the gap between the government-controlled

FIGURE 5.1. Nigeria's petrol pump prices are among the lowest in the world

Retail petrol prices during the week of June 6, 2022




Source: : https://www.globalpetrolprices.com/Nigeria/gasoline_prices/.
Note: Of the 170 economies in the database, 23 countries are shown.

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

retail price and the cost of supply has been steadily widening since early 2021. The PIA provides for provision of the petrol subsidy by the NNPC for up to six months as a transitional measure. Legally, therefore, the government's authorization to reimburse the NNPC for losses suffered from selling petrol at a loss expired by mid-February 2022. The government has since decided to extend the subsidy period for the rest of 2022.

## The petrol subsidy is opaque

**Until 2022, the petrol subsidy has always been an off-budget expenditure immune to annual scrutiny by the National Assembly.** In 2006, the government launched the Petroleum Support Fund in part to smooth petrol prices, a concept that has been tried repeatedly by many other governments and that has consistently failed to achieve its objectives. The approach is simple and intuitively appealing: when global fuel prices fall below the domestic fixed prices, the Petroleum Support Fund accumulates resources, which are used to finance the subsidy when global fuel prices rise. In practice, however, such fuel price stabilization funds eventually become insolvent because the concept works only if fuel prices revert to the mean frequently, whereas global oil price movements over the last two decades have not shown constant reversion to the mean. The last transactions reported by the Petroleum Products Pricing Regulatory Agency (PPPRA) date from October 2011,[71] and the Petroleum Support Fund was officially closed in December 2015. The budget-implementation reports published by the Budget Office of the Federation in the 2010s show withdrawals from the Excess Crude Account to cover some of the subsidy expenditures.[72]

**After 2016, when the government stopped reimbursing fuel marketers for selling petrol at a loss, the NNPC became the supplier of last resort due to its ability to finance the shortfalls from petrol imports through deductions from Federation oil and gas revenue.** The government administered the so-called Price Modulation Mechanism from January to May 2016 and the Appropriate Pricing Framework beginning in May 2016. Neither scheme explicitly envisaged a petrol price subsidy and no provisions were made to reimburse fuel marketers, but currency depreciation combined with rising global oil prices caused the price subsidy to return. Because the NNPC is the only fuel seller that can reimburse itself when selling petrol at a loss (via deductions from Federation oil revenue), it emerged as the monopoly wholesaler.[73]

**Annual audits by the Nigeria Extractive Industries Transparency Initiative (NEITI) indicate that fuel price subsidies have been deducted in full from the payments due to the Federation Account, but information recently made available suggests that the NNPC uses other mechanisms to reimburse itself for the cost of the petrol subsidy.** While reporting on this issue is sparse, the NNPC's financial statements[74] mention other means of recovering the losses incurred by petrol subsidies. According to the 2020 financial statement of the Nigerian Petroleum Development Company (NPDC), an NNPC subsidiary, its reimbursement arrears to the NNPC peaked at more than US$8.5 billion and were repaid by two means. The NNPC borrowed US$5.5 billion against Nigerian Liquefied Natural Gas (NLNG) dividends, and used the Pre-Export Financing (PXF) scheme to cover the remaining US$3 billion. The PXF was established in 2013 and is based on an agreement allowing the future sale of an agreed quantity of crude oil (20,000 daily barrels) produced by the NPDC. As of December 31, 2020, US$0.65 billion remained to be repaid. In addition, the NNPC's financial statements and submissions to

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

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

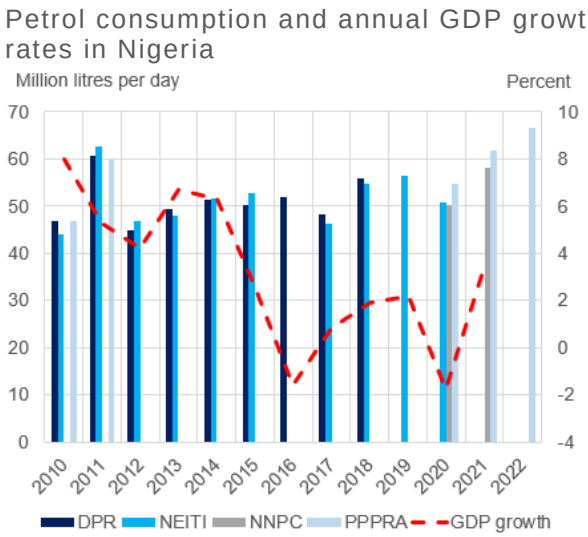
[73] http://pppra.gov.ng/wp-content/uploads/2019/01/PRESS-STATEMENT.pdf

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

the Federation Account Allocation Committee (FAAC) reported that the National Fuel Support Funding Scheme had ₦445 billion in liabilities as of December 31, 2020. It is unclear when, how, and in what amount this scheme had been funded, and what these liabilities are for.

**Petrol consumption figures are difficult to understand, and year-to-year trends are inconsistent across government sources.** Particularly puzzling is the large discrepancy between what was imported in 2020 and 2021 and reported by the NNPC on the one hand and what was trucked out as monitored by the Authority on the other, with the latter exceeding the imported volumes by about 4 and 3 million liters per day, respectively. In addition, demand for petrol has not necessarily followed changes in the overall economic activity as measured by GDP. For example, a sharp drop in GDP in 2016 was accompanied by an increase in petrol consumption (FIGURE 5.2)**Error! Reference source not found.**. Similarly, a large spike in petrol "consumption" in 2011 was not consistent with changes in economic activity, suggesting that the elections held that year may have influenced claims for fuel subsidies—arguably made easier by the dramatic increase in the number of importers eligible to claim subsidy reimbursements, from six in 2006 to 140 in 2011. Likewise, the rise in petrol consumption of 13 percent (trucked out volume) or 16 percent (imported volume) observed in 2021 far exceeded the GDP growth rate for this year, further underscoring the role of noneconomic factors in determining "apparent" petrol consumption (FIGURE 5.2**Error! Reference source not found.**).

FIGURE 5.2. Domestic petrol consumption does not systematically correlate with economic growth.



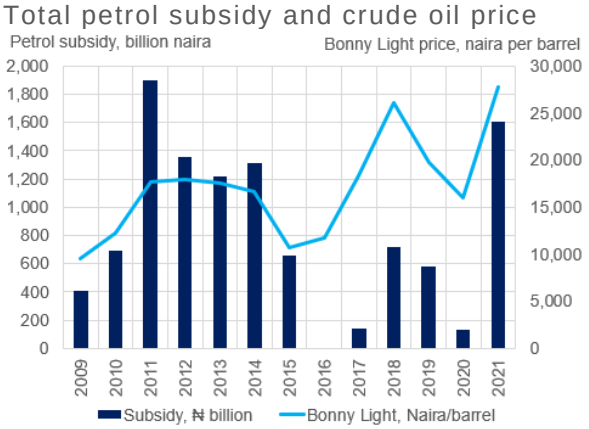

Sources: PPPRA (undated), NEITI, NNPC monthly financial and operations reports, PPPRA, the Authority, and WDI.
Note: The 2022 trucked-out volume is through May 2022.

## The petrol subsidy imposes an unsustainable fiscal burden

**The total cost of the petrol subsidy reached an all-time high in 2011.** The magnitude of the subsidy depends on the unit price gap and consumption volume. Excluding 2022 and taking only those years for which full-year data are available, petrol consumption peaked in 2011 and the fiscal cost of the subsidy reached US$12 billion before declining to US$8.5 billion in 2012 and US$8 billion in 2014. In recent years, the annual cost of the petrol subsidy has more closely tracked developments in the global petrol price than in the early 2010s (FIGURE 5.3).

**The price gap grew rapidly in 2021 and has risen even faster in 2022, slashing the NNPC's oil revenue transfers to the Federation Account to zero during the**

FIGURE 5.3 The total petrol subsidy bill has varied broadly in line with the oil price.




Sources: NEITI for the annual subsidy amounts through 2018 and the NNPC's submissions to FAAC thereafter, supplemented by the NNPC Group's 2020 financial statement for the 2020 subsidy, and CBN for the exchange rate
Note: The 2021 subsidy is the amount corresponding to petrol landing in Nigeria starting in January 2021.

**first four months.** The NNPC manages and monetizes the Federation's equity oil and gas on the government's behalf, and additionally acts as a fiscal agent for collection of taxes, royalties, and the government's share of profit oil in PSCs. The NNPC does not transfer the full value of the oil and gas it receives to the Federation Account, and instead deducts large amounts at the source of income. In 2020 and 2021, 42 percent and 16 percent, respectively, of the values of the total oil and gas received by the NNPC were transferred to the Federation Account.[75] Meanwhile, the share of total oil and gas revenue for the Federation received first by the NNPC and subsequently used to finance the petrol subsidy rose from 4 percent in 2020 to 42 percent in 2021. In the absence of the petrol subsidy, rebounding oil prices would have more than offset the decline in daily production between 2020 and 2021 and nearly doubled the Federation's net oil and gas income captured by the NNPC before accounting for inflation.

## The petrol subsidy reduces the oil and gas revenues received by the three tiers of the Nigerian government

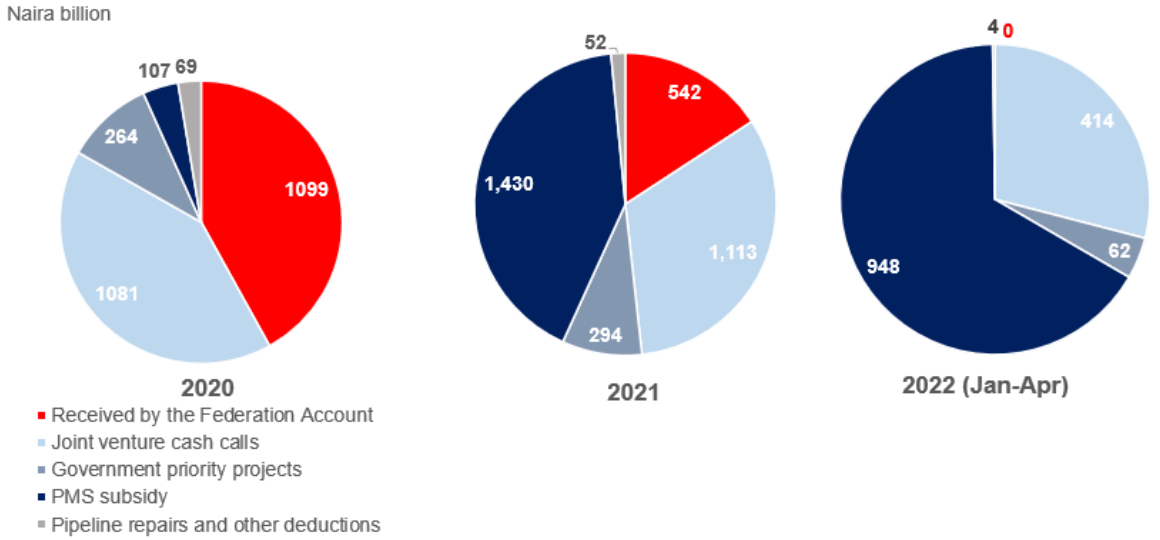
**All NNPC deductions are taken from in-kind payments of oil and gas fiscal revenues before they are transferred to the Federation Account.** The NNPC obtains cash by selling oil and gas owned by the Federation (in joint-venture operations) or else owed to it by other companies (in PSCs), and deducts expenses incurred on behalf of the Federation from the amount designated to be transferred to the Federation Account. These deductions cover capital and operational expenditures related to the production of the Federation's equity oil and gas (which are legitimate and represent what the Federation should pay to cover its production costs), subsidy reimbursement (which should be accounted for in the budget rather than deducted by the NNPC from the Federation's revenues), execution of the Federation's priority projects (with the largest share going to domestic gas development, followed by refinery rehabilitation, renewable energy development, and oil exploration), and other expenses that include pipeline repairs and maintenance, strategic petroleum reserves, and "product losses." However, the petrol subsidy in recent years has been by far the most volatile component of NNPC deductions and has emerged since 2021 as the single largest deduction, severely eroding the revenue accruing to the Federation Account (FIGURE 5.4**Error! Reference source not found.**).

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

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

FIGURE 5.4. Rising global petrol prices have slashed the NNPC's transfers to the Federation

Breakdown of revenues received by the NNPC, naira billion




Sources: World Bank staff calculations based on data from the FAAC reports at https://nnpcgroup.com/NNPC-Business/Business-Information/Pages/Monthly-Performance-Data.aspx

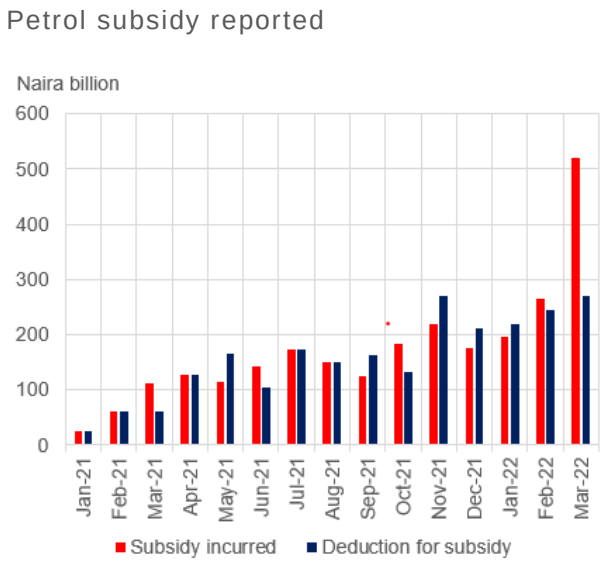
Note: The Federation Account during the first four months of 2022 received no revenue from the NNPC. The petrol subsidy in each year is the amount deducted rather than the amount incurred. Because there is a lag of two months between the time petrol shipments land in Nigeria and the time of reporting to FAAC, the 2021 subsidy amount corresponds to deductions for the shipments landing in Nigeria between December 2020 and November 2021 for a total of ₦1.43 trillion, whereas the subsidy for petrol landing in Nigeria between January and December 2021 amounted to ₦1.61 trillion.

**At the global petrol prices and official exchange rate that prevailed in May 2022, the petrol subsidy could cost Nigeria more than ₦550 billion a month.** At the official exchange rate, 66.5 million liters a day trucked out on average during the first five months of 2022, and international petrol prices prevailing in May, the monthly subsidy would exceed ₦550 billion—more than double the monthly charge from late 2021 (FIGURE 5.5), while the government has authorized ₦4 trillion to be spent on the petrol subsidy. At the current rate of petrol consumption and global petrol prices, the total subsidy in 2022 could surpass ₦4 trillion.

**Nigeria is sacrificing investm*ents in essential goods and services to pay for the petrol subsidy.*** The benchmark petrol price rose from less than US$200 per metric ton in April 2020 to more than US$1,040 per metric ton by March 2022. ₦4 trillion is nearly a quarter of ₦17 trillion appropriated from the Consolidated Revenue Account for the entire annual budget set in the 2022 Appropriation Act (FIGURE 5.6FIGURE 5.6).[76]

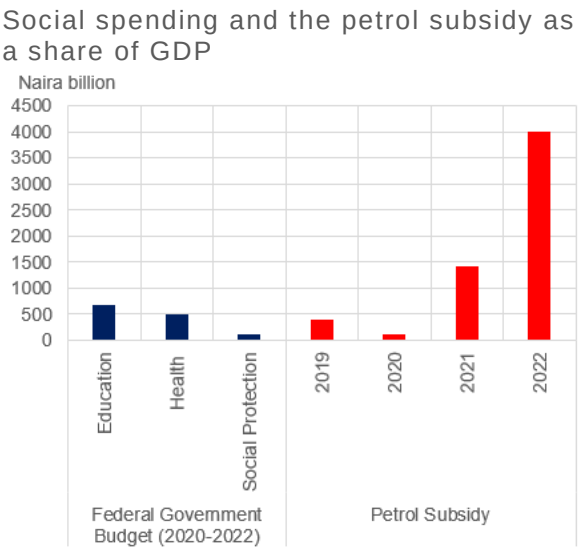
[76] https://www.budgetoffice.gov.ng/index.php/resources/internal-resources/budget-documents/2022-budget.

FIGURE 5.5. The petrol subsidy's cost is steadily rising.




Sources: World Bank staff calculations based on FAAC reports and NNPC financial statements.

FIGURE 5.6. The petrol subsidy is eroding Nigeria's limited fiscal space to provide essential services




Source: World Bank staff calculations based on OAGF.

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

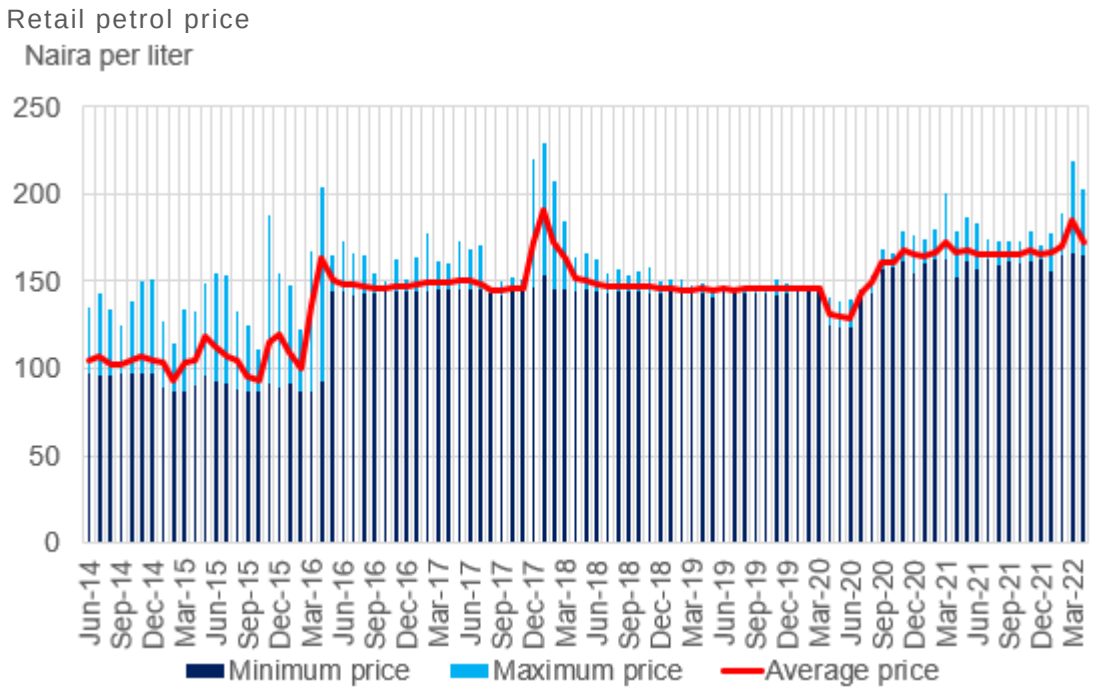
**Subsidizing petrol creates economic distortions and inefficiencies that slow medium-term growth.** To finance the subsidy, the government must increase its borrowing, raise additional revenue elsewhere, or reduce spending on other public goods and services, hindering growth and weakening the fiscal accounts. By freezing retail prices, the petrol subsidy prevents consumers from adjusting their purchasing behavior in response to changes in the cost of supply and creates financial incentives to overconsume petrol, resulting in a loss of consumer surplus. The subsidy also distorts relative fuel prices, encouraging the use of petrol even when other energy sources might be more efficient. According to data collected by the International Energy Agency, the gasoline-to-diesel consumption ratio in Nigeria increased from 2.8 in 2000 to 7 in 2010, more than triple the second highest ratio in the world (United States), before falling to 4.8 in 2019 (IEA 2022). Moreover, all fuel importers and refiners must sell petrol at prices below cost but the government cannot ensure their timely and full reimbursement, which deters new firms from entering the market. Without new entrants and infusions of capital, the downstream petroleum sector becomes increasingly inefficient and undercapitalized, further intensifying its reliance on government support. The refining sector is a case in point. Not only has Nigeria been unable to attract credible investors, none of the refineries have operated since June 2019, despite having a notional installed capacity of 445,000 barrels per day.

**The petrol subsidy creates fuel shortages and rationing through the black market increases prices paid by end-users.** Monthly fuel-price surveys covering all 36 states and the Federal Capital Territory show great variation in actual petrol prices paid, especially in times of acute petrol shortages (FIGURE 5.7FIGURE 5.7).[77] In many months in 2015 and again in March 2022, petrol was not sold at the official price in any state, underscoring the extent to which black marketeers capture the subsidy. As a result, consumers are constrained in accessing petrol. According to the nationally representative 2018 Nigerian Economic Summit Group Nigeria Tax and Subsidy Perception Survey, one-third of fuel-purchasing Nigerians face constraints at the

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

pump, such as queuing, paying above the official price, or facing disrupted supply (NESG 2019; McCulloch Moerenhout, and Yang 2021).

FIGURE 5.7. The price ceiling has often been breached and spatial price differences can be large despite the use of the Petroleum Equalization Fund



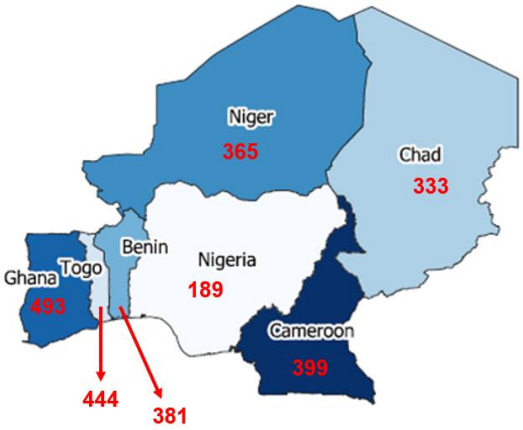

Source: NBS

**The differences in petrol prices between Nigeria and its neighbors provide powerful financial incentives to smuggle petrol out of the country.** Petrol prices in the neighboring countries are more than double the official price in Nigeria, and as much as 250 percent higher in Ghana. Such large price differences create potential profit margins that easily offset the risks and costs involved in smuggling (FIGURE 5.8**Error! Reference source not found.**). Ending the subsidy would substantially reduce incentives to import petrol for sale in other countries and make importing of petrol no different from that of diesel, which has been deregulated for many years.

**Oly a small share of the petrol subsidy goes to poor and vulnerable households.** Poor households benefit little from the petrol subsidy. Combining information on household consumption of petrol from the 2018/19 NLSS with information on other entities' petrol consumption (such as firms and government agencies) from other government statistics, only about one-quarter of petrol sold in Nigeria was purchased by households, while purchases by firms, public transport operators, and government agencies as well as cross-border smuggling accounted for the remaining three-quarters (FIGURE 5.9FIGURE 5.9). Moreover, Nigerians in the top 40 percent of the income distribution purchased 77 percent of all petrol consumed by households, while those the bottom 40 percent purchased just 10 percent. Overall, Nigerians in the bottom 40 percent of the income distribution purchased less than 3 percent of all petrol sold in Nigeria.

FIGURE 5.8. Large petrol price differences between Nigeria and its neighbors create strong incentives for fuel smuggling.

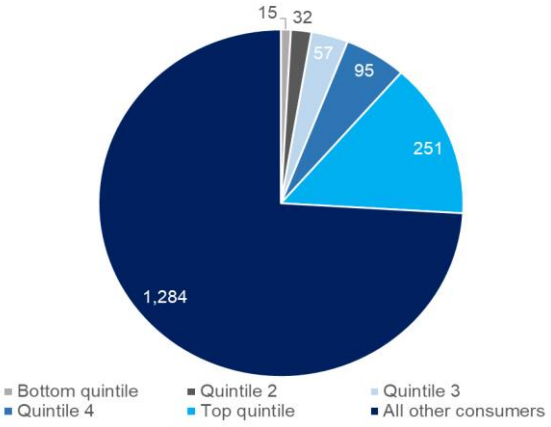
Petrol prices in Nigeria and neighboring countries in September 2022




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

FIGURE 5.9. Households consume only a small fraction of petrol sold in Nigeria, and higher-income households dominate household petrol purchases

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

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Sources: World Bank staff calculations based on data from the 2018–19 NLSS, NBS, and NNPC

## Neither self-sufficiency in fuel refining nor fuel switching to compressed natural gas would eliminate the need to phase out the petrol subsidy

**Increased domestic petrol refining will have little effect on the cost of petrol supply and will not reduce the fiscal burden of the subsidy materially.** Nigeria can supply petrol to consumers by (i) selling crude oil to the highest bidder and importing petrol from the lowest-price bidder, or (ii) refining domestic crude to produce petrol and other fuels. The oil revenue accruing to the government should be the same in both cases, as domestic refineries should purchase crude at the prevailing international price. The savings from switching from imports to domestic refining would arise from shipping costs, which are about US$0.01–0.04 or ₦4–17 per liter. Benchmark petrol prices are set in the major global refining centers, where economies of scale and other sources of efficiency enable refiners to keep the cost of refining low, offsetting the disadvantage incurred by the shipping cost.

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

**Substituting compressed natural gas (CNG) for petrol would take a long time and would also require heavy taxation of petrol for financial sustainability.** A proposed program would support the conversion of one million vehicles from petrol to CNG. The available distribution

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

## The petrol subsidy can be phased out while mitigating negative impacts on poor and vulnerable Nigerians

**The PIA has several provisions that affect the future petrol pricing policy.** The PIA allows a petrol subsidy to be provided by the NNPC for a maximum of six months, marking February 16, 2022 as the date by which the subsidy has to be ended. Because the petrol subsidy continues to be provided, the PIA needs to be amended. The PIA also closes out the Petroleum Equalisation Fund, the instrument used until now to set uniform prices throughout the country. In the absence of the Petroleum Equalisation Fund, petrol prices will vary from location to location depending on the distance from the closest port of entry or refinery as well as the economies of scale. Lastly, the PIA requires that the Authority base pricing on “unrestricted free market pricing conditions” unless there is a monopoly or “an excessively dominant supplier” in the market. That is, as long as there are conditions for adequate competition in the market, petrol pricing is to be deregulated.

**The conditions enabling adequate competition in the petrol market determine whether petrol pricing can be deregulated or should continue to be regulated by the Authority**. The first pre-requisite for competition is adoption of a single, market-driven exchange rate, whereby all qualified petrol importers have nondiscriminatory access to the same exchange rate. The NNPC used an overvalued exchange rate of ₦384–389 to the dollar for petrol imports from June 2021 to March 2022, signaling an exchange rate subsidy. Absent such a reform, the NNPC will continue to be a monopoly importer, thereby requiring economic regulation by the Authority. Downstream of the import terminals and refineries, there are enough fuel suppliers to enable competition. All other fuels in Nigeria—diesel fuel, liquefied petroleum gas (cooking gas), aviation fuel, household kerosene, and heavy fuel oil—have been deregulated for years despite being much smaller markets. The size of the petrol market dwarfs those of all other fuels, providing ample market conditions for vigorous competition.

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

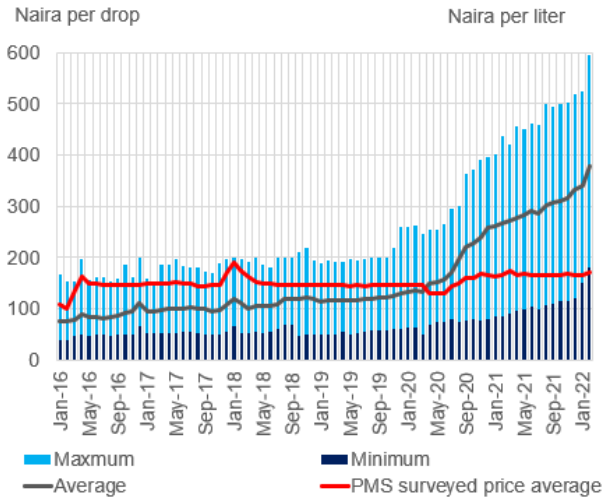
foster and enhance competition to enable a transition to unrestricted free market pricing. Once the petrol market is deemed to be competitive, the Authority can start deregulating pricing while continuing to monitor and enforce competition rules and other standards and regulations.

**The government could phase out the petrol subsidy with the goal of deregulating the market, the timing of which will depend, among others, on whether the petrol market conditions are ripe for adequate competition.** Even before market-based pricing is implemented, it is important to eliminate as many market distortions as possible, such as multiple exchange rates with an over-valued rate used in the oil sector. The issues calling for attention from the Authority include how to foster and promote competition, how to move away from uniform prices throughout the country to location-specific prices without prices soaring in some parts of the country, and defining benchmark performance indicators that could be used to determine when to end administrative pricing and deregulate. The Authority can issue new regulations with specific clauses designed to enhance competition. For example, fuel marketers can be required to post fuel prices that are clearly visible from a distance. The Authority can also require all fuel marketers to upload prices on a designated website as well as an app accessible by smartphones and other devices, and give a time window within which price changes have to be uploaded, such as no earlier than within 15 minutes of the next price change. The website and the app can enable consumers to list filling stations in order of decreasing price where they live to promote price competition.

**Distinguishing between the inflationary impact of higher petrol prices and other factors is critically important in assessing policy options and outcomes.** The inflationary impact of subsidy elimination is a key reason behind the persistence of the petrol subsidy. Fuel-price increases have direct and indirect inflationary effects: direct effects are experienced by fuel purchasers, while indirect effects arise when the fuel is used as an intermediate good. Unlike diesel, which is widely used as an intermediate good in many commercial and industrial processes, petrol is rarely used as an intermediate good except when employed as an automotive fuel for light- and medium-duty vehicles transporting goods and passengers. Higher petrol prices will therefore pass through to transportation prices, although wage rates, vehicle purchase and maintenance costs, and other factors unrelated to petrol will also affect transportation prices. For example, the average motorcycle taxi fare increased by 45 percent between January 2021 and February 2022 despite no increase in the official price of petrol over the period (FIGURE 5.10).

FIGURE 5.10. Despite petrol prices remaining fixed in 2021 and 2022, the average motorcycle taxi fare has steadily increased.

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




Source: NBS.

**The removal of the petrol subsidy may be followed by price increases that are only indirectly related to the policy change.** While the change in fuel prices will be visible to all Nigerians immediately, changes in wage rates, vehicle parts and maintenance, and other costs will be known only to a much smaller group of people. As a result, service providers may take advantage of fuel-price increases to charge much more than the price increase itself would warrant. For example, when the government of Bangladesh raised the price of diesel by 11 percent in 2011, one large trucking company increased the trucking fare by 22 percent, while a

food-transport company announced that transportation prices would rise by 50 percent. While these disproportionate increases in transportation prices were driven by factors unrelated to the price of diesel, the firms involved cited higher diesel prices as the sole reason for rising fares (*Financial Express* 2011; *New Nation* 2011). The Nigerian authorities should be well prepared for similar behavior by domestic transportation companies following the removal of the petrol subsidy and take appropriate action, such as coordinating with transport operators and communicating clearly with the public.

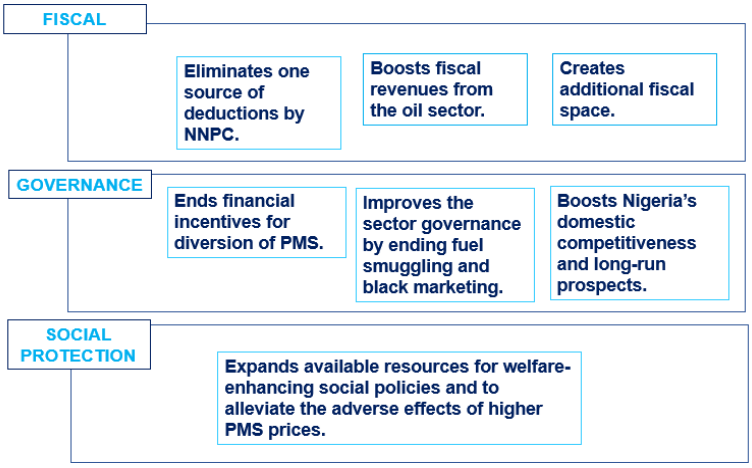
**Removing the petrol subsidy can deliver benefits far beyond fiscal savings.** The opportunity cost of the subsidy is forgone investment in productive infrastructure and human capital, and redirecting resources to national development priorities would accelerate growth while advancing the government's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

**While only a small share of the petrol subsidy goes to poor and vulnerable Nigerians, many of them still purchase petrol, pay for transport, and could face other indirect costs if petrol subsidies were to be removed.** According to the 2018/19 NLSS, as many as 31.4 percent of those Nigerians in the bottom 6 deciles of the national consumption distribution directly purchased petrol; they would be directly exposed to any increase in petrol prices, were subsidies to be removed (Lain and Vishwanath 2022). Turning to indirect effects, in many countries, diesel dominates bus and freight transportation, but Nigeria's history of diesel-price deregulation and the continuing petrol subsidy have encouraged the widespread use of petrol as an automotive fuel. Petrol is also widely used in small backup power generators. The potential rise in transport and electricity costs therefore further exposes poor and vulnerable Nigerians to any increase in petrol prices. Overall, assuming a 20-percent pass-through from petrol prices to inflation, removing the petrol subsidy in the second half of 2022 could cause the headline inflation rate to rise by an additional 3.0 percentage points over the following two years. This poses a significant threat to purchasing power. With no compensating measures for the poor and vulnerable, removing petrol subsidies thus risks pushing a significant number of Nigerians into poverty (Lain and Vishwanath 2022).

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

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

FIGURE 5.11. Eliminating the petrol subsidy will yield a wide range of benefits.




Source: World Bank.

**Government credibility is vital to garner public support for ending the petrol subsidy.** If the public believes that the savings generated by eliminating the subsidy will not be put to good use, pressure to maintain the policy or reverse the reform will intensify. A survey conducted in July 2018 involving 16,000 Nigerians combined with focus-group discussions found that respondents who had faced petrol shortages or black-market prices were more inclined to support subsidy reform, but the survey also revealed low levels of public trust in the Nigerian government. Although overall trust in the government was not correlated with support for subsidy reform, respondents who believed that the government was corrupt or that it would not use the savings from eliminating the subsidy effectively favored keeping the policy in place by a very large margin (McCulloch, Moerenhout, and Yang 2021). These findings underscore the critical importance of effectively publicizing the launch of the cash-transfer program, clearly linking it to subsidy reform, and forming a credible compact with the Nigerian public that emphasizes the tangible benefits of ending the petrol subsidy.

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## 5.2 The electricity subsidy

### A lack of cost-reflective tariffs between 2012 and 2021 created a significant fiscal burden

**Electricity tariffs are set through a MYTO, and different tariff rates apply based on how much electricity a consumer uses**. However, before 2022, average tariffs were well below the cost-reflective tariff, i.e., the tariff that fully reflects the cost of generating, transmitting, and selling power to the final consumer, for all consumers. As the power sector has been private since 2013, the federal government has financed below-cost electricity prices through a public subsidy.

**At the root of the problem was the poor performance of the power sector.** The transition from a publicly owned to a largely privately owned power sector did not bring the expected performance and service quality outcomes. Government ministries and agencies, the NERC, and the private sector have all fallen short of their expected contributions to the sector's turnaround. The sector's financial sustainability is jeopardized by weak tariff regulation, high technical losses, and low collections.

- Poor implementation of tariff policies: Although sector regulator the NERC periodically issues MYTOs[78], these were not actively enforced, with delays often due to external factors such as litigation and political interference. Delays in tariff implementation have weakened the financial situation of power sector companies, especially distribution companies (DISCOs), and left the NERC unable to enforce the contractual obligations of privately-owned generation companies (GENCOs) and DISCOs.
- High losses and low collections: The sector's aggregate technical, commercial, and collection (ATC&C) losses are extremely high, with DISCOs reporting on average losses of 50 percent in 2020, versus 26 percent allowed by the NERC's tariff policy. These high losses are exacerbated by inadequate metering of end-use customers and the failure of many ministries, departments, and agencies (MDAs) of federal, state, and local governments to pay their electricity bills. High losses, coupled with a lack of payment discipline by DISCOs and inadequate contractual enforcement of those payments by the Nigerian Bulk Electricity Trading (NBET) and the NERC, result in low remittances to NBET by the DISCOs.

**The federal government has intervened to cover the difference between allowed and cost-reflective tariffs, i.e., the tariff shortfall.** Tariff policy has not allowed tariffs to be cost reflective, and the federal government has become responsible for funding this gap. For example, in 2019, allowed electricity tariffs only covered 56 percent of the sector's required revenue. Between 2015 and 2020, the tariff shortfall widened significantly because allowed tariffs stayed flat but cost-reflective tariffs shot up due to foreign exchange depreciation and domestic inflation. The cumulative shortfall for 2015–20 was an estimated ₦2,168 billion (roughly US$7 billion). In 2019 total federal government support reached ₦524 billion (US$1.7 billion), or 0.4 percent of GDP—higher than the ₦428 billion budget for health and just 20 percent less than the ₦650 billion budgeted for education.

**To ensure that GENCOs and gas suppliers received sufficient payments to continue generating electricity, the federal government has borrowed from the CBN a total of ₦1,301 billion (US$3.6 billion) since 2017 under the Payment Assurance Facility (PAF).** Debt service obligations for the CBN PAF have become a significant fiscal burden on the federal government, at ₦198 billion (US$550 million) per year from 2020 to 2027 as per the original term-sheet. The original PAF, which was unconditional, was used by the NBET to supplement the remittances of

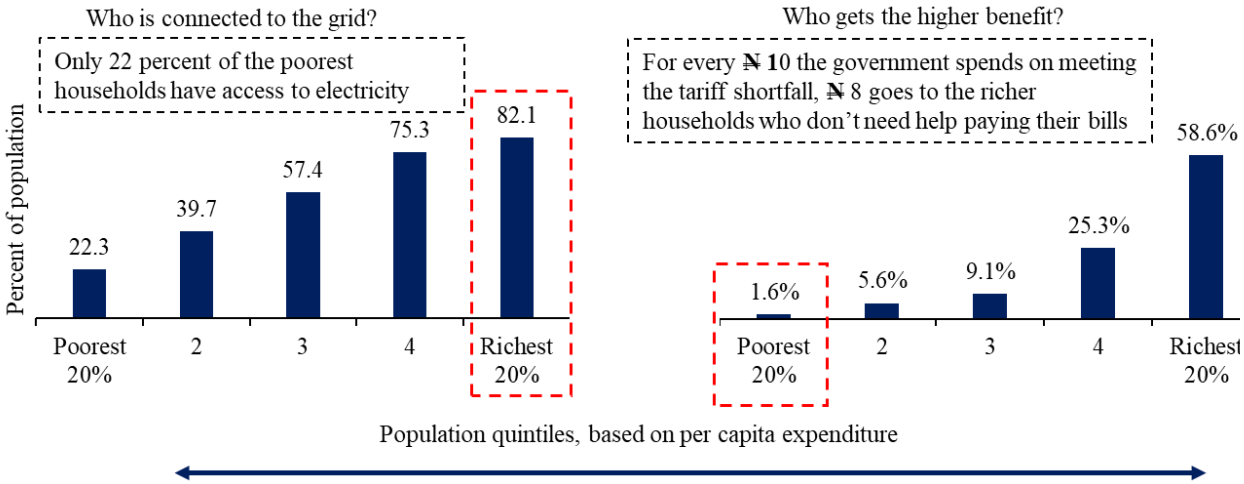
[78] The MYTO methodology followed in Nigeria uses an incentive-based regulation that seeks to reward performance above certain benchmarks.

DISCOs and ensure that GENCOs would be paid at least 80 percent of their costs. A PAF expansion, approved by the government in May 2019, was conditional and underpinned by an Accountability Framework, based on the PSRP approved by the government in March 2017 to address key issues in the sector. Even with this approved bridge lending, there were more than ₦550 billion outstanding in tariff shortfall arrears owed to GENCOs. The CBN PAF also undermined fiscal transparency and debt management, because it is currently not part of the federal government debt stock.

## The electricity subsidy, through the financing of the tariff shortfall, benefits more the relatively wealthy

**The current structure of government funding to the power sector is highly regressive.** Every Nigerian who receives electricity from a DISCO pays less[79] for electricity than the cost of supplying it. However, the significant public resources spent on funding tariff shortfalls disproportionately benefit the relatively wealthy, who have better access to the grid and use more electricity. 80 percent of spending on tariff shortfalls benefits the richest 40 percent of the population; only 8 percent benefits the bottom 40 percent, and of this less than 2 percent benefits the poorest 20 percent (FIGURE 5.12).

FIGURE 5.12. Distribution of government spending to meet the tariff shortfall




Source: World Bank 2020.

## The government's experience with the electricity subsidy demonstrates that it is possible to reduce fiscal costs while protecting the poor.

**At the beginning of 2020 the situation became critical, and it was estimated that if the sector continued with its past performance and tariffs stayed below cost-recovery levels, the federal government would have to provide another N3.082 trillion (US$7.94 billion) in regressive subsidies through 2023.** There was broad political consensus and real commitment to start turning around the sector by addressing critical points as set out in the government's PSRP, which has already been partly implemented. The PSRP is a comprehensive package of financial, operational, governance, and policy interventions for restoring the sector's financial viability, improving service delivery, reducing its fiscal burden on the government's budget, strengthening sector governance and transparency, and ensuring that contracts are enforced and reforms communicated. The government chose to undertake critical PSRP actions in all four of

[79] This excludes the sums spent by consumers on gasoline, gensets, solar and other alternatives to augment the unreliable supply.

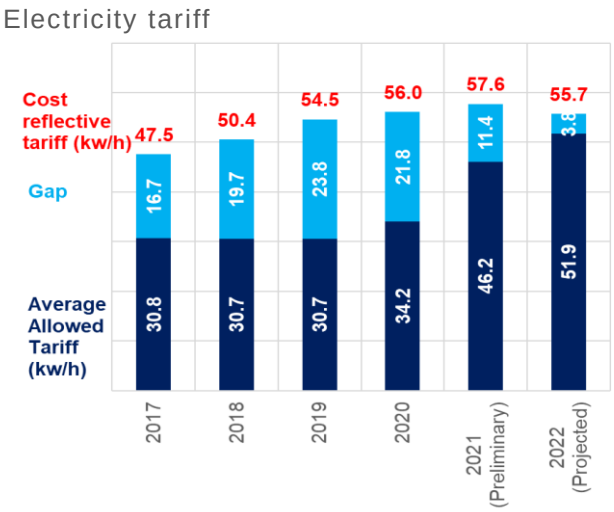
its areas: (a) policy and regulatory environment; (b) fiscal and financial sustainability; (c) operational efficiency; and (d) network infrastructure.

**To quantify and monitor the government's annual funding to the power sector, in 2020 a multi-agency committee under the leadership of the FMFBNP resumed the preparation of annual Financing Plans.** The Financing Plan (FP) presents funding requirements and the relevant sources of funds to cover new and historical tariff shortfalls until cost recovery is achieved. The first PSRP Financing Plan was prepared in November 2017, but it was not subsequently updated. In 2020, a new Financing Plan was prepared by a multi-agency technical committee. It quantified the government funding required by the sector for 2020–2027 to cover historical and new tariff shortfalls, including the repayment of the CBN PAF, and identified the sources of such funding. The Financing Plan used credible and realistic macro and sectoral assumptions, consistent with the 2020 MYTO, and was based on the principles of completeness, fiscal affordability, and social sustainability.

**As part of the 2020 PSRP Financing Plan, the government approved a total funding envelope of ₦380 billion (US$1.056 billion) for covering new tariff shortfalls in 2020, and the NERC committed to adjusting end-user tariffs to fit this envelope.** The government and the NERC also approved a set of measures to mitigate the impact of tariff adjustments on poor households. In November 2020, the government took a significant step by introducing a service-based tariff (SBT),[80] which effectively increased tariffs by an average of 38 percent. The transition to the SBT and increased payment discipline have enabled distribution companies to increase collection efficiency and remittances to the NBET.

**In 2021 tariff shortfalls decreased further as tariffs continued to rise.** The 2021 PSRP Financing Plan (FP) is the first annual update to the 2020 PSRP FP approved by Federal Executive Council. It presents an update on the use of funds in 2020, a baseline FP for 2021, and an assessment of the implementation of the FP in 2021. The government has targeted a reduction in new tariff shortfalls from ₦502 billion in 2020 to less than ₦300 billion in 2021, as it moves the power sector towards full cost recovery and a fair electricity pricing policy. In April and September 2021, tariffs were further increased, reaching 89 percent of the cost-reflective tariff. The plan envisages the complete removal of the electricity subsidy by 2023 (FIGURE 5.13).

FIGURE 5.13. Administrative tariffs and cost-reflective tariffs




Source: NERC.

**Shocks to macro variables and poor technical performance are the two main risks towards the elimination of the electricity subsidy**. Unpredictable changes to foreign exchange rates, inflation, energy sent out, DISCO capex, and allowable ATC&C losses may jeopardize the achievement of cost-reflective tariffs.

- Foreign exchange rates and inflation: Consistent macroeconomic policies could reduce uncertainty around foreign exchange and maintain inflation low and stable. Moreover,

[80] The SBT was introduced on September 1,2020 and suspended for the month of October, but has been in effect since November 1, 2020.

better access to foreign exchange will reduce the cost of maintenance of generating plants, thus reducing technical losses associated with inadequate maintenance investment.

- Technical performance: Increasing the capacity and reliability of the transmission network is critical to the sector's financial viability, and thus to reducing the burden on the federal government. Insufficient investment in transmission has curtailed the network's capacity to transport power, to the point that only 33 percent of installed capacity is usable. Historically, transmission investment has been led by political pressure to connect all parts of the country to the grid, rather than by demand from DISCOs to deliver power where paying customers are located. Hence, much of the grid is underused while transmission capacity in high-demand areas is inadequate. There is a clear need to refurbish transmission infrastructure to enhance system stability and ensure that the grid can dispatch electricity at lower cost while increasing the supply. At the same time, Nigeria is a critical member of the West Africa Power Pool (WAPP), the regional market launched in 2018, which can significantly improve the electricity supply not only in Nigeria but throughout West Africa.

## 5.3 The exchange rate subsidy

### Nigeria's exchange rate subsidy stems from complexities in exchange rate management

**While Nigeria's exchange rate policy has multiple objectives, maintaining a stable nominal exchange rate is one of its priorities.** The stated objectives of the Central Bank of Nigeria (CBN)'s exchange rate policy are: preserving the value of the domestic currency (the naira); maintaining a favorable external reserves position; and ensuring external balance without compromising internal balance and overall macroeconomic stability. The CBN has over time prioritized a stable naira, pursuing this objective through conventional and, at times, unconventional means of foreign exchange or exchange rate management, based on factors such as the changing pattern of international trade, institutional changes in the economy and structural shifts in production.

**Multiple Currency Practices (MCP)[81] have been a feature of the CBN's efforts to maintain a stable exchange rate, but this has implied implicit "tax" and subsidy being created, with a number of impacts.**

- *The implicit "tax" impact*: The CBN has often kept an artificially low official exchange rate which is only applicable to government transactions, including for the conversion of foreign currency-denominated revenue flows to the general government[82] (**Error! Reference source not found.** on exchange rate management practices in Nigeria). This official rate differed from the exchange rate applicable to other types of transactions, which was often more market-determined, implying foregone revenues to the general government—i.e., an implicit "tax" on general government revenues.
- *The implicit subsidy impact*: The CBN converts foreign currency-denominated government revenue inflows at an artificially low exchange rate, but it supplies foreign

[81] Multiple Currency Practices (MCPs) refers to having separate exchange rates for different groups of exchange transactions. This contrasts with a unified exchange rate system. International Monetary Fund (IMF) MCP policy posits that an MCP occurs if an exchange transaction in a country takes place at an exchange rate spread that does not reflect normal commercial realities. For spot transactions, the policy establishes a uniform permissible spread of up to 2 percent.

[82] From June 2017, a Mandated Rate—closer to the private sector rate than the official rate—has been used to convert foreign currency revenues, but the excess arising from the difference between the mandated and official (budget) rate is placed in a forex stabilization account and distributed when there is a revenue shortfall.

exchange to the other foreign exchange windows at a more market-determined rate, which amounts to a subsidy for the CBN.

**Following the 2015–2016 oil shock and the severe foreign exchange pressures that ensued, MCP intensified as the CBN continuously fine-tuned its foreign exchange management framework, in a bid to support various economic sectors while maintaining a stable naira (FIGURE 5.14).**[83] In the process, additional foreign exchange windows were established, with mostly fixed or managed exchange rates. In particular, the IEFX window was established in early 2017, as a platform for investors, exporters and end-users (with the CBN also being a participant) to boost liquidity in the foreign exchange market. Over time, most private sector transactions were consolidated into this window. The exchange rate at the IEFX window—the NAFEX rate—started off as a market-determined rate, but it subsequently became managed and did not move very often. However, a gap remained between the NAFEX rate and the CBN official rate, to the tune of 18 percent by the end of 2017.

**In August 2020, for the first time since the NAFEX was established, the CBN official rate stood at a deviation of less than 2 percent from the NAFEX rate, effectively eliminating the MCP.** However, by December 2020 the NAFEX rate again deviated significantly from the official rate, which had remained fixed at ₦380/US$1, and the MCP subsidy to the CBN was resumed, reaching 8 percent by April 2021. In May 2021, the CBN renewed the moves to fully operationalize the use of the NAFEX rate as the guiding rate for the economy, by replacing the official rate published daily on its website with the daily NAFEX closing rates. The CBN now supplies foreign exchange to the few remaining windows mostly within the range of the NAFEX rate.[84] Government transactions were still to be executed at a rate 2 percent lower than the IEFX rate, thus maintaining a 2 percent subsidy for the CBN. Effectively, since June 2021 the quantum of the foreign exchange subsidy to the CBN has been negligible. Nonetheless, the NAFEX rate remains managed and is not fully reflective of market conditions.

**The BDC and parallel foreign exchange markets continue to exist, but their rates remain outside the CBN's control.** The BDC and parallel premia over the NAFEX rate reached 29 percent in August 2021, after the CBN cut off its weekly US$20,000 per BDC foreign exchange supply[85], providing ample opportunities for currency round-tripping. The BDC and parallel market premia reached 67 percent at the height of the foreign exchange crisis in 2016 **Error! Reference source not found.**(FIGURE 5.15).

[83] In June 2015, the CBN disqualified 40 products from access to foreign exchange in any of the markets. In June 2016, it announced the introduction of a flexible exchange rate system in response to the continued slide in external reserves, but from September 2016 it resumed a closely-managed exchange rate system in practice.
[84] The existing windows are the I&E, the Secondary Market Intervention Sales (SMIS) retail, the Small and Medium-size Enterprises (SME) and the Invisibles windows. The CBN sells at a discount to the SME window (NAFEX rate minus ₦2) but the rate at the SMIS fluctuates and has been as high as ₦476/US$1.
[85] The CBN supplied forex to BDCs from 2005 until July 2021, with some breaks in between.

FIGURE 5.14. Multiple Exchange Rates in Nigeria

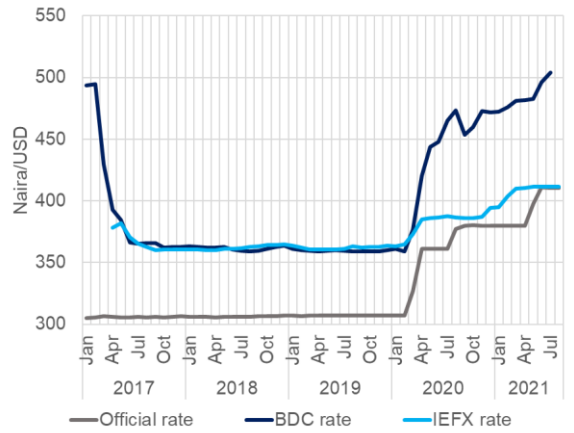
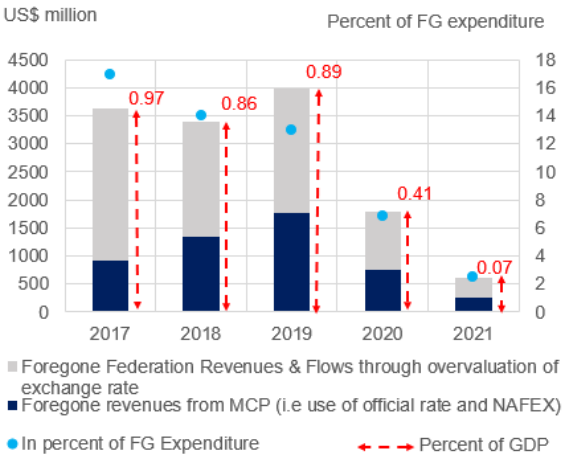


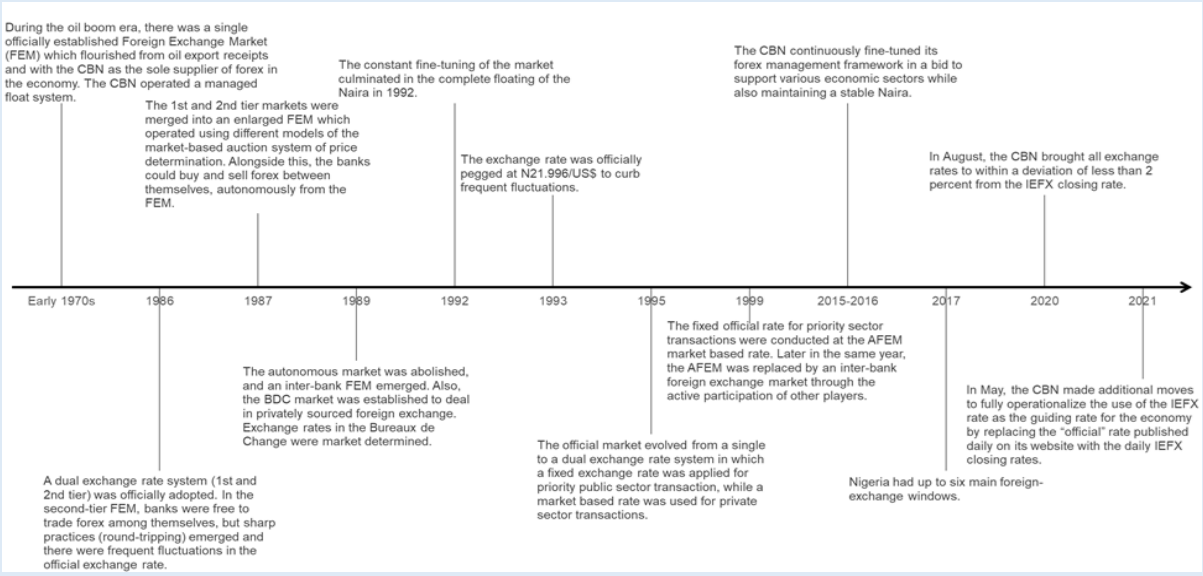

FIGURE 5.15. Exchange Rate Premia




Sources: CBN, FMDQ, Nairametrics
Note: Daily SMIS, SME and Invisible rates are not published and thus are not captured in this chart

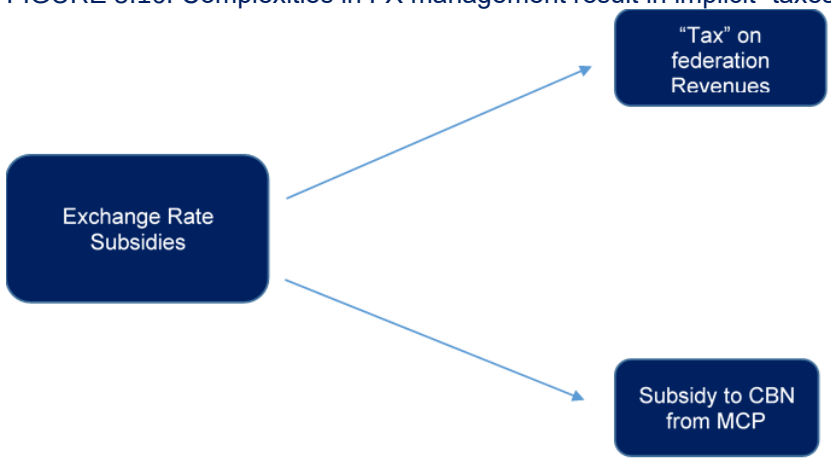
## BOX 5.1. Foreign Exchange Management Practices in Nigeria

**At various times, different foreign exchange management systems and frameworks have been adopted by the CBN.** Given Nigeria's reliance on crude oil proceeds for its foreign exchange earnings, developments in the oil market have been a critical factor in many of the foreign exchange management system transitions. The following chart provides an account of the various foreign exchange management systems adopted in Nigeria since the 1970s




Source: CBN

FIGURE 5.16. Complexities in FX management result in implicit "taxes" and subsidies




## The multiple currency practice (MCP) generates an "implicit tax" on federation revenues and financing flows

**The implicit MCP tax on net general government revenues amounted to an estimated US$8.1 billion between 2017 and 2021 H1 ().**[86] In 2020 alone, Nigeria received approximately US$13.4 billion in foreign currency-denominated oil and gas and customs revenue. Based on the CBN-mandated rate (average of ₦368/US$1), this amounted to ₦4,901 billion, but if the more widely used IEFX rate (average of ₦382/US$1) had been applied, this sum would have amounted to ₦5,116 billion—implying foregone revenues, or an implicit "tax" on general government revenues, of ₦216 billion. In 2020 Nigeria also received US$10.5 billion in new external debt financing, which translated to ₦3,806 billion based on the official rate (average of ₦368/US$1) but could have amounted to ₦4,018 billion had the IEFX rate been applied. This occurred at a time when Nigeria's fiscal flows were severely hit by the fallout of COVID-19 and a consequent oil price drop, while the country needed to safeguard distributable revenues and financing to the general government to address the human and economic impact of the pandemic.

TABLE 5.1. Value of implicit "tax" on Federation revenues and financing flows due to MCP (2017-2021 H1)

| | 2017 | 2018 | 2019 | 2020 | 2021 H1 |
|---|---|---|---|---|---|
| Loss to Federation Account (Net, US$ mn) | 2,733.31 | 2,050.93 | 2,222.30 | 1,052.30 | 61.51 |
| Per capita (US$) | 14.32 | 10.47 | 11.06 | 5.10 | 0.30 |
| In % of GDP | 0.73 | 0.52 | 0.50 | 0.24 | 0.06 |
| In % of General Government Spending | 6.69 | 4.35 | 4.13 | 2.22 | .. |
| In % of Federal Government Spending | 12.76 | 8.44 | 7.20 | 4.02 | 0.46 |

Sources: Government data, World Bank staff estimates

## The CBN's forex sales generate an implicit exchange rate subsidy

[86] This is net of external debt service, which is also remitted at the preferential exchange rate, thereby yielding a subsidy to the government. In addition to foreign currency-denominated revenues, this amount included new disbursements from foreign loans.

**The implicit subsidy from the MCP is linked to the CBN's use of undervalued U.S. dollar inflows (from crude oil sales and financing flows) to stabilize the exchange rate in the I&E and in other windows by supplying them with foreign currency at the NAFEX rate or similar.** The CBN injected US$14.5 billion into the I&E window from 2017 to 2020. In 2020, the supply was only US$2.7 billion; this was largely due to pandemic-related efforts by the CBN to guard against the depletion of foreign reserves, which saw the CBN cutting off supply for six consecutive months.[87] The MCP subsidy to the CBN during 2017 and 2021 H1 amounted to an estimated US$4.8 billion (TABLE 5.2.**Error! Reference source not found.**).[88]

TABLE 5.2. Value of MCP subsidy to the CBN (2017–2021 H1)

| | 2017 | 2018 | 2019 | 2020 | 2021 H1 |
|---|---|---|---|---|---|
| US$ mn | 903.81 | 1,347.19 | 1,763.42 | 740.69 | 82.63 |
| Per capita, US$ | 4.73 | 6.88 | 8.77 | 3.59 | 0.40 |
| In % of GDP | 0.24 | 0.34 | 0.39 | 0.17 | 0.04 |
| In % of Consolidated Government Spending | 2.21 | 2.86 | 3.28 | 1.56 | .. |
| In % of Federal Spending | 4.22 | 5.54 | 5.72 | 2.83 | 0.36 |

Sources: Government data, World Bank staff estimates

## There are exchange rate complications associated with NNPC transactions

**While the NNPC directly deducts from the government's oil revenue to reimburse itself for petrol subsidy, its use of variable exchange rates in accounting (in naira) for its transactions raises questions around clarity and transparency.** The exchange rates applied by the NNPC, including when accounting for the cost of the petrol subsidy (termed "under recoveries"), are formally "as advised by the CBN"; however, these rates have sometimes diverged from those of all foreign exchange windows. For example, from May 2021, when the official rate was merged with the NAFEX rate and thus depreciated to ₦411/US$1, the NNPC continued to use a rate of ₦387/US$1 to account for "under-recoveries", thus under-representing the value of the petrol subsidy.

## What is the overall fiscal cost of Nigeria's exchange rate subsidy?

**The implicit subsidies and "taxes" engendered by Nigeria's MCPs have resulted in high fiscal costs and opaqueness in public financial flows.** In total, between 2017 and 2020, they have amounted US$16.5 billion (TABLE 5.3.), equivalent to 8 percent of the total general government budget and 14 percent of the total federal government budget over this period. The subsidies peaked in 2018, when they amounted to US$4.9 billion (1.2 percent of GDP) and constituted 10 percent of total general government expenditures. Similar to other tax expenditures, their use add to the fiscal murkiness and inefficiency of public finances, as the instruments are not scrutinized and applied transparently in the same way as on-budget expenditure programs.

[87] CBN data.
[88] World Bank staff estimate. The CBN's latest published financial statements are from 2015; thus, the exact size of its income from the MCP is not clear.

TABLE 5.3. Total Value of foreign exchange implicit "taxes" and subsidies (2017–2021 H1)

| Implicit Subsidy/Tax | 2017 | 2018 | 2019 | 2020 | 2021 H1 |
|---|---|---|---|---|---|
| Subsidy on MCP to CBN (US$ million) | 903.81 | 1,347.19 | 1,763.42 | 740.69 | 82.63 |
| Net "Tax" on Federation Revenues & Flows (US$ million) | 2,733.31 | 2,050.93 | 2,222.30 | 1,052.30 | 61.51 |
| **TOTAL** | **3,637.11** | **3,398.12** | **3,985.71** | **1,792.99** | **144.13** |
| *In per capita terms (US$)* | *19.05* | *17.35* | *19.83* | *8.70* | *0.70* |
| *In % of GDP* | *0.97* | *0.86* | *0.89* | *0.41* | *0.07* |
| *In % of General Government Expenditure* | *8.91* | *7.21* | *7.41* | *3.79* | *--* |
| *In % of Federal Government Expenditure* | *16.97* | *13.98* | *12.92* | *6.84* | *0.63* |

Sources: Government data, World Bank staff estimates

**Besides the fiscal cost, the strategy of supporting the economy through multiple exchange rates (most of which are fixed or managed) has created distortions and imposed broader costs on the economy.** Preferential rates have usually aimed at protecting certain sectors or segments of the economy, but they have in effect distorted relative prices and created an uneven playing field. Preferential rates have given some market participants preferential access to overvalued foreign exchange windows, while those in other sectors have adapted by raising prices, or cutting production, or using the parallel market to import goods (some of them smuggled). The use of multiple exchange rates, especially from the 2015–16 crisis until at least 2020, further distorted decision-making by creating round-tripping opportunities. Moreover, the MCP has discouraged private investment, especially during periods of financial stress. International experience also illustrates how MCPs cause higher inflation and lower per capita growth. In summary: the MCP in Nigeria has been a drain on fiscal resources, undermined macroeconomic stability, and is slowing post-crisis recovery, as it did in the wake of the 2015–16 oil shock.

**The use of different rates for different types of transactions also complicates national accounting, especially when variables are to be reflected in foreign currency terms and international comparisons are to be made.** It is often unclear which exchange rate should be applied, and the choice of rate could imply wide variations in the value of relevant variables and indicators.

## 5.4 Extrabudgetary entities, transactions, and quasi-fiscal expenditures

### Bringing extrabudgetary entities into the national budgetary framework would improve fiscal oversight and mitigate fiscal risks

**There are hundreds of extrabudgetary units at the Federal Government level alone. In addition to 832 Federal Government Budgetary units, there are 532 extrabudgetary units at the federal government tier alone**. As outlined in the Federal Government PEFA 2019 Report, most of them receive some budgetary contributions (see TABLE 5.4.). The number of budgetary and extrabudgetary units at the subnational tiers of government remain to be estimated. The proliferation of extra-budgetary funds into hundreds of individual units are associated with the dilution of accountability and control, atomizing political governance and fragmenting and undermining the overall quality of fiscal management, including solidity of fiscal rules framework, and problems in reporting and consolidating fiscal data, in support of assessing fiscal deficit and other key fiscal indicators (Federal Government PEFA 2019).

**In the PFM cycle, the lack of information on extra budgetary entities does not allow proper budgeting, cash-management, internal and external control, including monitoring fiscal**

**risks.** The National Assembly and the National Treasury have the responsibility to carry out the oversight within the public sector as such, i.e., general government fiscal matters and extra-budgetary entities. Achieving fiscal discipline has been affected by weaknesses in the control of the total budget, the lack of information and control of extra-budgetary operations, and by the lack of proper oversight of aggregate fiscal risk of extra-budgetary units and public enterprises by the National Treasury and National Assembly.

**Actual and forward estimates of revenues and expenditure of extra budgetary entities are not widely and readily available in the fiscal reports and MTEF, if at all.** Although budget documents only report 10 top GoE revenues, those estimates account for almost 28 percent of FGN total revenues. [89] Revenue collected from extra budgetary agencies are paid into sub-accounts at CBN, which are linked to TSA, and partially funded budgetary units use the GIFMIS platform to access the CBN Payment Gateway for the management of their sub-accounts for budget execution. However, information on extra-budgetary entities is not integrated and/or included in the fiscal reports. A joint exercise with BOF and OAGF revealed that a sample of 112 extrabudgetary entities reported revenues and expenditures outside the FGN financial reports in an amount more than 10 percent of the Federal Government revenues and expenditures. [90]

TABLE 5.4. Number of entities in the Public Sector of Nigeria (2017)

| | Public Sector | | | | |
|---|---|---|---|---|---|
| | Government Sub-sector | | Social Security Funds | Public Corporations | |
| | Budgetary Units | Extrabudgetary Units | | Nonfinancial Public Corporations | Financial Public Corporations |
| Federal budgetary entities | 832[91] | 532[92] | | 15 | 10 |
| State Governments | 36 + FCT | | | | |
| Local Governments | 774 | | | | |

Sources: Budget Office of the Federation and Office of the Accountant General of the Federation; PEFA 2019

## Priority public infrastructure investments are increasingly taken out of the budget framework

**With funding shortfalls and PFM/PIM challenges in capital budget implementation priority projects (particularly, roads and power) have increasingly been taken out of the federal government budget framework and diverted to be implemented by extra-budgetary units or the private sector agencies** outside the government systems.

**Several mechanisms have been established to implement these priority capital projects, from tax credits to Presidential Funds and Initiatives.** Examples include: i) Road Infrastructure Tax Credit Scheme' (RITCS, Executive Order 07 of 2019), under which private companies implement road construction from a list of projects approved by the President, and reclaim the

[89] Calculated as GoE revenues [N2,174 b] as a share of FGN total revenues [N7,986 b] – source: 2021 Appropriation Act.
[90] PEFA (2019).
[91] 306 are funded fully from federal government budget while 526 are partially funded from federal government budget.
[92] 526 are partially funded through federal government budget but generate additional revenue as well as incur expenditure that are not captured in the annual budget and government financial report. 6 are entities that and not funded through the federal budget.

cost through tax credits from their Companies Income Tax (CIT) bill; and ii) the Presidential Infrastructure Development Fund (PIDF, established in 2018, housed at the National Sovereign Investment Agency), which receives government (federation) seed funding, can syndicate it with external partner funding, to implement road and power projects.

**These extrabudgetary mechanisms, devised to accelerate the implementation of the priority projects, have significant fiscal implications.** These include some of the fiscal issues related to extrabudgetary entities, such as dilution of accountability and political governance. In addition, revenue foregone will occur due to the targeted tax expenditures as been established, as well as it diverts the oil, gas and other government revenues and savings towards spending due to efforts to accelerate the priority project implementation. While most of the projects (with some exceptions, for instance, the PPI) would have undergone the standard budgetary practices of project costing, feasibility, appraisal and prioritization, and most even have budget codes assigned to them, there is a lack of clarity of the oversight and control as the removal of these projects from the budget circumvent systems and procedures and establish parallel structures not subject to the same oversight and controls or monitoring and evaluation. The pathways for the budgeting of the maintenance of these roads is also not clear: for instance, the Nigeria Road Investment Tax Credit Scheme (RITCS) only requires the implementing companies to maintain the roads for 5 years

| Type of Extra-budgetary spending | Funding type (fund, SPV, PPP, tax expenditure) | Type of projects implemented | Initial funding and source, and annual expenditures | Oversight structure | Fiscal Risks |
|---|---|---|---|---|---|
| Executive Order 07[93] | • Tax Expenditure ('Road Infrastructure Tax Credit') against CIT (up to 50% annual CIT due, no limit for economically disadvantaged areas) as a PPP | • Construction and refurbishment of Roads<br>• | • [Value of 2019-2020 Certificates issued]<br>• Annual tax credits for the amounts of project costs (plus the 'uplift')<br>• | • Management committee chaired by the HMFBNP<br>• HE President – approves the list of roads (based on HMFBNP recommendation)<br>• FIRS – Issues Certificate (transferrable/ tradable)<br>• M&E carried-out by the responsible Ministry | • No limit for annual tax credits<br>• GoN is the owner of the Roads<br>• Procurements procedures don't follow public sector regulations and additional costs can be recognized<br>• Budgeting for project maintenance outside the budget framework |
| Presidential Infrastructure Development Fund (under Nigeria Sovereign Investment Agency) | • NSIA acts as fund and investment manager, government (federal and states, through NEC) provides seed funding[94] | • Critical Roads and Power Projects | • US$650 million seed funding in 2018 from NLNG dividends. Additional government contribution US$299 million in 201995<br>• 2018 investments US$260 million; 2019 deployment US$640 million96 | • PIDF is managed by NSIA and has its oversight framework.<br>• Disbursements based on tripartite agreements between NSIA, Ministry of Works and Ministry of Finance | • Same as NSIA (see below) |
| NSIA: other funds (NIF) | • Excess crude account (ECA), NLNG dividends.<br>• Allocations: The Future Generations Fund (40%), The Nigeria Infrastructure Fund (40%), The Stabilization Fund (20%) | • NIF: Hospitals, food production, fertilizer.<br>• FGF: long investment time horizon financial assets<br>• SF: short time horizon and low returns financial assets | • Capital contributions: US$1 billion (2013), $250 million each year from 2016 to 2019.<br>• (2019) Expense from infrastructure investments: N35.7 billion. | • Governing council (35), Board of Directors (9). Managing Director appointed by the President, Chief Investment Officer and Chief Risk Officer - report to the Board of directors.<br>• Member of the International Forum of Sovereign Wealth Funds (IFSWF) and a signatory to the Santiago Principles<br>• Independent audit appointed by the Board. | • Infrastructure projects assessments (risks, returns, costs), execution of huge infrastructure projects, competitive procurements procedures, cost verification, investment portfolio performance, oversight of NSIA investment decisions. |

[93] https://nipc.gov.ng/ViewerJS/?#../wp-content/uploads/2019/03/PRESIDENTIAL-EXECUTIVE-ORDER-007-OF-2019.pdf
[94] Press release of NEC approval of the PIDF (https://nsia.com.ng/~nsia/sites/default/files/press-release/NEC%20Approves%20Press%20Release.pdf)
[95] MTEF 2020-2022, Special Federal Transfer to NSIA
[96] NSIA Annual Report 2019 (https://nsia.com.ng/~nsia/sites/default/files/downloads/NSIA%20Annual%20Report%202019_0.pdf)

| Type of Extra-budgetary spending | Funding type (fund, SPV, PPP, tax expenditure) | Type of projects implemented | Initial funding and source, and annual expenditures | Oversight structure | Fiscal Risks |
|---|---|---|---|---|---|
| Presidential Power Initiative (Siemens) | • SPV: FGN Power Company and Siemens AG<br>• 85% from a consortium of banks, guaranteed by the German government 15 % of FG's counterpart funding | • Power sector (generation, transmission and distribution) | • 2020 Special Federation Transfer US$222 million (N72 billion). | • FGN Power Company Board chaired by the Minister of Finance.<br>• PPI Implementation Committee chaired by the Chief of Staff to the President. | • Set tariffs to ensure suppliers the recovery of costs.<br>• Same as NSIA (see above). |

*Source: World Bank based on publicly available data*

## The Central Bank of Nigeria has increasingly incurred in quasi-fiscal expenditures

**In recent years, the CBN has placed increasing reliance on a growing number of development finance 'schemes', targeting various sectors with highly-subsidized credit and guarantees.** In developing this line of business activities, the CBN has contributed to the weakness of commercial bank credit flows to the real sector of the economy beyond select blue-chip enterprises. Thus, rather than depending on the complex transmission mechanism of conventional monetary policy interventions, the central bank through these schemes, aims to directly influence investment in the real sector and ultimately, aggregate demand. Many of these schemes provide credit at subsidized (single digit) interest rates and for longer terms than would be available from the commercial banks. Others provide guarantees for loans advanced by the commercial banks to certain sectors of the economy – thereby imposing contingent liabilities on the CBN.

**As of November 2020, the CBN had recorded disbursements of up to NGN4.3 trillion (US$11.2 billion) to various schemes.** This schemes included the Commercial Agricultural Credit Guarantee Scheme (CACS), the Anchor Borrowers' Program (ABP), the Micro, Small and Medium Enterprises Development Fund (MSMEDF), the SME/Rediscount & Refinancing Facility (SMERRF), the Real Sector Support Facility (RSSF), the Power and Airline Intervention Fund (PAIF), the Nigerian Bulk Electricity Trading Payment Program (NBET-PAF) and more recently, the COVID-19 Intervention for the Manufacturing Sector (CIMS), among others (TABLE 5.5.). Previously, other types of activities were funded by the CBN. For example, the CBN financial statements of 2014 show expenses for the construction of structures in various tertiary and secondary schools around the country, construction of an International Convention Center in Abuja, and financing of Centers of Excellence in Universities amounting to N74 billion (US$368 million).

**Apart from being extraneous to the CBN's core mandate of price and financial system stability, financing of these schemes places the CBN in a fiscal policy role which circumvents the overall fiscal framework, including budgetary process.**[97] In effect, the CBN's operating surpluses (mainly deriving from seigniorage and investment of the foreign exchange reserves) provide a convenient source of extra-budgetary funding - spending of public resources, but outside of the budgets; constituting quasi-fiscal activities. These activities ultimately affect the overall public sector balance without affecting the FGN budget deficit. While the Fiscal Responsibility Act (2011) directs that 80 percent of the net income of the CBN is to be transferred to the consolidated revenue fund of the federal government of Nigeria, the schemes significantly reduce the net income that the CBN is able to remit to the government. In 2014 for example, the CBN was unable to make any transfer to the federal government because it recorded a net income deficit of N150 billion (US$752 million).

**Furthermore, the CBN quasi-fiscal activities undermines the efficiency and effectiveness of federal- and states' expenditures.** The CBN offers schemes with policy objectives and interventions are similar to programs already on-budget, and hence enters into 'competition' with the budgetary entities, how unfair it may be since the terms of the CBN are more favorable than the on-budget entities may propose.

[97] The CBN Act of 2007 establishes that "The principal objects of the Bank shall be to – (a) ensure monetary and price stability; (b) issue legal tender currency in Nigeria; (c) maintain external reserves to safeguard the international value of the legal tender currency; (d) promote a sound financial system in Nigeria; and (e) Act as banker and provide economic and financial advice to the Federal Government".

**The implicit subsidies associated with CBN's development schemes are considerable. As of November 2020, the subsidies on the ten (10) largest schemes amounted to an estimated ₦ 570 billion (US$1.5 billion), equivalent to 0.4 percent of GDP (TABLE 5.5.).**[98] This estimated amount was calculated as the difference between the maximum allowable lending rate in Nigeria's money market and the subsidized interest rate on these schemes multiplied by the volume of credit extended since inception of each of the schemes. While these subsidies benefit the end-user who borrows at discounted negative real interest rates, they do have distortive effects on resource allocation and compromise the commercial banks' incentives to provide credit to marginal borrowers in the targeted sectors.

TABLE 5.5. Implicit interest subsidies on CBN's Schemes as of 2020

| | Max lending rate (%) | Subsidized rate (%) | Amount extended (NGN billion) | Interest subsidies (NGN billion) |
|---|---|---|---|---|
| Commercial Agriculture Credit Scheme | 28.9 | 9.0 | 672.9 | 133.9 |
| Anchor Borrowers Program | 28.9 | 9.0 | 497.2 | 98.9 |
| Power & Airline Intervention Fund | 28.9 | 7.0 | 311.2 | 68.2 |
| SME / Rediscount & Refinancing Facility | 28.9 | 10.5* | 300.9 | 55.4 |
| COVID-19 Intervention for Manufacturing Sector | 28.9 | 5.0 | 228.2 | 54.5 |
| Nigerian Electricity Market Stabilization Facility | 28.9 | 10.0 | 189.2 | 35.8 |
| Youth Entrepreneurship Development Program | 28.9 | 9.0 | 173.4 | 34.5 |
| Real Sector Support Facility | 28.9 | 9.0 | 166.2 | 33.1 |
| Targeted Credit Facility | 28.9 | 5.0 | 149.2 | 35.7 |
| CBN-BOI Industrial Facility | 28.9 | 9.0 | 100 | 19.9 |
| **Total** | | | **2,788.40** | **569.81** |

Sources: CBN, WB staff estimates
* Set at 2 percentage points below the MPR.

## Policy options

**There is a lack of policy direction for managing extra-budgetary entities, transactions, and quasi-fiscal expenditure.** An assessment is required about for which areas, and with which instruments and schemes, the use of extrabudgetary entities and programs might be preferable to an on-budget status. As illustrated on the three areas above, the size of these extra-budgetary activities is material and the activities undermine any efforts on sound fiscal policy framework and management, including accountability, managing towards a fiscal deficit target and efficiency and effectiveness of expenditure.

**The federal government is encouraged to establish a sound fiscal framework, including setting out policy objectives on the use on specific sector areas, and subsequently, to review and to discontinue any extra-budgetary entities, activities, and quasi-fiscal expenditure which are out of line with the framework.** As an example, the responsibility for administering development finance operations – rather than being housed within the CBN – should lie exclusively with specialized on-budget agencies according to their specific mandates in a sustainable and non-distortionary way.

[98] This is the total for the ten largest non-government monetary financing activities of the CBN. It excludes the Nigerian Bulk Electricity Trading Program (NBET-PAF).

**In the interim, and in the short-term, a moratorium on any new quasi-fiscal expenditure at CBN should be established, as well as, in the short-term, a review of how to incorporate priority investment projects into the current budget framework, including the PIM.** Similarly, a moratorium on the creation of new extra-budgetary entities should be established, until fiscal objectives are being set out, as suggested above.

TABLE 5.6.. Central Bank of Nigeria Interventions

| Type | Intervention | Beneficiaries | Allocated Funding (N bn) | Fund Manager | Year Established |
|---|---|---|---|---|---|
| **Credit guarantees** | Agricultural Credit Guarantee Scheme (ACGSF) | Farmers | 50.0 /1 | CBN | 1978 |
| | Nigeria Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL) | Agriculture sector | 75 | SPV: NBFI (CBN, AGRA, MoA, MoF, MCaI) | 2011 |
| | Nigerian Bulk Electricity Trading (NBET) | Electricity trader (GENCOs) | 1301 | FMoF and FMBNP | 2017 |
| | SME Credit Guarantee Scheme (SMECGS) | SME | 200 | CBN, commercial banks | 2010 |
| | Anchor Borrowers' Programme (ABP) | Farmers | From MSMEDF | CBN, commercial banks | 2015 |
| **Commercial credits** | Commercial Agriculture Credit Scheme (CACS) /2 | SME/State govts | 200 | SG and private banks /3 | 2009 |
| **Development schemes** | Power & Airline Intervention Fund (PAIF) | Power and airline sectors | 500 | CBN, BoI, commercial banks | 2010 |
| | Nigerian Electricity Market Stabilization Facility (NEMSF) | DisCos | 213 | CBN initial seed fund of the EIF | 2014 |
| | Real Sector Support Facility (RSSF) /4 | Real sector/SME | 300 | CBN, commercial banks | 2014 |
| | Micro Small and Medium Enterprises Development Fund (MSMEDF) /5 | Micro and SME | 220 | MFBs/FCs and Commercial banks/DFIs | 2013 |
| | Textile Sector Intervention Facility | Textile enterprises | 50 | BoI | 2015 |
| | Agribusiness/ Small and Medium Enterprises Investment Scheme (AgSMEIS) /6 | Agrobusiness SMEs | 5% of DMBs PAT | CBN, commercial banks | 2017 |
| | CBN-BOI Industrial Facility (CBIF) | Manufacturing, cottage and service | 235 | CBN and BoI | 2018 |

| Type | Intervention | Beneficiaries | Allocated Funding (N bn) | Fund Manager | Year Established |
|---|---|---|---|---|---|
| | Intervention Facility for the National Gas Expansion Project | Several sectors and households | From PAIF, NMFB and AgSMEIS | NNPC | 2020 |
| | Presidential Fertilizer Initiative (PFI) | Farmers | 35 | CBN, NSIA | 2016 |
| | National Food Security Programme (NFSP) | Agro-allied processors and Farmers | 59.1 | BOI | 2002 |
| **Export facilities** | Non-Oil Export Stimulation Facility (ESF) | Non-oil sector from south-west and north-west zones | 500 | NEXIM, commercial banks | 2015 |
| | Export Rediscounting and Refinancing Facility (ERRF) | Exporters | 50 | NEXIM, commercial banks | 2016 |
| | Export Development Facility (EDF) | Women and youth export enterprises | 50 | NEXIM, commercial banks | 2017 |
| | Export Facilitation Initiative (EFI) | Several commodities | n.a. | Commercial banks/7 | 2019 |
| **COVID-19 support** | Targeted Credit Facility (TCF) | Households and microenterprises | 50 | Same as MSMEDF | 2020 |
| | Healthcare Sector Intervention Facility (HSIF) | Healthcare sector | 100 | Same as RSSF-DCRR | 2020 |
| | COVID-19 Intervention Facility for the Manufacturing Sector (CIFMS) /8 | Manufacturing sector | 1,000.00 | Same as RSSF | 2020 |
| | Healthcare Research and Development Intervention Fund (Grants) (HRDIF) | Research, development and manufacturing | n.a. | Body of Experts (BoE) | 2020 |

Source: CBN

**Notes:**

/1 An amendment in 2020 enabled an increase in the share capital of the ACGSF from N3 billion previously to N50 billion.

/2 The CACS funds the Paddy Aggregation Scheme (PAS) (2017), Rice Distributors' Facility (RDF) and the Maize Aggregation Scheme (MAS) (2019).

/3 Funded through FGN Bonds.

/4 Includes Differentiated Cash Reserves Requirement (DCRR) and Corporate Bonds (CBs) (2018). Funds the 100 for 100 Policy on Production and Productivity Facility (2021).

/5 Funds the Youth Entrepreneurship Development Program (YEDP) (2016), Accelerated Agricultural Development Scheme (AADS) (2017), Shared Agent Network Expansion Facility (SANEF) (N25 billion, managed by commercial banks, 2018).

/6 Funds the Creative Industry Financing Initiative (CIFI) (2019).

/7 Funded by AGSMEIS, DSRR and NESF

/8 Funded from the RSSF

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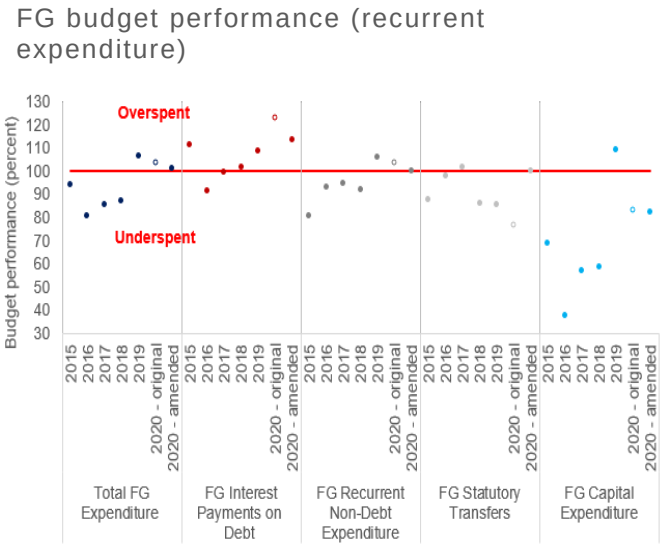
## 5.5 Budget credibility and revenue forecasting

### Federal government: Budget credibility is tied to the oil cycle through revenue and financing fluctuations

#### While overall Federal Government Budget expenditure credibility is relatively sound, systemic revenue shortfalls translate into low budget execution rates on capital expenditures

**While the overall federal budget credibility is close to the average of peers, capital budgets showcase low and erratic budget implementation rates.** The overall federal government budget credibility (measured as the total actual expenditure against the budget)[99] has averaged about 90 percent over the last 5-6 years. While the overall credibility is not low, there is considerable variation across expenditure groups (FIGURE 5.17FIGURE 5.16), where the execution rates are highest among the recurrent expenditures: and recurrent non-debt spending (salaries, overheads, and statutory transfers). The actual spending on the debt service has been increasing over time and increasingly over-shooting the budgeted allocations, resulting in budget implementation exceeding 100 percent; to a large extent due to the interest payments on the overdrafts from the central bank, which are not budgeted for. However, the capital budget implementation has been considerably lower, averaging 66 percent over the last 5 years, and going as low as 38 percent during the 2016 fiscal crisis.

FIGURE 5.17. While recurrent spending performance against budget is high, capital budget suffers from systemic under-implementation




SOURCES and NOTES: Calculations using OAGF Fiscal Reports data. Actual capital expenditures capture capital releases during the financial year (January-December); due to delayed budget passing in the past, the actual annual capital spending may span multiple annual budgets, and results in implementation rates in excess of 100 percent.

**Two key reasons undermine the capital budget implementation: delays of the budget passing, and systemic revenue shortfalls against budget targets.** Shocks (changes to amounts or timing) to external debt issuance can further aggravate capital budget implementation.

**Despite the usually timely submission by the executive, the budget faces considerable delays during the review process at the National Assembly, resulting in late budget enactment** (TABLE 5.7.) for the days of Federal

[99] PEFA methodology measures budget turnout against the *original* budget. With the exception of 2015, and 2020, there were no supplementary or amended budgets, and the charts present expenditure outturns against the final budget. For 2020, where the budget has been amended (mostly reallocating among expenditure lines) in the face of the COVID-19 pandemic and economic shock, and both measures are presented for illustration.

Budget enactment and delay in months from the start of the fiscal year). Delays in budget passing led to a lack of synchronicity between the budget (fiscal) year and the financial year. While the implementation of the recurrent budget is effective undisturbed (the equivalent of up to 50% of previous year's budget is allowed to be spent), the capital budget cannot be implemented until the budget is passed into law; the capital expenditure budget implementation begins on the day the budget is passed and is allowed to continue for one calendar year. in 2015-2019, the budget enactment was delayed by on average 5 months. Since 2020, following the efforts from the Budget Office of the Federation, and reflecting a better alignment since the 2019 election, the budget has been passed on time for the first time in over a decade, and consequently, going forward a positive impact on the budget execution rates on capital expenditure may emerge.

TABLE 5.7. Dates of the Enactment of Federal Budget with Months of Delay

| Year (calendar and fiscal) | Date of Federal Budget Enactment | Delay (in months) since the beginning of the fiscal year |
|---|---|---|
| 2007 | December 22, 2006 | 0 |
| 2008 | April 14, 2008 | 4 |
| 2009 | March 10, 2009 | 2 |
| 2010 | April 22, 2010 | 4 |
| 2011 | May 27, 2011 | 5 |
| 2012 | April 13, 2012 | 3 |
| 2013 | February 26, 2013 | 2 |
| 2014 | May 24, 2014 | 5 |
| 2015 | May 19, 2015 | 5 |
| 2016 | May 6, 2016 | 4 |
| 2017 | June 12, 2017 | 5 |
| 2018 | June 20, 2018 | 6 |
| 2019 | May 27, 2019 | 5 |
| 2020 | December 17, 2019 | 0 |
| 2021 | December 31, 2020 | 0 |

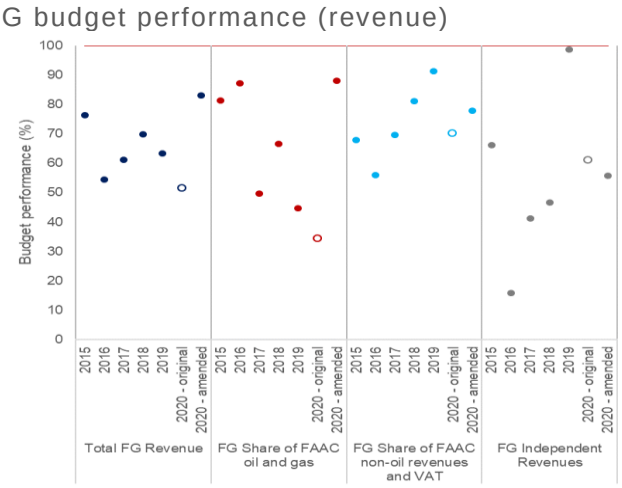
Notes: Based on information provided by the BOF

**The actual execution of capital expenditures is sensitive to revenue shortfalls during the fiscal year.**

As the federal government derives most of its revenues from the federally collected oil and non-oil revenues, it faces multiple revenue forecasting and actualization challenges described:

- Federation (FAAC) oil and gas revenue performance has been hampered by a host of factors, including: i) The actual oil production falling below the budgeted targets, and ii) Discretionary deductions and underpayments by the Nigeria National Petroleum Corporation, including for the unbudgeted fuel subsidy in 2017 (see the NEITI Oil and Gas Industry Audits Reports for more information).

FIGURE 5.18. All sources of federal government revenues systemically underperform against budget targets (even after 2020 budget amendments)




SOURCES and NOTES: Calculations using OAGF Fiscal Reports data

- The federally collected (FAAC) non-oil revenue underperformance is attributable to increased revenue target without corresponding tax policy or administration reforms to increase actual collections.
- Federal Government Independent Revenues, which include surpluses of the government-owned enterprises (GOEs) (as well as Personal Income Taxes of Federal Government Employees) in the past faced collection difficulties due to lack of enforcement**,** and hence, drives an under-performing actual collection rate as compated to the budgetgu.

As the states depend largely on the FAAC revenues, they face comparable issues.

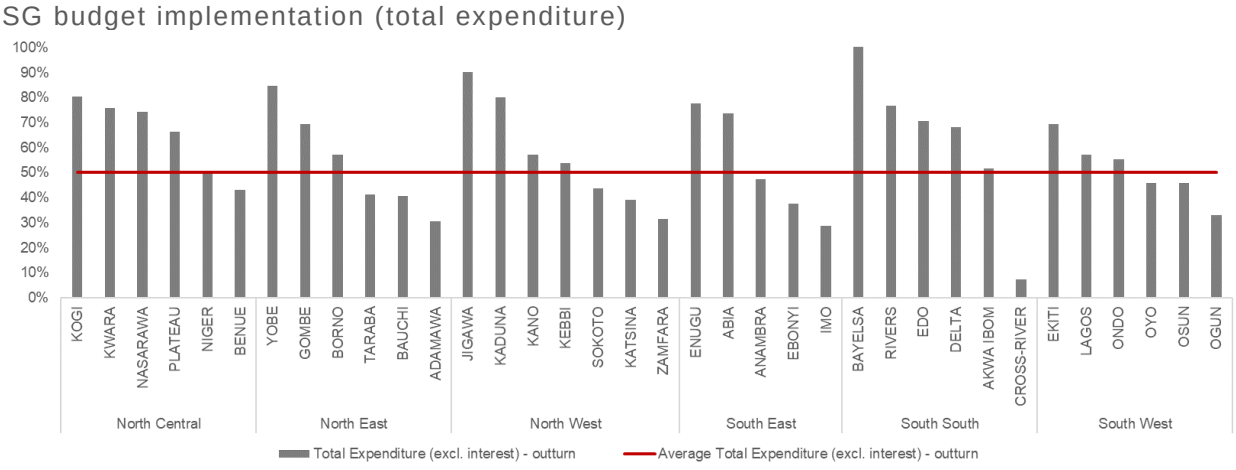
## State governments: Budget credibility faces similar issues, though there is considerable heterogeneity

### State budget credibility is low – an average state implements only about 50 percent of their annual budget

**On average, only about 50 percent of state budget is being executed.** There is substantial variation across states - and in each of the six geopolitical zones - with budget implementation rates ranging from about 30 to 100 percent (FIGURE 5.19), with some particularly peculiar outliers include the Cross-River state. It is notorious for over-inflated budgets, resulting in abysmally low (e.g., 7 percent in 2019) budget execution rate.

**Similar to budget execution at the federal level, capital budget implementation is highly volatile at the state level.** In general, the capital expenditure implementation rate is, however, particularly low at the state level – on average, in 2019, only 30 percent of state capital expenditures were executed (FIGURE 5.20). While some states show high and exemplary execution rates for capital spending (for instance, Kaduna's capital implementation rate of 90 percent in 2019 even exceeds its non-debt recurrent budget execution of 50 percent), most states execute far less than half of their capital spending. Recurrent budget implementation rates – as for the federal government - are considerably higher at about 80 percent – though again with substantial variation across states (FIGURE 5.20).

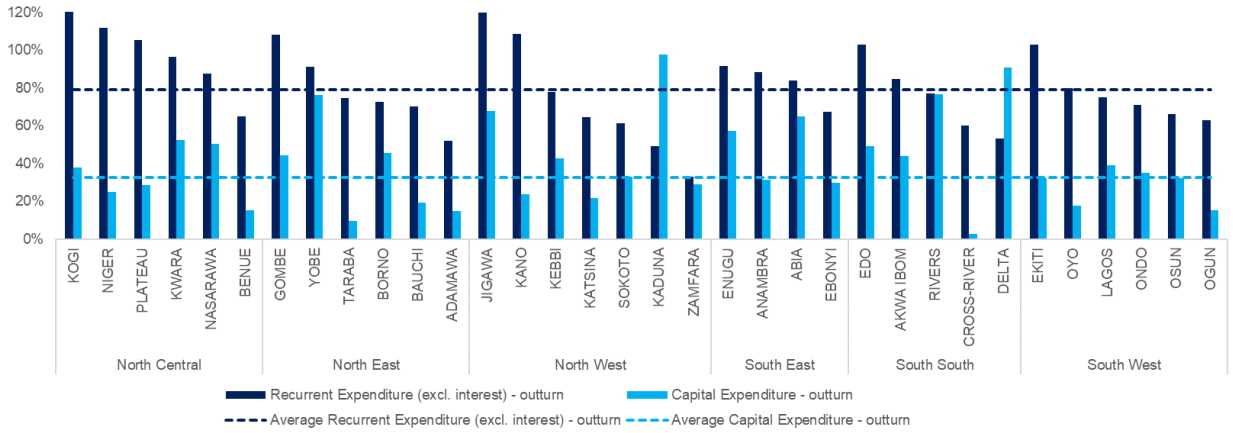
FIGURE 5.19. Average budget implementation at SG level was only about 50% in 2018 and 2019




Sources: State Financial Statements 2018 and 2019.
Note: Budgeted expenditures exclude debt services (as the methodology of budgeting for it varies substantially across states).

FIGURE 5.20. Recurrent budget implementation is substantially higher (80 percent) than capital (30 percent)

SG budget implementation (recurrent and capital expenditure)

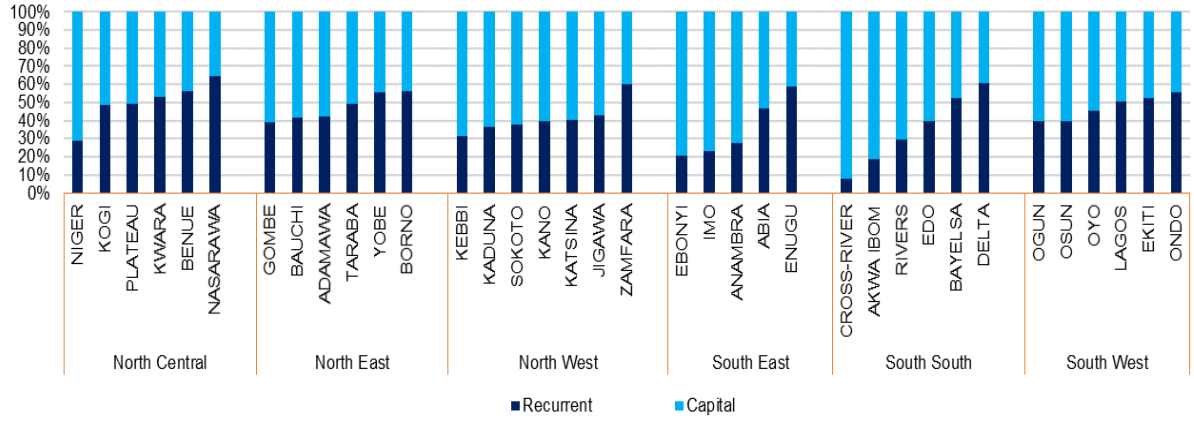



Sources: State Financial Statements 2018 and 2019.
Note: Budgeted expenditures exclude debt services (as the methodology of budgeting for it varies substantially across states).

**The divergence in the SG budget implementation rates across capital and recurrent components inverts the states' intentions articulated in the budget laws (FIGURE 5.21 and FIGURE 5.22).** Although SG budgets prioritize capital investments, by allocating 60 percent of the non-debt budget envelope to capital component, the *actual* SG expenditures contain only 40 percent of capital spending due to the low capital budget implementation rates. While the actual execution of 40 percent of SG public resources to capital spending exceeds the corresponding ratio at the FG (26 percent in 2019), further analysis would be needed to review the actual contents of what is defined as 'capital'. Similar classification issues were identified at the FG level where a fraction of capital spending can be considered to contain recurrent components (Nigeria PIMA 2019).

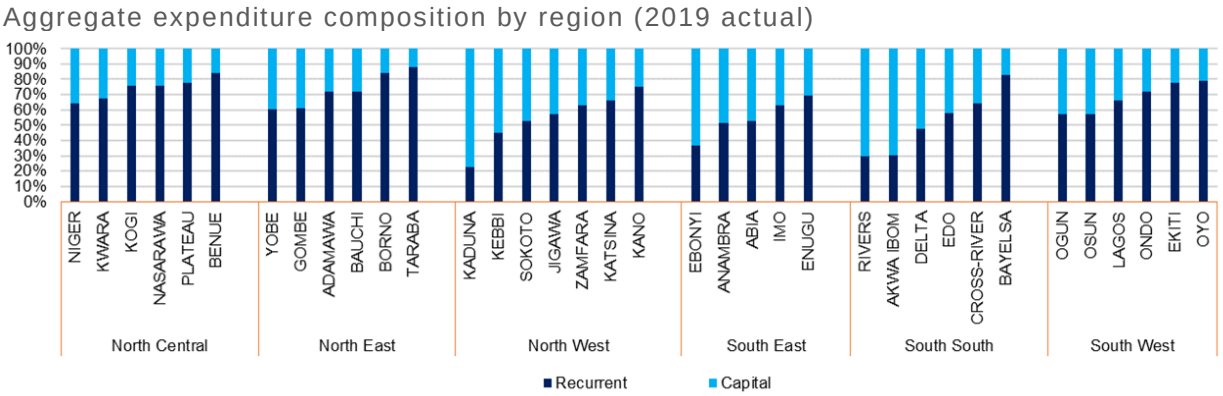
FIGURE 5.21. States on average allocate 60 percent of their budgets for capital investments….

Aggregate expenditure composition by region (2019 budget)




Source: State Financial Statements 2018 and 2019.
Note: Budgeted expenditures exclude debt services (as the methodology of budgeting for it varies substantially across states).

FIGURE 5.22.. But in their actual spending the ratio is reversed – with only 40 percent of the actual expenditure devoted to capital



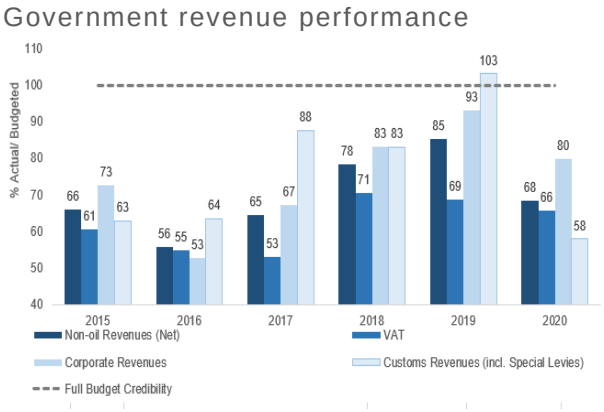

Source: State Financial Statements 2018 and 2019.
Note: Budgeted expenditures exclude debt services (since the methodology of budgeting for debt services varies substantially across states).

## Revenue forecast accuracy is being undermined by the actual level of expenditures, their effectiveness, and the increase of debt management costs

**Accurate revenue forecasting is critical for governments to correctly anticipate and bridge fiscal gaps in their budget allocations.** Changes in a country's demographic characteristics, economic activities, public policy, external and internal economic shocks often result in uneven revenue streams and subsequently in budget surpluses and deficits. Capturing these future events accurately allows for better government planning, adjustments in revenue and debt mobilization and ultimately smoother continuation of government operations and delivery of public services.

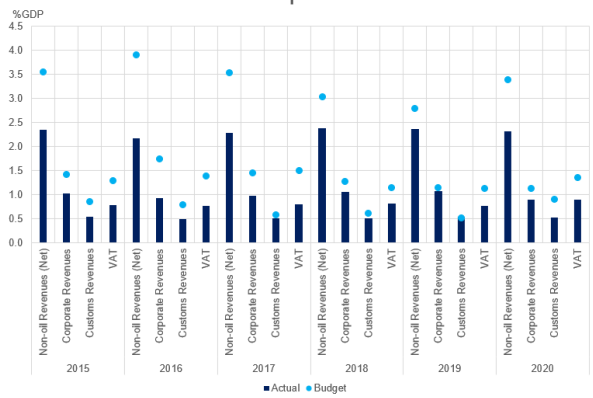
**According to the OAGF data on Nigeria's budget for 2018 and 2019, actual fiscal deficits were more than double the budget estimates, resulting in underestimation of overall deficits and subsequent financing needs**. For the past decade, Nigeria's actual non-oil revenues collected has consistently fallen short of the budgeted figures. In 2020, the federation's non-oil revenue collected was 68 percent of the budgeted collection, a slight improvement from 2016 when it was at its lowest (56 percent). Often, the gap in the budget necessitates tapping into public debt which subsequently results in unpredictable debt patterns and an unreliable Medium-Term Debt Management Strategy (FIGURE 5.23 and FIGURE 5.24FIGURE 5.25).

FIGURE 5.23.. Federation non-oil revenue performance (percent of actual/budgeted)




Source: OAGF

FIGURE 5.24. Federation non-oil revenue performance (percent of GDP)




Source: OAGF

**In many countries, inconsistencies in revenue forecasting often arise from technical challenges in the forecasting models.** These may include inaccurate macroeconomic assumptions when deriving the spending and revenue baselines, poor economic forecasting when predicting short-run revenue, and inaccurate inputs when determining anticipated income and production levels. While these challenges are also present in Nigeria, other idiosyncratic pitfalls make the Nigeria case even more challenging. As an example, the Fiscal Responsibility Act of 2007 which established a budget deficit threshold of 3 percent of the GDP for the federal government further distorts budget forecasts as the budget office attempts to plan within this legal provision. In an environment where actual revenues and government expenditures are not adjusted to reflect this legal requirement, the budget forecast becomes the only adjustable element, resulting in perennially very inaccurate projections.

**When forecasting the individual tax types, systematic non-compliance due to weak tax administration and high cost of compliance among other factors can result in volatile projections.** Among the three main tax types, VAT projections are the least credible with compliance in tax payments varying between 15 and 40 percent. In addition to low compliance and a low VAT rate, Nigeria also has a weak collection efficiency (C-efficiency[100]) ratio, a measure of the amount of VAT collected relative to potential. The collection ratio is low because of extensive exemptions on commercial vehicles, farming inputs including capital equipment, medical and pharmaceutical products, educational material, and basic food items. In addition, only an estimated 40 to 70 percent of consumption is subject to VAT, creating large variance in actual VAT revenues collected across time. In addition, the merging of the VAT office with other FIRS offices has led to loss of focus on VAT resulting in weaker public engagement and lower follow-up by officials to ensure compliance. Predicting developments in these highly exempted tax bases is in particularly challenging, since difficult to forecast the extent to which taxpayers intend to benefit from the access to exemptions in any given fiscal year.

**Similarly, revenue collection from corporate income tax is equally unpredictable mainly due to irregular and unbudgeted tax expenditures in the form of tax incentives and waivers.** The Nigerian Investment Promotion Commission (NIPC) can award tax holidays and income tax exemptions without approval from the Ministry of Finance and FIRS and without a determination

[100] *C-efficiency parameter = Actual VAT collection/Potential VAT collection*. Potential VAT is defined as the nominal VAT rate times nominal consumption. Actual VAT collection will be less than potential if there are policies that make the tax base smaller than total consumption. The higher the ratio, the more efficient the collection. A ratio of 1 indicates that all consumption is taxed at the nominal VAT rate and there is no administrative inefficiency.

of the costs (revenue foregone) and economic benefits to guide the use of these tax incentives. Such unpredictable use of tax expenditures makes revenue forecasting unreliable. In addition, the irregular use of tax incentives to advantage some corporations over others creates apathy among taxpayers. Less than 6 percent of registered CIT taxpayers are active.

**Import duty and tariff waivers are also irregularly deployed to avoid paying custom levies. In 2020, the Nigerian government conceded to having issued ₦ 1.024 trillion import duty waivers, concessions and grants in the three years leading up to 2015.** While targeted waivers and support for sectors with high impact economic multipliers and high capacity for positive spillovers can stimulate economic growth and overall development, their discretionary use on individual firms can distort markets and create perverse incentives. In addition, this discretionary use generates volatility in projection of income from customs levies. Despite these challenges, customs revenues outperformed other tax types in the credibility of their forecasting, a reflection of the limited avenues for unbudgeted tax expenditures.

## 5.6 Public debt in Nigeria and its sustainability

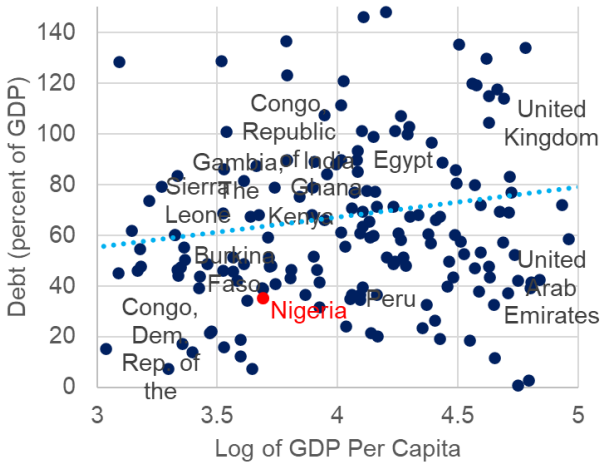
### Nigeria's public and publicly guaranteed (PPG) debt remains sustainable, albeit under pressure from rising fiscal deficits and stagnating growth.

**Standing at 36 percent of GDP in 2020, Nigeria's PPG debt is well within the commonly recognized boundary of debt sustainability (70 percent of GDP) and is expected to remain there over the medium term.** However, breaking down the PPG debt portfolio into its components reveals certain vulnerabilities. Namely, short-term debt remains high, and debt servicing – which accounted for 86.2 percent of consolidated revenues in 2020 – crowds out expenditure on delivery of public services.

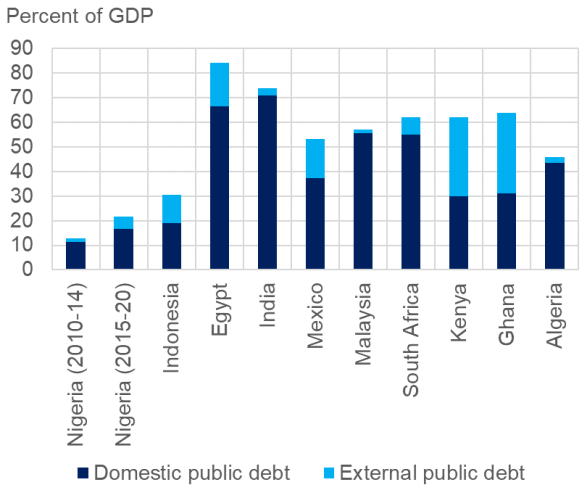
**Nigeria's public debt is smaller and more manageable than in many relevant comparator countries (FIGURE 5.25 and FIGURE 5.26Error! Reference source not found.).** However, low debt is primarily a function of Nigeria's insufficient levels of public spending, which remain among the lowest in the world.

FIGURE 5.25. International comparison of public debt (percent of GDP) and log GDP per capita (PPP), latest available data


FIGURE 5.26. International comparison of domestic and external debt (percent of GDP)




Source: WEO




Source: WEO

**Despite Nigeria's low overall debt, the country's debt to GDP ratio is rising, as public revenue remains constrained and economic growth is muted.** Annual fiscal deficits have remained below 6 percent of GDP in recent years, but they are increasing as revenue collection fails to pick up. The debt stock has grown by 30 percent per year between 2015 and 2020, a significant acceleration compared with 23 percent per year between 2010 and 2015 (FIGURE 5.27 and FIGURE 5.28).

FIGURE 5.27. Over the past decade, growth has stalled while fiscal deficits have accumulated…

GDP growth and fiscal deficit

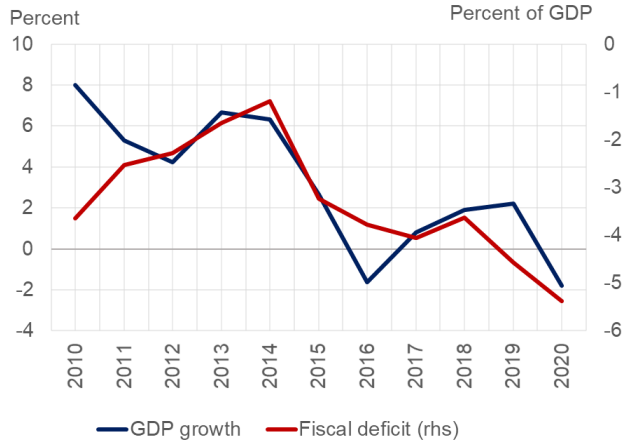
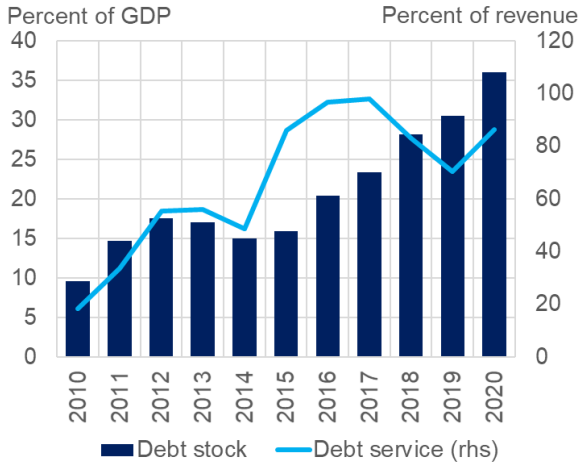



FIGURE 5.28. … fueling an increase in debt and debt servicing

Debt stock and services

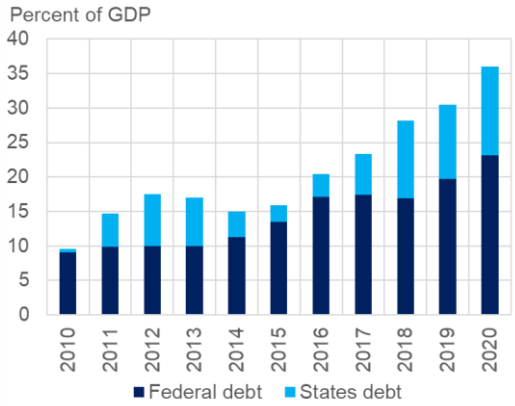



Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates

FIGURE 5.29. Federal government holds the majority of Nigeria's PPG debt, but the share held by states is increasing as fiscal indicators worsen

Federal and state debt

**The federal government holds the majority of Nigeria's PPG debt, but the share of debt held by state governments has been rising gradually, especially after the economic recession of 2016 (FIGURE 5.29**FIGURE 5.30**).** As the recession reduced state revenues – both those internally generated and those transferred from the federal government – the states had to rely on federal bailout loans, as well as on loans from commercial banks and the Central Bank of Nigeria.




Sources: Debt Management Office (DMO) and World Bank staff estimates

## Fiscal deficits, short-term borrowing from the central bank and currency depreciation drive the growth of Nigeria's debt stock.

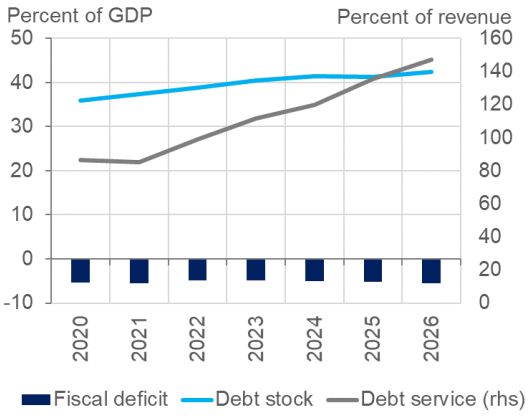
**With no major revenue-side reforms expected in Nigeria over the medium-term, fiscal deficits are projected to remain high as spending needs and debt servicing continue to grow.** The debt stock is expected to reach over 42 percent of GDP by 2026, with debt growth forecast to slow down to 17 percent per year between 2021 and 2026. Although this level of debt would still be sustainable by international standards, debt servicing is expected to grow rapidly (at 22 percent per year between 2021 and 2026) with a potential to erode fiscal space and further contribute to fiscal deficits (FIGURE 5.30, FIGURE 5.31 and FIGURE 5.32).

FIGURE 5.30. PPG debt to GDP is expected to remain sustainable but debt servicing relative to revenue is expected to rise rapidly, squeezing critical fiscal space, and further worsening fiscal deficits

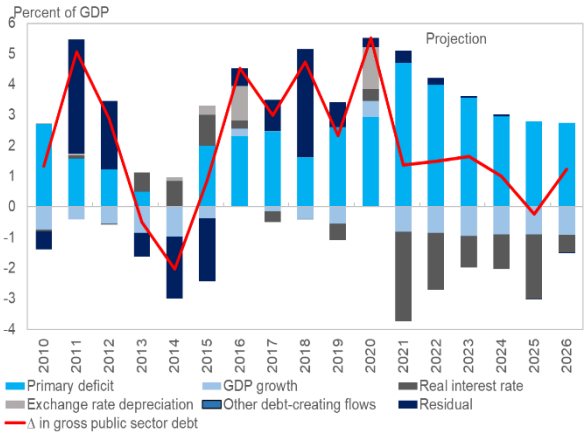
Fiscal deficit, debt stock and debt service

FIGURE 5.31. Primary deficits are expected to remain the major contributors to the increase in PPG debt stock

Deficit, GDP growth, interest rate, exchange rate depreciation and other debt creating flows

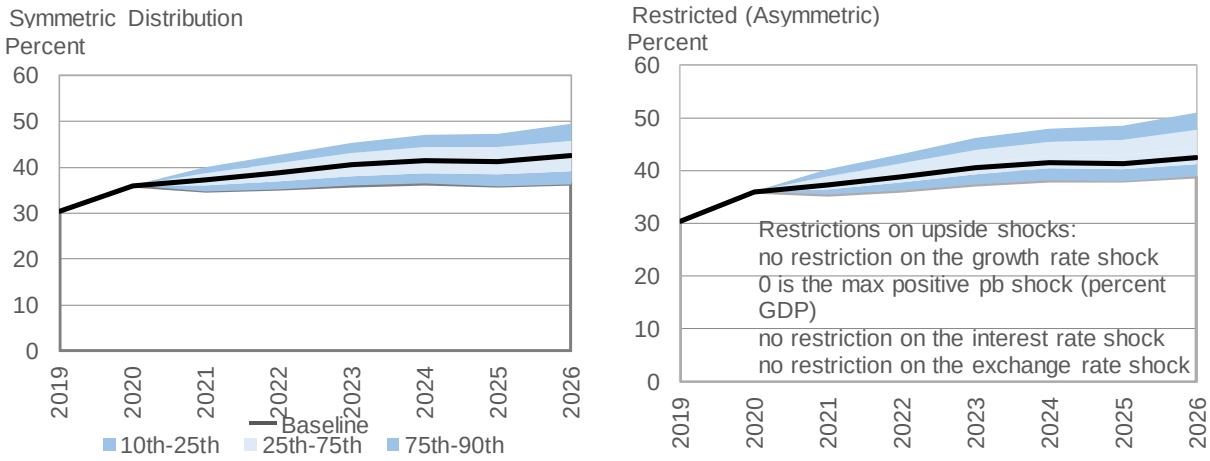



Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates




Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates using the Market Access Countries Debt Sustainability Analysis tool (IMF)

FIGURE 5.32. Nigeria's PPG debt is expected to remain sustainable, although uncertainty remains as indicated by the wide distribution around the baseline



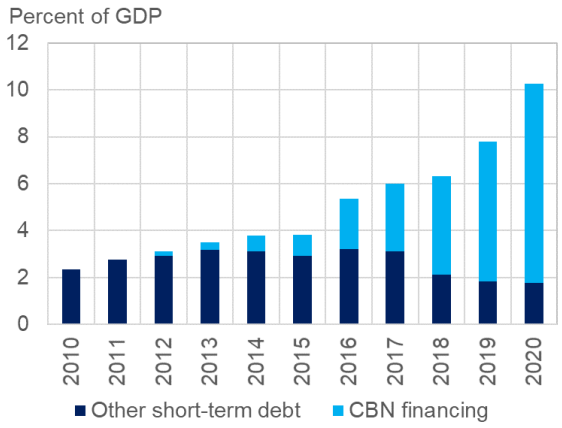

Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates using the Market Access Countries Debt Sustainability Analysis tool (IMF)

**Short-term PPG debt in Nigeria is high, due in particular to federal and state governments borrowing extensively, and on expensive terms, from the country's central bank starting from 2014.** This trend has led to ballooning debt servicing costs, which in turn are liable to constrain expenditure on core service delivery, especially at the federal level. Notably, between 2010 and 2014 short-term debt was equivalent to 3.1 percent of GDP on average, but it increased to an average of 6.6 percent of GDP between 2015 and 2020. As a result, debt servicing between 2015 and 2020 stood at an average of 87 percent of consolidated revenues, compared to 42 percent between 2010 and 2014 (FIGURE 5.33FIGURE 5.35).

FIGURE 5.33. Increasing CBN financing of fiscal deficit is pushing up short-term debt stock

CBN financing and other short-term debt

**Risks also emanate from PPG debt held in foreign currency, which amounted to 23 percent of total PPG debt as of 2020.** In the same year, currency depreciation accounted for a debt stock increase equivalent to 1.4 percent of GDP, second only to primary deficit which accounted for debt growth equivalent to 2.9 percent of GDP. With the maintenance of an official exchange rate that differs widely from the parallel market rate[101], the risk of currency depreciation remains high (FIGURE 5.34, FIGURE 5.35 and FIGURE 5.36). The potential consequences would be seen in the form of rising total debt stock, debt servicing burden, and fiscal deficit – although the effect of depreciation on Nigeria's PPG debt to GDP ratio is expected to be milder, as outlined in TABLE 5.8.**Error! Reference source not found.**




Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates

FIGURE 5.34. It is expected that the stock of CBN overdraft will be restructured in the future and Nigeria will shift away from short-term debt…

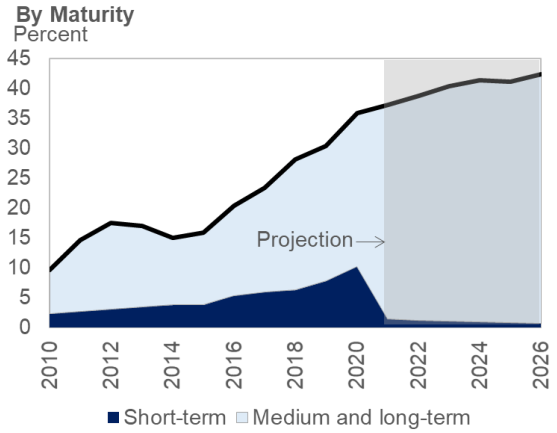
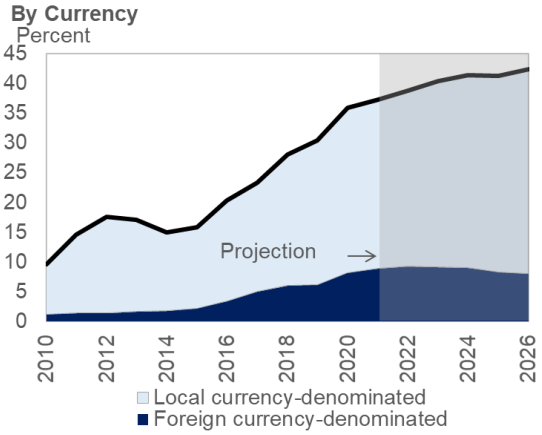



FIGURE 5.35. …and with currency depreciation risk on the horizon, it is expected that Nigeria will continue to rely on domestic financing




Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates using the Market Access Countries Debt Sustainability Analysis tool (IMF)

[101] As of 14 January 2022, the value of the naira was 27.2 percent lower on the parallel market against the official rate.

FIGURE 5.36. The largest risk to the debt profile of Nigeria stems from increasing short-term debt, primarily due to CBN financing

**Nigeria Public DSA Risk Assessment**

**Heat Map**

| | | | | | |
|---|---|---|---|---|---|
| Debt level [1/] | Real GDP Growth Shock | Primary Balance Shock | Real Interest Rate Shock | Exchange Rate Shock | Contingent Liability shock |
| Gross financing needs [2/] | Real GDP Growth Shock | Primary Balance Shock | Real Interest Rate Shock | Exchange Rate Shock | Contingent Liability Shock |
| Debt profile [3/] | Market Perception | External Financing Requirements | Change in the Share of Short-Term Debt | Public Debt Held by Non-Residents | Foreign Currency Debt |

Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates using the Market Access Countries Debt Sustainability Analysis tool (IMF)

## Macro-fiscal shocks are the major threat to debt sustainability.

**The sustainability of Nigeria's debt is vulnerable to macro-fiscal shocks. GDP shocks, in particular, are expected to have the biggest potential impact on PPG debt to GDP ratio, greater than shocks to the primary balance or real interest rate.** A combined macro-fiscal shock could increase Nigeria's gross financing needs by around 2 percentage points of GDP and debt to GDP by 10 percentage points in the medium-term (by 2026). This would push debt to 52.6 percent of GDP, a ratio that would remain sustainable but require rapid corrective measures to avoid further deterioration (FIGURE 5.37 and FIGURE 5.38).

FIGURE 5.37. Combined macro-fiscal shocks can increase PPG debt to GDP ratio by 10 percentage points…

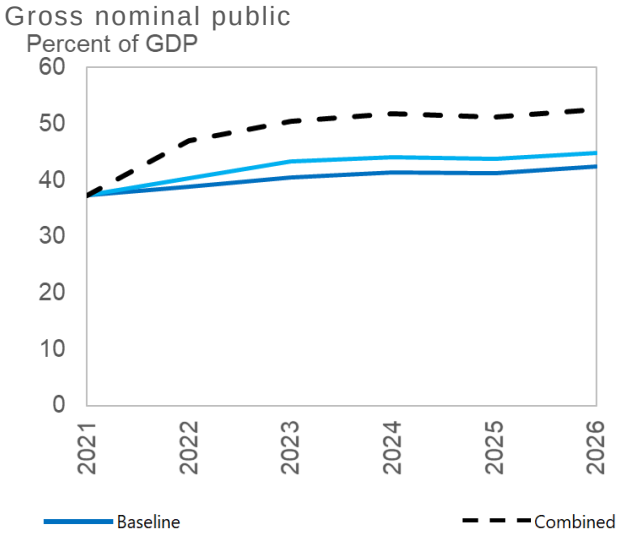
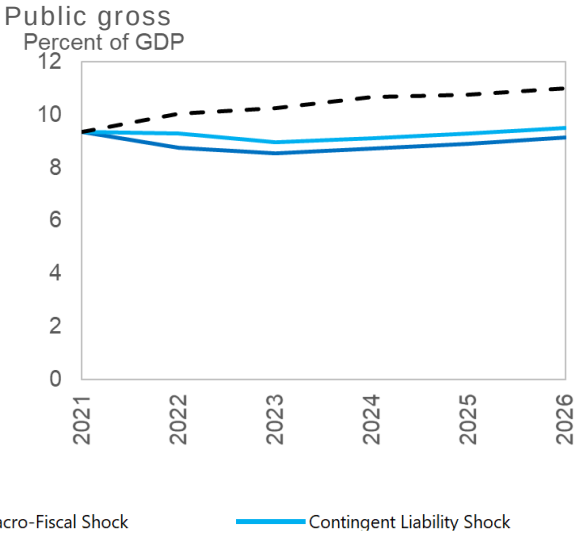
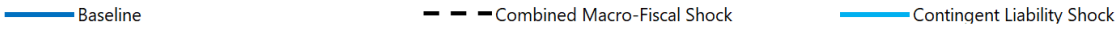



FIGURE 5.38. …and public gross financing needs by almost 3 percentage points of GDP




Sources: Debt Management Office (DMO), Office of the Accountant General of the Federation (OAGF), and World Bank staff estimates using the Market Access Countries Debt Sustainability Analysis tool (IMF)

TABLE 5.8. Impact of Macro-Fiscal Shocks to the PPG Debt to GDP ratio over the medium term

| Scenario | If… | Then… |
|---|---|---|
| GDP shock | GDP growth falls to -0.2 percent in 2022 and adjusts subsequently back to 2.5 percent by 2024… | PPG Debt to GDP is expected to rise by 2.8 percentage points of GDP by 2026 |
| Primary balance shock | Primary balance increases by 2 percent of GDP… | PPG Debt to GDP is expected to rise by 1.8 percentage points of GDP by 2026 |
| Real interest rate shock | If interest rate increases by 200 basis points… | PPG Debt to GDP is expected to rise by 1.1 percentage points of GDP by 2026 |
| Exchange rate shock | Nominal exchange rate falls by 73 percent | PPG Debt to GDP is expected to rise by 0.4 percent of GDP in 2022 and 2023 but should adjust over the medium term to baseline trends |
| Combined Macro-Fiscal Shock | All the above shocks occur | PPG Debt to GDP is expected to rise by 10.6 percentage points of GDP by 2026 |

## Nigeria's debt management has improved over time, but more can be done to enhance transparency and rationalize financing policies.

**Nigeria has improved its financing policies over the last decade.** Under the guidance of the Debt Management Office (DMO), the country has introduced several new financing instruments and improved the transparency of its debt stock and servicing. The DMO undertakes robust diagnostics of the federal debt portfolio and contributes to building capacity within the states' debt management departments, to ensure they are aware of their debt stock and servicing requirements and can produce their own sustainability analyses and management strategies. The DMO also collaborates with the CBN on the reconciliation of debt stocks, including those of the states.

**However, it is important that debt transparency continues to improve, especially with regard to the growing stock of CBN borrowing.** At present, CBN overdraft and loans are not officially recognized as part of the country's public debt stock. They are not reported by the DMO or the federal government, nor are they included in official debt diagnostics. The DMO is in negotiations with the CBN to restructure the outstanding CBN overdraft stock as a debt instrument, but it is unclear when this decision may materialize[102], and there are no plans to stop the federal government from further relying on CBN overdraft. Similarly, public guarantees, albeit disclosed annually on a standalone basis, are not tracked in real time, nor are they included in the official public debt diagnostics published by the DMO.

**Part of the reason for large and growing CBN overdrafts lies in the financing policies of the federal budget.** Revenues are often overestimated and, in the absence of robust scenario design, financing requirements are underestimated as a result. Therefore, any increase in deficit during the year leads to the government relying on CBN financing to cover budgetary shortfalls. Moreover, the government adopts a 50-50 borrowing policy whereby half the budget deficit is expected to be financed domestically, and the remainder through external sources. This seemingly arbitrary policy is applied with no consideration for the relative cost of borrowing, the

[102] The World Bank's debt sustainability analysis assumes that CBN debt will be restructured into a medium- to long-term debt instrument in the medium term.

existing debt portfolio, the impact of risk factors such as currency depreciation, and the effects on growth and private sector borrowing.

## Policy Options

| Key Challenge | Policy Option | Timeline[103] (ST, MT, LT) | Impact on Fiscal Sustainability[104] (L, M, H) | Financing requirements[105] (L, M, H) |
|---|---|---|---|---|
| Lack of transparency on extent of debt and relevant financing | Disclose the stock of outstanding CBN financing on a quarterly basis | ST | H | L |
| | Develop a plan to convert outstanding CBN financing stock into a long-term debt instrument | ST/MT | H | L |
| | Impose expenditure sanctions for breaching CBN borrowing rules (e.g., if CBN borrowing limit is breached, the federal government cannot increase aggregate salaries for the following fiscal year) | MT | H | L |
| | Publish the stock and breakdown of contingent liabilities of the federal government on a quarterly basis | ST | M | L |
| | Publish the stock and breakdown of state contingent liabilities at least annually | MT | M | L |
| Financing plans in the budget lack focus on cost and feasibility | Publish Annual Borrowing Plan along with annual budget documents to explain rationale for proposed borrowing strategies, including forecasts on cost and feasibility | ST | H | L |
| | Utilize and update the Medium-Term Debt Strategy tool on an annual basis, publishing results of the analysis | ST/MT | H | L |
| Data collection and reconciliation is cumbersome and time-consuming | Use an integrated debt management system for federal and state debt management offices to offer a complete debt profile, and minimize the need for frequent and lengthy reconciliations | LT | M/H | H |

[103] The timeline horizons are defined as: ST (short-term), 0-12 months; MT (medium-term), 1-3 years; LT (long-term), more than 3 years.
[104] The impact of fiscal sustainability can be categorized as: L (low), when the expected reduction in annual consolidated fiscal deficit is <0.3 percent of GDP over the medium term; M (medium), when the expected reduction in annual fiscal deficit is 0.3-0.6 percent of GDP over the medium term; and H (high), when the expected reduction in annual consolidated fiscal deficit is more than 0.6 percent of GDP over the medium term.
[105] Financing requirements consider the capacity of the relevant institution to implement the policy recommendation and the need for additional resources to implement the reform. This is measured as: L (low), usually for "stroke of pen" reforms that do not require additional resources; M (medium), for reforms that require some but not extensive resources over the short term; H (high), for reforms whose implementation requires significant resources and/or financing over the short term.

## 5.7 Benchmarking Nigeria's efficiency of public spending in social sectors at the general and subnational government levels

**Indicators[106] for service availability and citizen's access to infrastructure illustrate strained public service provision.** The quality of Nigeria's infrastructure and citizens' access to services score poorly overall, across sectors (FIGURE 5.39**Error! Reference source not found.**). Nigeria underperforms in all categories compared to peers and Sub-Saharan African average, in particular: i) electricity production per capita (0.2 kWh per capita in Nigeria compared to 0.7 in sub-Saharan Africa); ii) public health infrastructure (0.5 beds per 1,000 people compared to 1.5); iii) roads per capita (1.5 Km per 1,000 people compared to 3.9); and iv) public education infrastructure (1.8 secondary teachers per 1,000 people compared to 3.3 in sub-Saharan African and 7.9 in EMEs (FIGURE 5.40FIGURE 5.40). Electricity and transportation have been identified among the top five obstacles to doing business, likely impacting private investment levels.[107]

FIGURE 5.39. Measure of Infrastructure Access (most recent year)

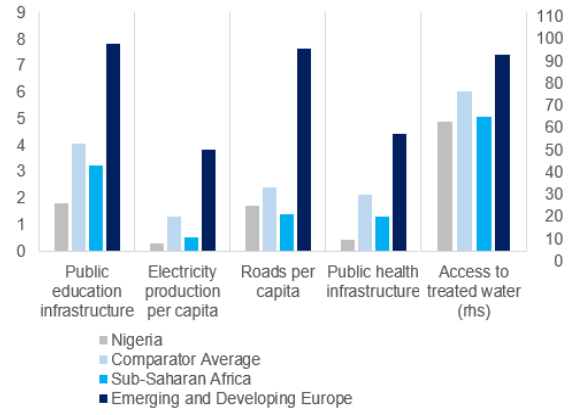
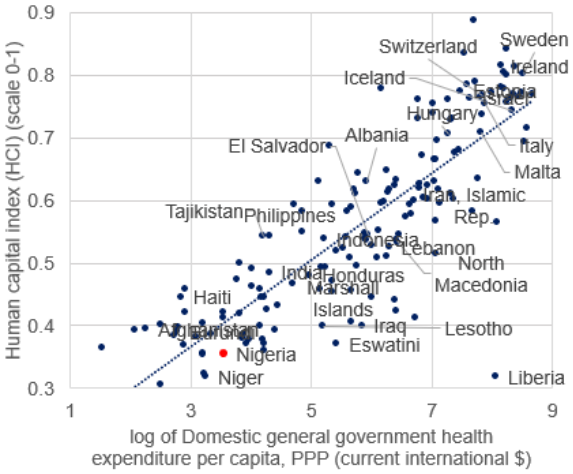



FIGURE 5.40. Nigeria's Score in human Capital Index




Sources: World Bank World Development Indicators and World Bank Human Capital Project.
Note: Left hand axis: Public education infrastructure is measured as secondary teachers per 1,000 persons; electricity production per capita as thousands of KWh per person; total road network as km per 1,000 persons; and public heath infrastructure as hospital beds per 1,000 persons. Right axis: Access to treated water is measured as the percent of population. Comparison based on latest data available.

### General government efficiency

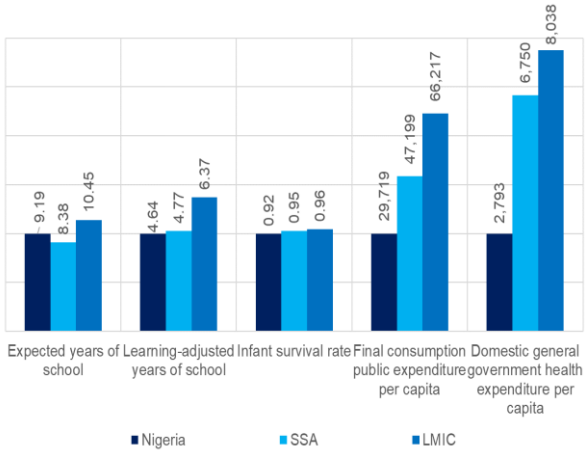
**Nigeria reports low levels of public spending and poor outcomes in education and health relative to peer countries.** Nigeria has comparatively low social sector spending coupled with

[106] World Bank World Development Indicators
[107] Firm-level data from the 2014 Nigeria World Bank Enterprise Survey shows that 27 percent of enterprises identified electricity as the main obstacle to doing business, which is more than twice the average of Sub-Saharan Africa. Transportation is identified as the fifth largest obstacle to doing business (5.7 percent of enterprises). (World Bank Enterprise Surveys 2014).

low social sector outcomes. Compared to LMIC averages, Nigeria's expected and learning-adjusted number of school years (9.18 and 4.6, respectively) and its infant survival rate (0.92) are below the average and its level of spending is also low[108](FIGURE 5.41FIGURE 5.41).

**The analysis looks at assessing Nigeria's expenditure efficiency with regards to social sectors, by comparing it to peer countries.** We use three set of country groups to benchmark Nigeria's efficiency: regional peers (fellow countries of Sub-Saharan Africa), lower middle-income countries, and countries that Nigeria could potentially improve to match its economic performance (aspirational peers such as India, Indonesia, Malaysia, and Mexico). Based on their levels of public spending and development outcomes in areas like education or health, countries can be divided into three clusters: (i) countries with relatively low levels of spending and relatively weak outcomes (e.g., years of schooling or share of infant mortality); (ii) countries with relatively high spending and relatively strong outcomes; and (iii) countries with higher spending and outcomes similar to group ii (**Error! Reference source not found.**FIGURE 5.42 and FIGURE 5.43). To account for differences in development outcomes among this large set of countries, we classify countries in categories based on their outcomes (good, moderate, and weak) and select the countries within the same group as Nigeria as its comparators.

FIGURE 5.41. Nigeria's expected number of years of school and infant survival rate are below the average of lower middle-income countries, and its levels of spending is also low.




NOTE: World Bank estimates based on the World Development Indicators Database.

**Compared to its peers, Nigeria's national spending is low, and there is ample room for improving the amount and quality of spending.** Analysis of public spending efficiency measures a country's ability to transform expenditure into outcomes for their citizens relative to other countries. To assess efficiency, we use the Data Envelopment Analysis (DEA) technique to calculate the ability of a country to achieve the best possibly development outcome (maximum output) at the lowest possible cost (minimum level of input). Within the group of countries with low levels of spending and poor outcomes, many countries are able to reach better outcomes than Nigeria, despite reporting similar spending per capita, such as Benin, Democratic Republic of Congo, Malawi, and Togo. We estimate two models, the methodologies for which are described further in **Error! Reference source not found.**. The first model measures efficiency in education using public final consumption as input and the average number of years in school as output, and the second specification estimates efficiency in health by considering health public expenditure as input and infant survival rate as output[109].

[108] Due to data constraints in education spending, we use final consumption public expenditure per capita as a proxy for education spending. The data on general government final consumption expenditure as a percentage of the GDP comes from the WDI Database, and it has been expressed in per capita terms by multiplying it by GDP per capita, PPP in constant 2017 international dollars. For health spending we use data from WDI on domestic general government health expenditure as a percentage of the GDP. Similarly, it is expressed in per capita terms after multiplying it by GDP per capita, PPP in constant 2017 international dollars.

[109] We calculated efficiency for models with alternative choices of outputs: for education, test scores, primary and secondary net enrollment; for health, maternal survival rate, life expectancy

FIGURE 5.42. Nigeria presents a low number of expected years of schooling and low public spending.

Expected years of schooling and GG consumption expenditure.

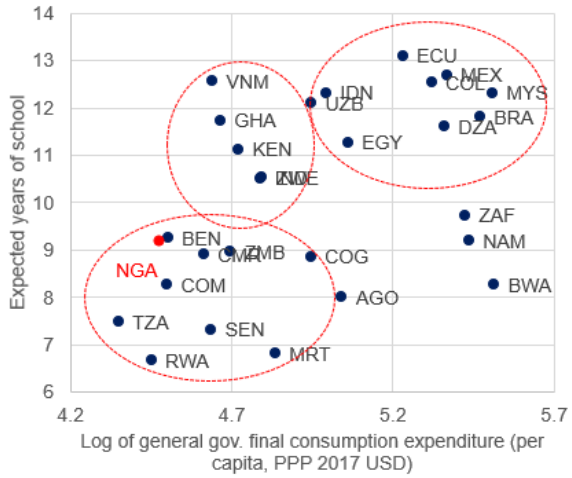
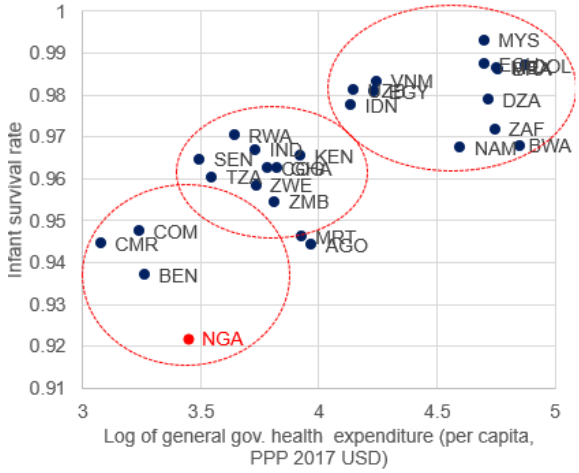



FIGURE 5.43 Nigeria has the lowest infant survival rate relative to its peers, and there are countries with lower spending and better outcomes.

Infant survival rate and GG consumption expenditure




NOTE: World Bank estimates based on the World Development Indicators Database. The efficiency analysis includes 105 countries among Sub-Saharan countries, lower middle-income countries, and oil exporters. For better visualization, the plot at the top presents 28 of them; these are mostly countries that fall under the first two categories (SSA and LMIC) and aspirational peers. The plot at the bottom displays the complete set of countries.

BOX 5.2. Benchmarking the efficiency of social spending in Nigeria

Data Envelopment Analysis (DEA) is a technique to estimate public spending efficiency, which is the ability of a country to achieve the best outcome (maximum output) at the lowest cost (minimum level of input). Typically, inputs include public spending in health, education, social spending and infrastructure, or a breakdown between current and capital expenditure, while outputs comprise development indicators such as health, education, and infrastructure. DEA calculates efficiency based on the proximity from the observed input-output combinations to an efficient frontier, which is the maximum attainable output for a given input level. The efficiency scores range between 0 and 1, where the countries that obtained a score equal to 1 are the most efficient, while the relative efficiency of the other countries is calculated through the distance to the frontier.

In this section, we focus on the results from input-oriented DEA models, which assess the efficient use of limited public resources by estimating the distance of a country's level of input with respect to the minimum level of input required (under full efficiency) to achieve that same level of output. The methodology is as follows. First, the model estimates the frontier based on the observed combinations of inputs and outputs. The frontier approximates the maximum attainable level of output given different levels of inputs, and the countries that lie on the frontier

and adult survival rate. Results show a moderately positive association across models. The average pairwise correlation across education efficiency scores is 0.53, and the correlation for health efficiency scores is 0.55. Moreover, efficiency in education and health are positively correlated (0.52), and the scores are stable for countries like Nigeria that are far from the efficiency frontier.

are operating at full efficiency. Next, the model calculates the relative efficiency of the units based on their distance to the frontier. The efficiency score of a country A is calculated by the ratio of the level of input that would be needed by a country operating at the frontier to achieve country A's level of output over the level of input used by country A. The ratio takes values between 0 and 1, and the higher this ratio is, the closer country A is to the frontier and the more efficient it is. Countries that obtain a score equal to 1 are at the frontier.

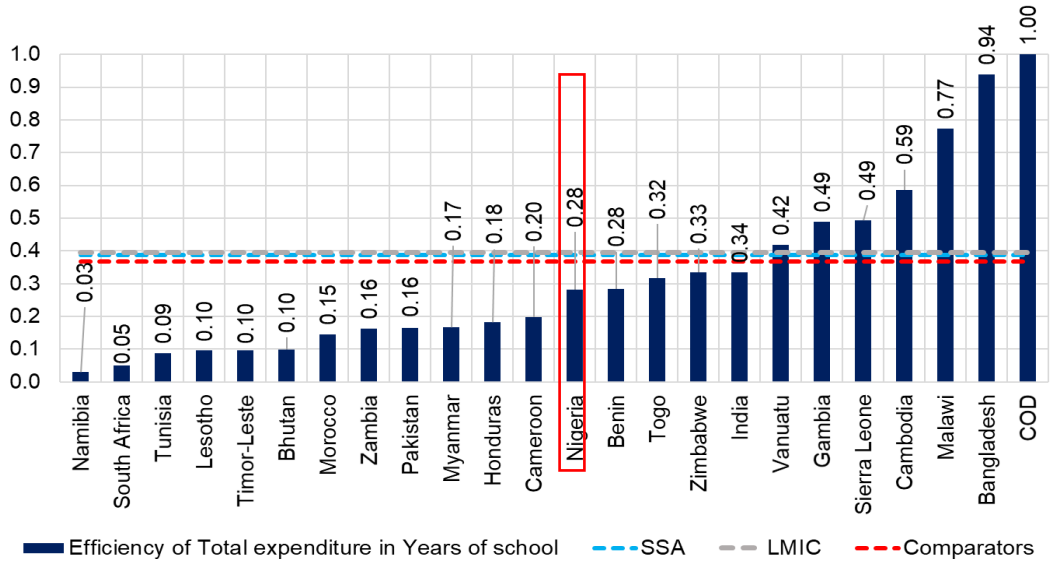
DEA presents a series of caveats. First, the efficiency indicators that it produces need to be interpreted in conjunction with other characteristics of the country, including their development outcomes and levels of spending. For example, a country with good outcomes could report low levels of efficiency if there are other countries that are able to achieve similar outcomes by spending less. Meanwhile, a country with low levels of development indicators could present high efficiency scores if its level of spending is so small than it cannot be reduced any further without worsening the outcomes. As a result, the analysis can benefit from making comparisons across units with similar levels of outcomes in order to control for differences across countries. In this section, we classify countries in categories based on their outcomes (good, moderate, and weak) and select the countries within the same group as Nigeria as its comparators. Second, in order to identify the underlying reasons that explain why one regional unit is more efficient than others, the analysis should be complemented with additional tools. For example, regression analysis can draw associations between efficiency and macroeconomic and policy variables. Third, models can use multiple inputs and outputs, but this makes the interpretation of the results more complicated—for interpretability purposes results in this chapter correspond to a one-input one-output model. Finally, DEA estimates the frontier directly from observed input-output combinations, and thus results are sensitive to the presence of outliers, especially when regional units are heterogeneous. In consequence, when the data is richer the quality of DEA improves considerably, as having more units to compare leads to a better assessment of relative efficiency.

Despite DEA's limitations, policymakers can benefit from the efficiency analysis, as it can be a first step in determining other countries that are spending less while achieving similar outcomes, or countries that are accomplishing better outcomes and spending the same amount of money as Nigeria. The next step involves identifying the lessons that can be learned from them.
We conduct an international benchmarking analysis to assess the ability of Nigeria to produce outputs compared to other 104 countries, including Sub-Saharan peers such as Kenya and Tanzania, lower middle-income countries such as India and Vietnam, and oil-exporters such as Saudi Arabia and Egypt. Health spending and public final consumption are used as inputs given data constraints on education spending. In addition, the availability of outputs differs by country and outcome variable. Following the best practices from similar studies (Herrera and Ouedraogo 2018, World Bank 2013, World Bank 2017), all the variables have been incorporated after calculating their five-year average from 2014 to 2018. The results from sensitivity analysis shows that the findings are consistent under multiple time transformations, such as ten-year averages, one-year lags, and averages of annual efficiencies.

**From the models estimated, Nigeria's efficiency of spending in education and health is low relative to that of regional peers and lower middle-income countries.** The efficiency of Nigeria in using its public spending to provide more years of education is scored as 0.28 (FIGURE 5.44), which indicates that a similar country performing under full efficiency would be able to spend 72 percent less and provide similar expected years of school to their citizens. Moreover, the efficiency score for health is 0.20 (FIGURE 5.45FIGURE 5.45**Error! Reference source not found.**), suggesting that a more efficient country would be able to spend 80 percent less and still report an infant survival rate similar to Nigeria's. Nigeria lags behind the average level of efficiency

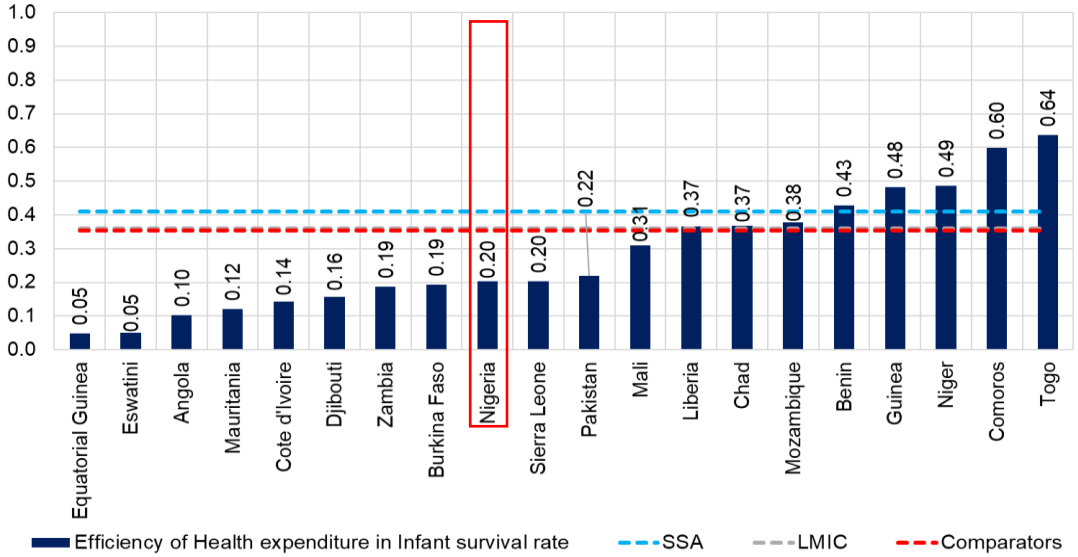
scores of its peers, which is 0.39 in education and 0.41 in health for countries in Sub-Saharan Africa and 0.39 in education and 0.36 in health for lower middle-income countries.

FIGURE 5.44. Nigeria's efficiency score in education spending is low relative to different benchmarks.




Note: Countries displayed are those that, similarly to Nigeria, report an intermediate level of expected years of school.

FIGURE 5.45. Nigeria also reports a low score of efficiency in health spending




NOTE: Countries displayed are those that, similarly to Nigeria, report low levels of infant survival rate.

**To achieve the outcomes in education at par with aspirational peers, Nigeria can either increase spending; increasing the efficiency of spending; or preferably both.** Regression analysis reveals the potential gains in education and health outcomes from improving efficiency and the amount of spending. At the current level of efficiency, Nigeria would need to at least

quadruple its spending to start closing the gap with lower middle-income countries (10.31 vs. 10.45 years of school).

**If Nigeria were to improve its efficiency of public spending on education to the level of lower middle-income countries, it would only achieve modest gains in education outcomes.** Nigeria's expected years of schooling would increase by 4 percent (from 9.18 to 9.54 years) by solely improving efficiency to the level of its peers (from 0.28 to 0.39).

**It is therefore crucial that Nigeria spends more to reach the same level of outcomes as its peers**. If Nigeria performed at their efficiency levels of LMICs (9.54 vs. 10.45 years) but at the same level of spending, its years of schooling would remain below the average levels of its peers. Only under full efficiency can Nigeria reach the same level of outcomes as LMICs. Therefore, Nigeria needs to spend more and to spend more efficiently. For instance, to move closer to peers such as Indonesia (12.31 years of school), Nigeria would need to be at the efficiency frontier and to spend three times more (FIGURE 5.46 and TABLE 5.9). Moreover, regression analysis indicates that Nigeria needs large increases in health spending to start closing the gap with its peers in health indicators such as infant survival rate (FIGURE 5.47and TABLE 5.10).

FIGURE 5.46. If Nigeria's efficiency moved up closer to the level of its lower middle-income peers, its number of expected years of schooling would still fall below the average level of the region (9.54 vs. 10.45 years of school). Nigeria would need to perform at full efficiency to reach that level.

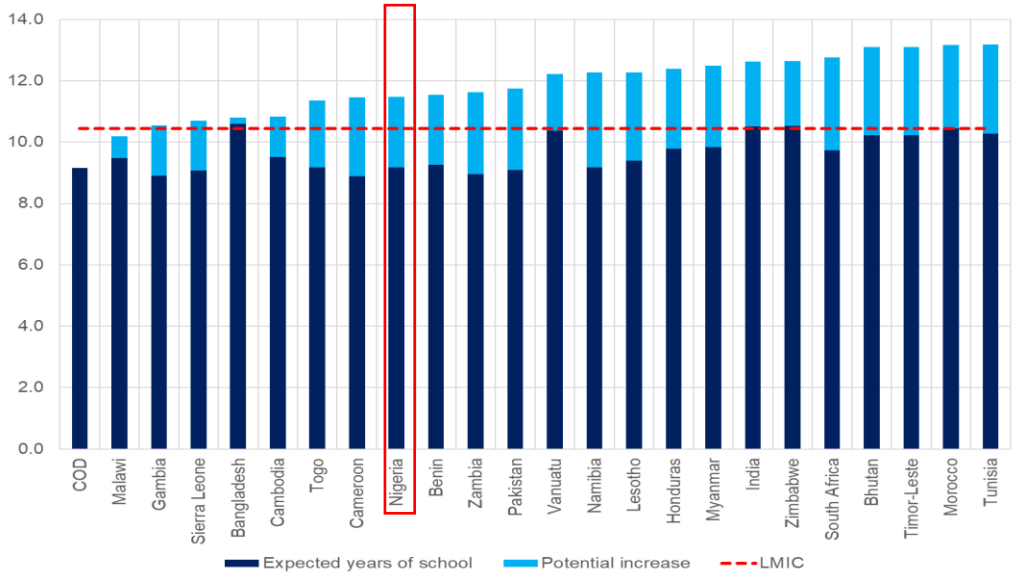



TABLE 5.9. To move closer to peers such as Indonesia (12.31 years of school), Nigeria needs to spend more and to spend more efficiently.

| | | Increases in total expenditure per capita | | | |
|---|---|---|---|---|---|
| | Current expenditure | 25% | 50% | 100% | 300% |
| Current efficiency (0.28) | 9.18 | 9.28 | 9.37 | 9.56 | 10.31 |
| Efficiency raises to LMIC level (0.39) | 9.54 | 9.64 | 9.73 | 9.92 | 10.67 |
| Effciency raises to Indonesia level (0.41) | 9.58 | 9.67 | 9.76 | 9.95 | 10.70 |
| Double efficiency (0.56) | 10.08 | 10.18 | 10.27 | 10.46 | 11.21 |
| At the efficiency frontier (1) | 11.47 | 11.57 | 11.66 | 11.85 | 12.60 |

NOTE: The marginal effect of increases in efficiency and expenditure on the number of years of schooling was obtained through OLS regressions of the expected number of years of schooling on expenditure and efficiency. Countries displayed are those that, similarly to Nigeria, report an intermediate level of expected years of school.

FIGURE 5.47. Nigeria needs to spend more and more efficiently to start closing the gap with the level of its lower middle-income peers.

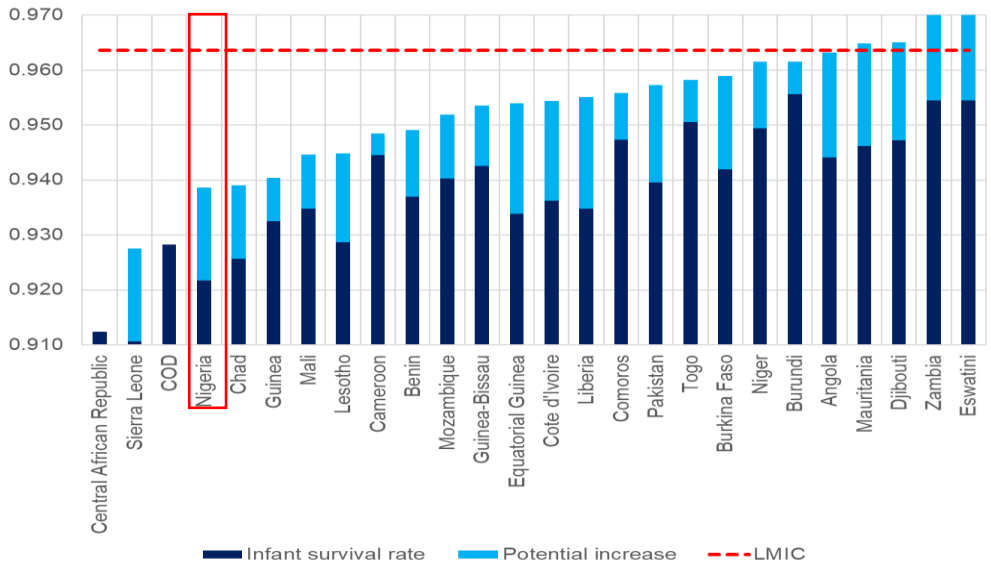



TABLE 5.10. Nigeria's infant survival rate would increase from 0.922 to 0.944 by spending three times more and operating at the efficiency frontier.

| | | Increases in health expenditure per capita | | | |
|---|---|---|---|---|---|
| | Current expenditure | 25% | 50% | 100% | 300% |
| Current efficiency (0.20) | 0.922 | 0.922 | 0.923 | 0.924 | 0.927 |
| Efficiency raises to LMIC level (0.36) | 0.925 | 0.926 | 0.926 | 0.927 | 0.930 |
| Double efficiency (0.40) | 0.926 | 0.926 | 0.927 | 0.928 | 0.931 |
| Near the efficiency frontier (1) | 0.939 | 0.939 | 0.940 | 0.940 | 0.944 |

NOTE: The marginal effect of increases in efficiency and expenditure on the infant survival rate was obtained through OLS regressions of the infant survival rate on expenditure and efficiency. Countries displayed are those that, similarly to Nigeria, report low levels of infant survival rate.

## Subnational level efficiency

**The efficiency analysis of public spending is extended to the sub-national level, in a bid to assess the outcomes observed in Nigeria's states relative to their cost.** Using the DEA methodology outlined in BOX 5.3, we analyzed data from 35 states (excluding FCT and Borno) for the year 2018. Although the analysis would have benefited from encompassing data over a longer time span, it was not possible to do so, because the information we relied on—detailing realized expenditure across states into a homogeneous source—only became available very recently. Nevertheless, this limited dataset still allowed for the first ever efficiency analysis to be conducted at the sub-national level in Nigeria, with results that can be updated in the future as additional data becomes available.

BOX 5.3. Assessing sub-national spending efficiency across Nigerian states

The efficiency analysis is based on four DEA models, with each including one input and one output. The models measure: efficiency of total expenditure per capita in education (output: secondary attendance); efficiency of total expenditure per capita in health (output: proportion of children not stunted); and efficiency of total expenditure per capita in infrastructure (outputs: access to improved drinking water and electricity).

For sensitivity analysis, we ran models with additional choices of inputs and outputs. Additional inputs include the breakdown of total spending between current and capital expenditure. Additional outputs consist of primary school attendance (education); the proportion of children that received all eight basic vaccinations, the proportion of children not wasted, the proportion of children not underweight, the proportion of people sleeping under nets, and the infant survival rate (health); and access to sanitation, mobile phones, and main roads (infrastructure). For a given input variable, efficiency scores are robust to the choice of output variable. The four models chosen for the main analysis present efficiency scores with high pairwise correlation with the efficiency scores from the other models within their corresponding development sector. For example, efficiency scores when the output is the proportion of children not stunted are highly correlated with the scores from models where the outcomes are the proportion of children not underweight or the infant survival rate.

## Outcomes are correlated with each other and with the level of state spending, but there are caveats

**We found that outcomes for citizens vary across Nigerian states, with a positive association across indicators: states that have better health outcomes also have better outcomes on education and access to infrastructure.** In particular, States in the North West and North East report low rates of secondary attendance and a larger prevalence of stunting, while Southern regions present better education and health outcomes (FIGURE 5.48), as well as better access to electricity and improved drinking water (FIGURE 5.49FIGURE 5.49**Error! Reference source not found.**). In addition, access to electricity is correlated with education and health indicators across states (FIGURE 5.50**Error! Reference source not found.** and FIGURE 5.51**Error! Reference source not found.**).

FIGURE 5.48. States present a high positive association between rates of secondary attendance and proportion of children not stunted

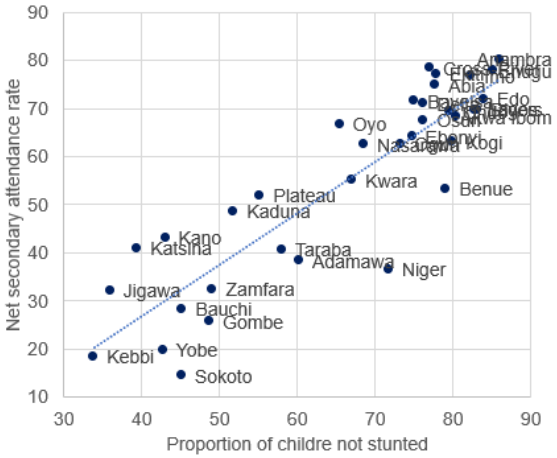
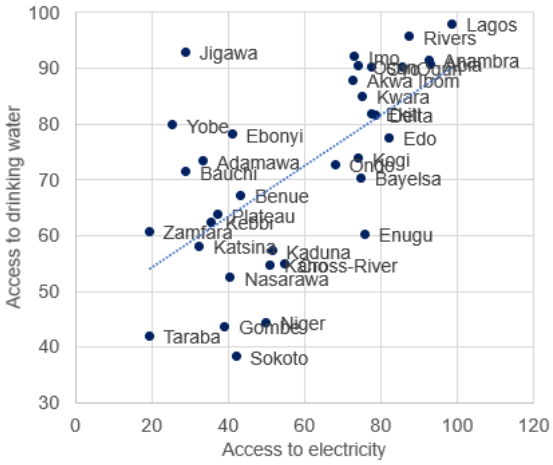



FIGURE 5.49 Infrastructure outcomes are also correlated.



Note: World Bank estimates based on DHS 2018. Excludes Borno (NLSS data is not available), and Bayelsa (outlier due to high per capita spending)

FIGURE 5.50. States with higher attendance rates are more likely to report a higher proportion of households with access to electricity.

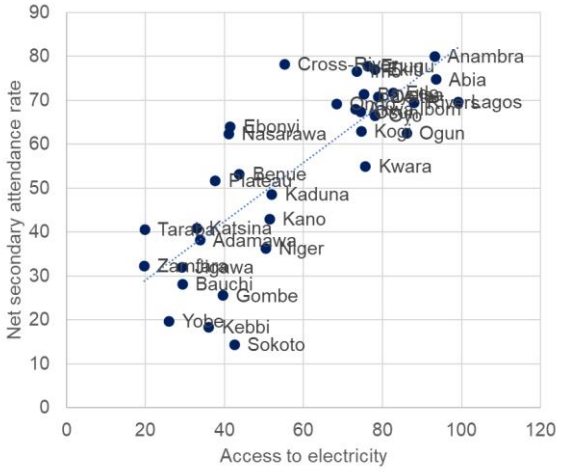
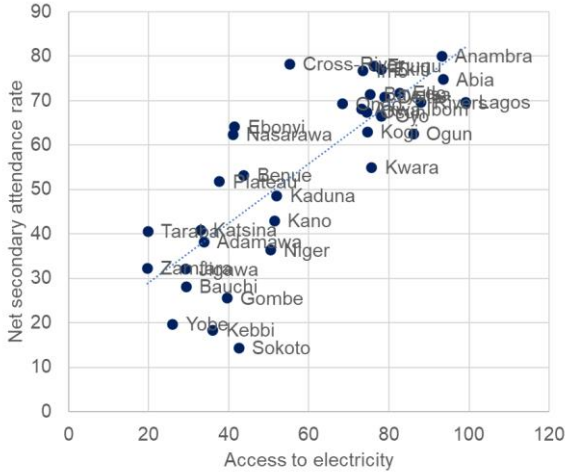



FIGURE 5.51. In addition, the prevalence of stunting is lower in these states

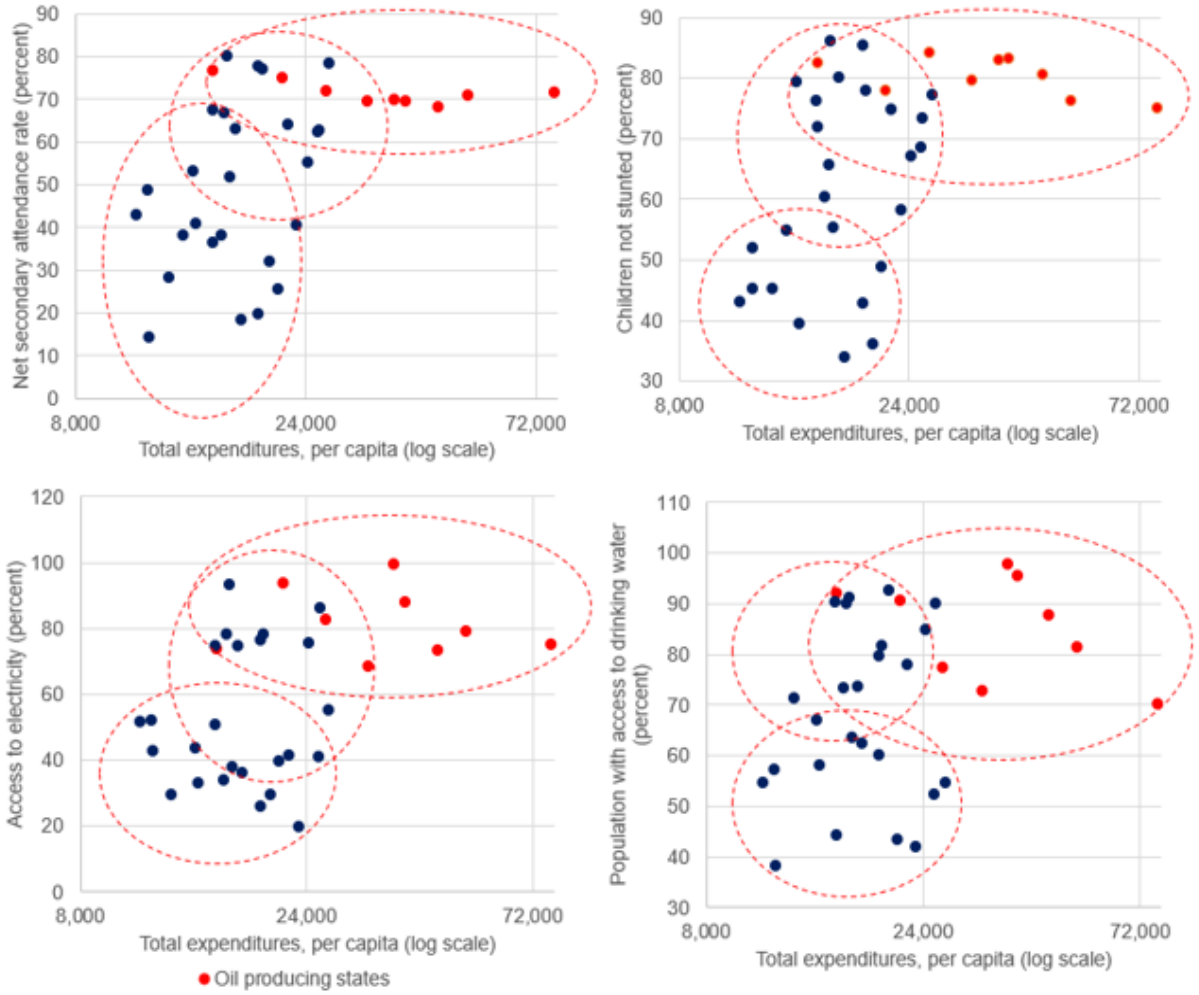



Note: World Bank estimates based on DHS 2018. Excludes Borno (NLSS data is not available), and Bayelsa (outlier due to high per capita spending)

**Based on variation in spending and outcomes, we broadly classify Nigeria's states into three groups**: the first has low spending and poor outcomes (states in the North East and North West, and some from the North Central region); the second has relatively higher expenditure and better outcomes (states in the North Central, South East, and South West regions); and the third has even higher spending, but similar outcomes to group two (oil producing states in the South West and South South).

**States with higher spending per capita tend to show better human and physical capital outcomes among their citizens;** however, spending levels are not the sole determinants of such outcomes (FIGURE 5.52**Error! Reference source not found.**). For example, despite reporting similar spending per capita (between 16,000 and 17,000 NGN), states in the South such as Oyo and Anambra present secondary attendance rates significantly higher than Northern states such as Adamawa and Plateau (66.6 percent and 80.1 percent vs. 38.1 percent and 51.8 percent, respectively). This indicates that a host of factors beyond state spending levels have an impact on citizens' access to basic services. State government expenditure efficiency is one of them, although its effect is likely compounded by structural elements (such as a state's urbanization rate) that were not directly accounted for in the analysis conducted.

FIGURE 5.52. States are clustered in three groups: (i) states with low spending and poor outcomes (North Central and North East), (ii) states with relatively higher expenditure and better outcomes (North Central, South East, and South West), and (iii) states with even higher spending but similar outcomes to group ii (oil producing states in the South West and South South).




Sources: World Bank estimates based on State Financial Statements 2018 and 2019; NLSS 2018/2019; DHS 2018.

**As well as revealing the efficiency of state spending, the fact that several many states have low government spending and poor welfare and human capital outcomes could also demonstrate the potential weaknesses of fiscal federalism in Nigeria.** As discussed in Section 1.3 (fiscal federalism), just 10 percent of the federal funding directed to Nigeria's states is allocated according to social development factors. Meanwhile, around 40 percent of funding is equally allocated across states. Since state spending is strongly linked to state allocations from the federal budget, this may explain why states with poorer welfare and human capital outcomes are not able to receive more and spend more to address the challenges they face. Nigeria's fiscal formula may not be able to redistribute resources towards those states that need them most.

## Efficiency of state spending is low in the South-South region, with poor outcomes relative to expenditure, and high in the South East region

**Focusing on the efficiency of state spending per capita, we analyzed efficiency scores on a state-by-state basis and across Nigeria's geopolitical zones.** DEA analysis is especially useful to assess efficiency in the domestic context, thanks to lesser structural differences across units relative to an international comparison, and to more homogeneous datasets.

**Our analysis reveals a large variation in the efficiency of state spending (FIGURE 5.53):** efficiency scores in education, health, and infrastructure range from 0.2 and 0.3 in South Southern states such as Bayelsa and Delta, to 1 in many states in the North West and South East. Despite their higher spending, South Southern states (particularly Bayelsa, Delta, and Akwa Ibom) do not obtain better outcomes than states in the South West (such as Lagos and Ondo) or South East (Anambra).

**Efficiency of spending in health and education is high in South East states.** Despite similar spending to North Central states (18,960 NGN vs. 18,875 NGN per capita, on average), education and health outcomes are better in the South East. Here, the average rates of secondary attendance and children not stunted are 74.7 percent and 81.2 percent, respectively, against 53.6 percent and 70.3 percent for North Central states.

**States in the North West report high efficiency scores on education and health, although their low outcomes show that this is largely a function of low spending per capita.** North Eastern states, on the other hand, spend significantly more on average than those in the North West; nevertheless, outcomes are generally similar (FIGURE 5.53

). For example, Kaduna, Sokoto, and Zamfara spend close to 11,070 NGN on average, with rates of secondary attendance and children not stunted of 31.8 percent and 48.8 percent, respectively. Gombe, Taraba, and Yobe spend twice as much (21,140 NGN), yet report similar outcomes (28.6 percent and 49.9 percent, respectively).

**South Southern states spend the most on average on education and health, yet report similar outcomes to lower spending states in the South East.** Spending per capita is on average much higher in the South South than in the South East (44,767 NGN vs. 18,960 NGN), but the attendance rate and proportion of children not stunted are nevertheless slightly lower in the former region (71.7 percent vs. 74.7 percent and 79.4 percent vs. 81.2 percent, respectively).

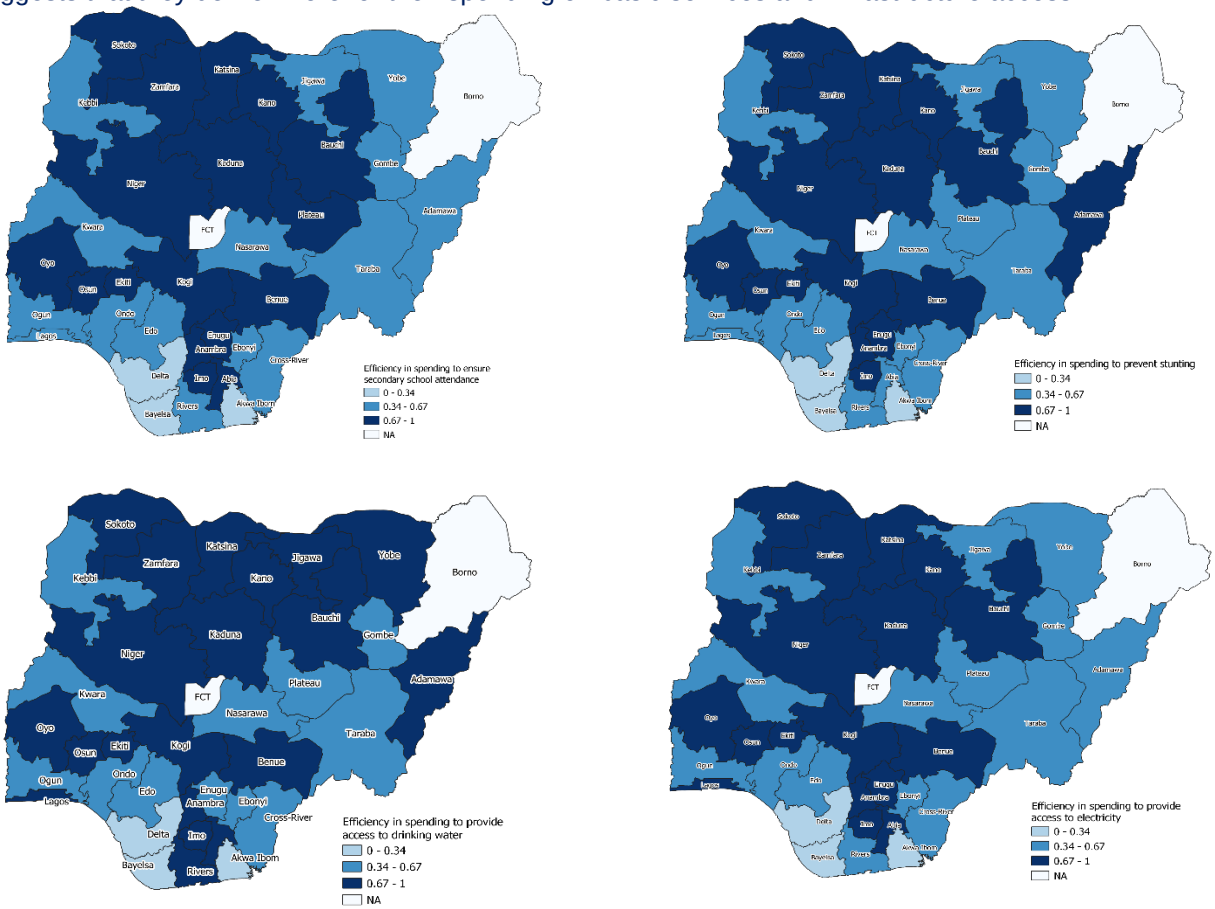
**States in the North Central, South West, and North East present efficiency scores in education and health close to the national average**, with medium levels of both expenditure and outcomes. For example, South Western states spend on average 24,350 NGN, and report rates of secondary attendance and children not stunted of 68.8 percent and 75.9 percent, respectively. States in the South East, on the other hand, on average spend less (18,960 NGN) and present better outcomes (74.7 and 81.2 percent, respectively).

**Efficiency of expenditure in infrastructure is higher in the North West, South East, and South West regions.** States in the North West report similar levels of access to improved drinking water and electricity as North Eastern states (60.4 percent and 37.6 percent vs. 61.8 percent and 29.7 percent, respectively), while spending less. Meanwhile, the South East and South West regions present almost identical efficiency scores because states in the South West spend more on average (24,350 NGN vs. 18,960 NGN) but also have higher rates of access to improved drinking water and electricity (86.98 vs. 82.32 percent and 80.68 vs. 75.51 percent, respectively).

**Importantly, there is variance in efficiency across states within the same region (FIGURE 5.53**Error! Reference source not found.**).** North Western states such as Zamfara, Kano, and Kaduna score high on efficiency, but Kebbi and Jigawa fall below the national average (TABLE

5.11 and TABLE 5.12). The latter states show relatively high spending compared to the North Western average (18,913 NGN vs. 11,624 NGN), yet their proportion of children not stunted is lower. .t the same time, some states in North Central (Benue and Niger) and South West (Osun) have high efficiency scores because although their spending is relatively low, they report a proportion of children not stunted comparable to the average rate of the South West(75.8 percent vs. 75.9 percent). Among South Southern states, Bayelsa and Delta spend twice as much as Rivers and Edo (65,579 NGN vs. 32,611 NGN on average), but their proportions of children not stunted and people with access to electricity are lower (75.7 percent vs. 83.6 percent, and 77 vs. 85.3 percent, respectively).

FIGURE 5.53. On average, the North West and South East regions report higher efficiency, which suggests that they deliver more for their spending on basic services and infrastructure access.




Sources: World Bank estimates based on State Financial Statements 2018 and 2019; NLSS 2018/2019; DHS 2018.

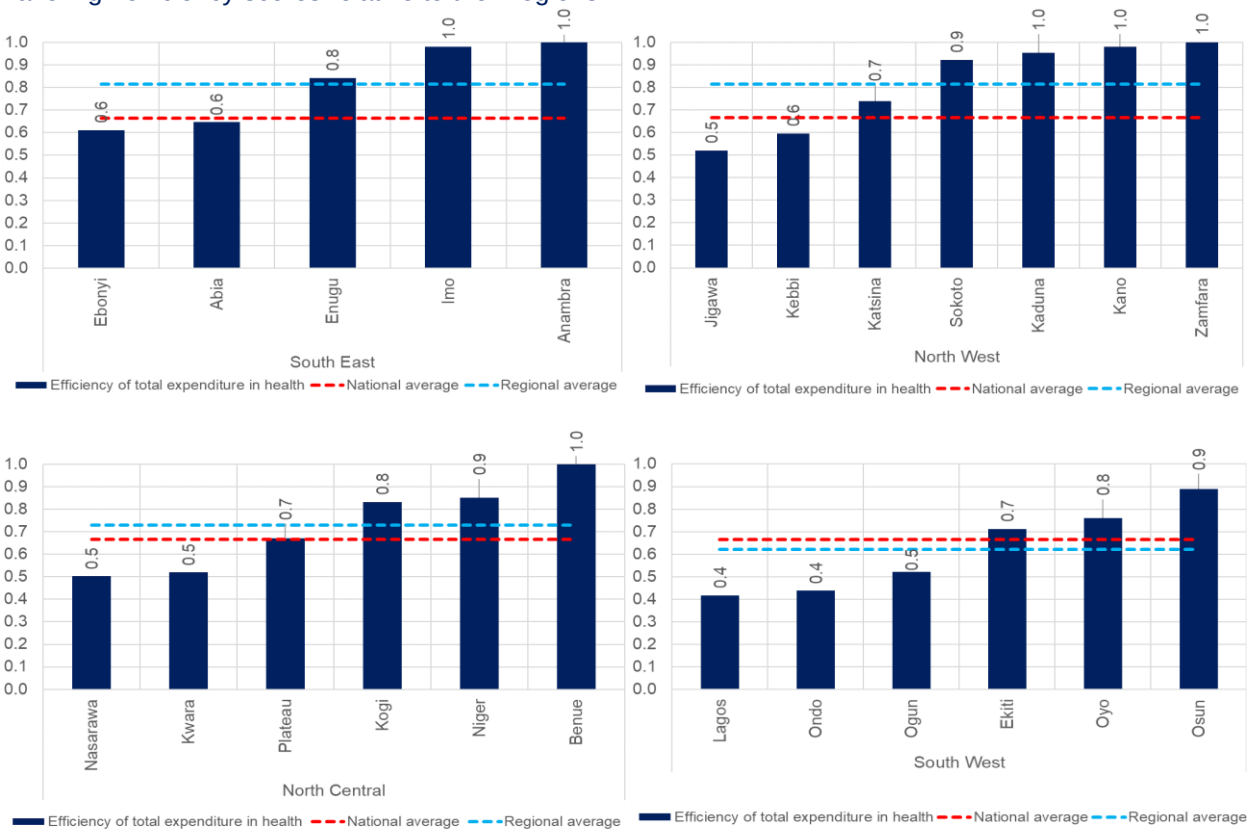
TABLE 5.11. South East is one of the most efficient regions, with relatively low spending but outcomes comparable to those of other Southern states.

| | Total expenditure per capita | Current expenditure per capita | Capital expenditure per capita | Net secondary attendance | Prop. children not stunted | Access to drinking water | Access to electricity |
|---|---|---|---|---|---|---|---|
| South East | 18,960 | 9,985 | 8,975 | 74.70 | 81.24 | 82.32 | 75.51 |
| North West | 13,707 | 7,342 | 6,365 | 32.81 | 42.69 | 60.41 | 37.64 |
| North Central | 18,875 | 13,432 | 5,443 | 53.63 | 70.33 | 64.21 | 53.82 |
| South West | 24,350 | 15,107 | 9,243 | 68.78 | 75.92 | 86.98 | 80.68 |
| North East | 18,397 | 11,779 | 6,618 | 30.46 | 51.06 | 61.83 | 29.66 |
| South South | 44,767 | 24,495 | 20,272 | 71.68 | 79.35 | 77.74 | 75.47 |

TABLE 5.12. States in the North West report low levels of spending and development outcomes, which suggests that they should be spending more in order to improve outcomes for their citizens.

| | Total exp. on sec. school attendance | Total exp. on prop. children not stunted | Total exp. on access to drinking water | Total exp. on access to electricity | Current exp. on sec. school attendance | Current exp. on prop. children not stunted | Capital exp. on access to drinking water | Capital exp. on access to electricity |
|---|---|---|---|---|---|---|---|---|
| South East | 0.83 | 0.82 | 0.76 | 0.78 | 0.71 | 0.73 | 0.50 | 0.55 |
| North West | 0.83 | 0.82 | 0.87 | 0.82 | 0.79 | 0.80 | 0.51 | 0.46 |
| North Central | 0.68 | 0.73 | 0.65 | 0.65 | 0.45 | 0.45 | 0.59 | 0.61 |
| South West | 0.66 | 0.62 | 0.77 | 0.75 | 0.41 | 0.41 | 0.68 | 0.70 |
| North East | 0.60 | 0.62 | 0.68 | 0.60 | 0.49 | 0.50 | 0.51 | 0.46 |
| South South | 0.38 | 0.38 | 0.39 | 0.36 | 0.35 | 0.36 | 0.21 | 0.20 |

FIGURE 5.54. There is heterogeneity within Nigeria's regions. North West scores high on efficiency overall, but the efficiency scores of the North Western states of Kebbi and Jigawa fall below the national average. At the same time, some states in North Central (Benue and Niger) and South West (Osun) have high efficiency scores relative to their regions.



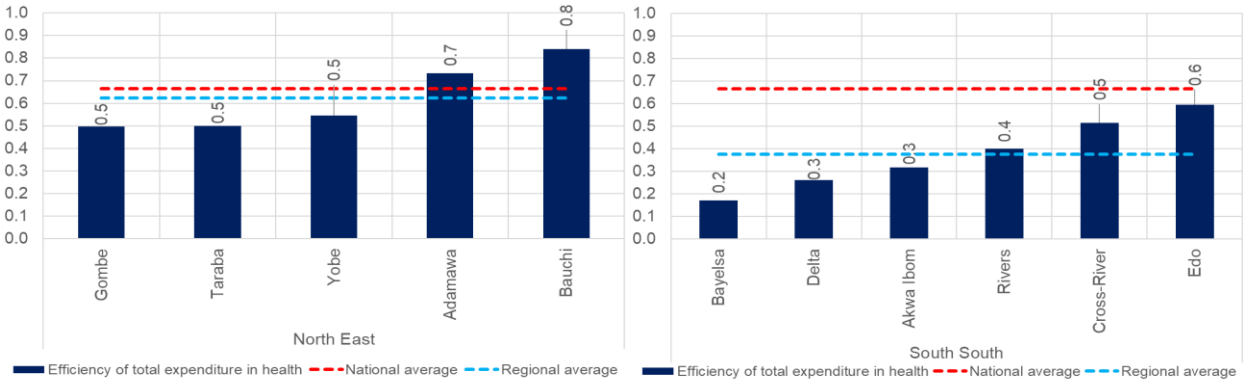
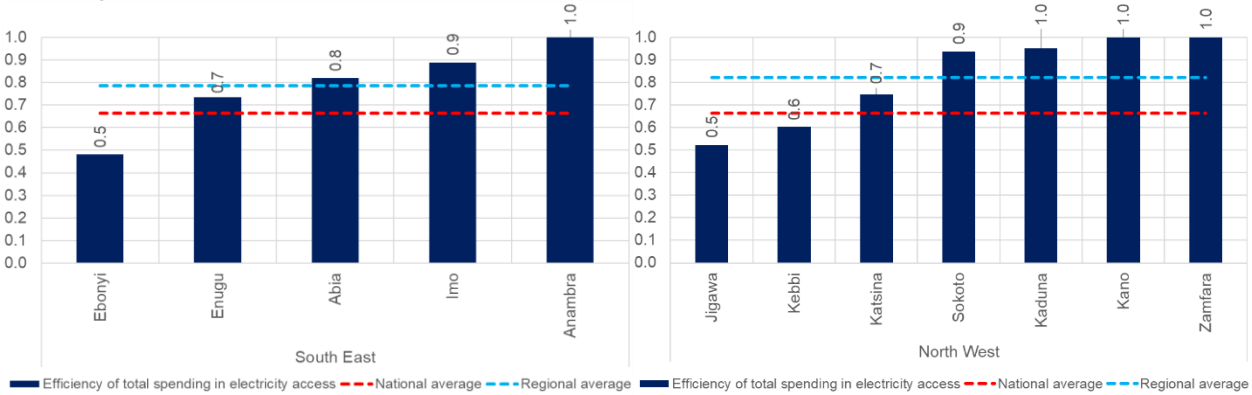
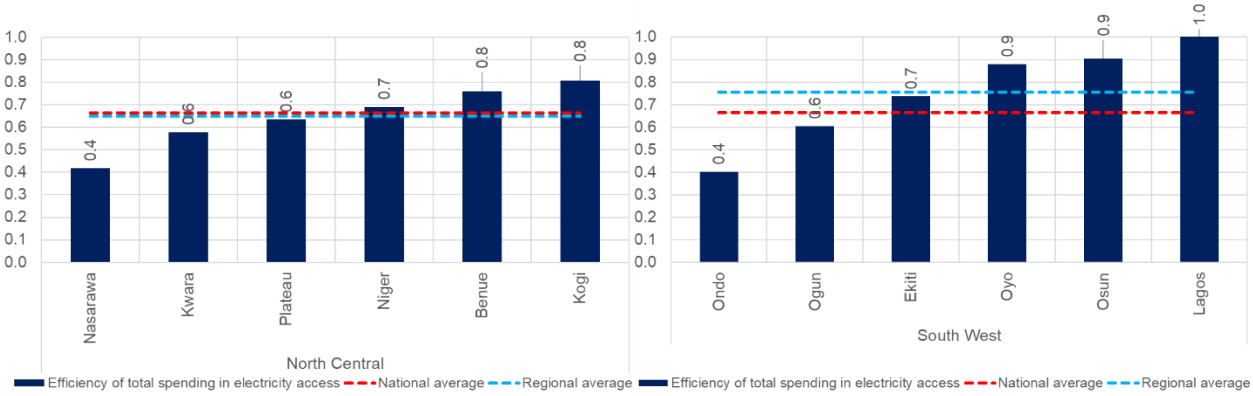
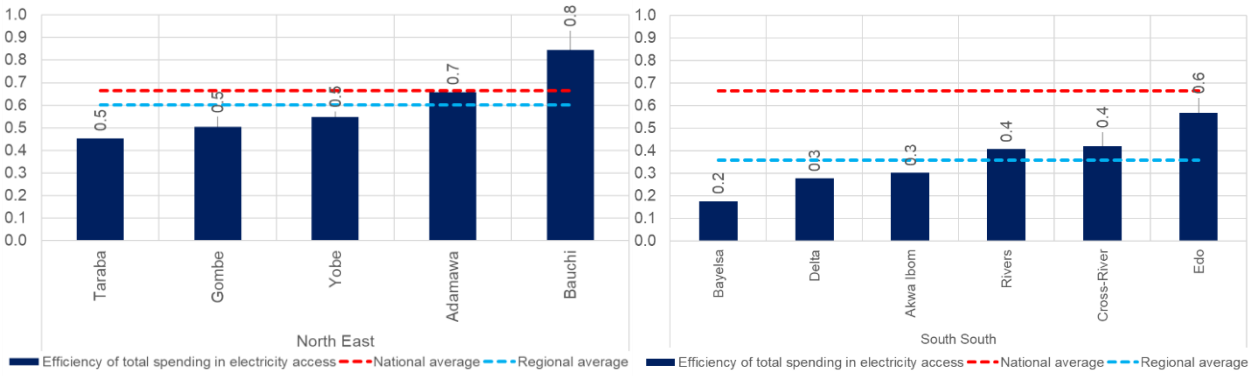



FIGURE 5.55. States in the South West report higher levels of efficiency in infrastructure compared to health and education, due to a large proportion of people with access to improved drinking water and electricity.






NOTES: World Bank estimates based on State Financial Statements 2018; NLSS 2018/2019; DHS 2018.

## States within the same region tend to cluster around similar levels of spending efficiency and outcomes

**We classify Nigeria's states into four categories based on their relative efficiency and performance, measured in terms of outcome level**s (TABLE 5.14, TABLE 5.15 and TABLE 5.16): higher efficiency and higher performance; lower efficiency and higher performance; higher efficiency and lower performance; and lower efficiency and lower performance.

**Most states in the South East (Abia, Anambra, Enugu, and Imo) are classified as higher efficiency and higher performance**. For example, Anambra's secondary school attendance rate, proportion of children not stunted, and share of people with access to electricity are above the national median (80.1 percent vs. 62.6 percent, 86 percent vs. 73.4 percent, and 93.1 percent vs. 55.2 percent, respectively), while its spending is below the national median (16,485 NGN vs. 19,231 NGN).

**North Western states (Kaduna, Kano, Katsina, Sokoto, and Zamfara) present higher efficiency and lower performance.** Their expenditure is low (11,624 NGN on average vs. the national median of 19,231 NGN), which boosts the efficiency score; but their secondary school attendance rate, proportion of children not stunted, and share of people with electricity access are below the national median (35.8 percent on average vs. 62.6 percent, 45.8 percent on average vs. 73.4 percent, and 39.7 on average vs. 55.2 percent, respectively).

TABLE 5.13. Most states in the South East fall under the classification of higher efficiency and higher performance for public spending on education, while states in the North West report higher efficiency but lower performance**.**

| | Higher performance (higher sec. attendance rate) | Lower performance (lower sec. attendance rate) |
|---|---|---|
| Higher efficiency | NC: Kogi; SE: Abia, Anambra, Enugu, Imo; SW: Ekiti, Osun, Oyo | NC: Benue, Niger, Plateau; NE: Adamawa, Bauchi; NW: Kaduna, Kano, Katsina, Sokoto, Zamfara |
| Lower efficiency | SE: Ebonyi; SS: Akwa Ibom, Bayelsa, Cross-River, Delta, Edo, Rivers; SW: Lagos, Ogun, Ondo | NC: Kwara, Nasarawa; NE: Gombe, Taraba, Yobe; NW: Jigawa, Kebbi |

NOTE: States are divided into higher or lower efficiency based on whether they fall below or above the middle efficiency score across the 35 Nigerian states. Similarly, the classification into higher and lower performance depends on whether the net secondary school attendance rate is above or below the median across the 35 Nigerian states.

TABLE 5.14. Most states in the South East fall under the classification of higher efficiency and higher performance for public spending in health, while states in the North West region report higher efficiency but lower performance.

| | Higher performance (lower stunting) | Lower performance (higher stunting) |
|---|---|---|
| Higher efficiency | NC: Benue, Kogi; SE: Abia, Anambra, Enugu, Imo; SW: Ekiti, Osun | NC: Niger, Plateau; NE: Adamawa, Bauchi; NW: Kaduna, Kano, Katsina, Sokoto, Zamfara; SW: Oyo |
| Lower efficiency | SE: Ebonyi; SS: Akwa Ibom, Bayelsa, Cross-River, Delta, Edo, Rivers; SW: Lagos, Ogun, Ondo | NC: Kwara, Nasarawa; NE: Gombe, Taraba, Yobe; NW: Jigawa, Kebbi |

NOTE: States are divided into higher or lower efficiency based on whether they fall below or above the middle efficiency score across the 35 Nigerian states. Similarly, the classification into higher and lower performance depends on whether the proportion of children not stunted is below or above the median across the 35 Nigerian states.

TABLE 5.15. Most states in the South East and South West fall under the classification of higher efficiency and higher performance for public spending in infrastructure.

| | Higher performance (higher access to electricity) | Lower performance (lower access to electricity) |
|---|---|---|
| Higher efficiency | NC: Kogi; SE: Abia, Anambra, Enugu, Imo; SW: Ekiti, Lagos, Osun, Oyo | NC: Benue, Niger; NE: Adamawa, Bauchi; NW: Kaduna, Kano, Katsina, Sokoto, Zamfara |
| Lower efficiency | NC: Kwara; SS: Akwa Ibom, Bayelsa, Cross-River, Delta, Edo, Rivers; SW: Ogun, Ondo | NC: Nasarawa, Plateau; NE: Gombe, Taraba, Yobe; NW: Jigawa, Kebbi; SE: Ebonyi |

NOTE: States are divided into higher or lower efficiency based on whether they fall below or above the middle efficiency score across the 35 Nigerian states. Similarly, the classification into higher and lower performance depends on whether the share of people with electricity access is above or below the median across the 35 Nigerian states.

## Correlation of efficiency scores

**The scores for efficiency of spending in education, health, and infrastructure are positively correlated**, but the association decreases when the input becomes current spending per capita, for education and health; and capital spending per capita for infrastructure. States in the North Central and North East report low scores of efficiency in education and health because their current spending is high compared to the South East (13,432 and 11,779 vs. 9,985 NGN) and report lower rates of secondary attendance (53.6 and 30.5 vs. 74.7 percent) and children not stunted (70.3 and 51.1 vs. 81.2 percent). Meanwhile, states in the South East present low efficiency scores compared to the South West because their levels of capital spending are similar (8,975 vs. 9,243 NGN) but their rates of access to improved drinking water and electricity are lower (82.3 vs. 87.0 and 75.5 vs. 80.7, respectively).

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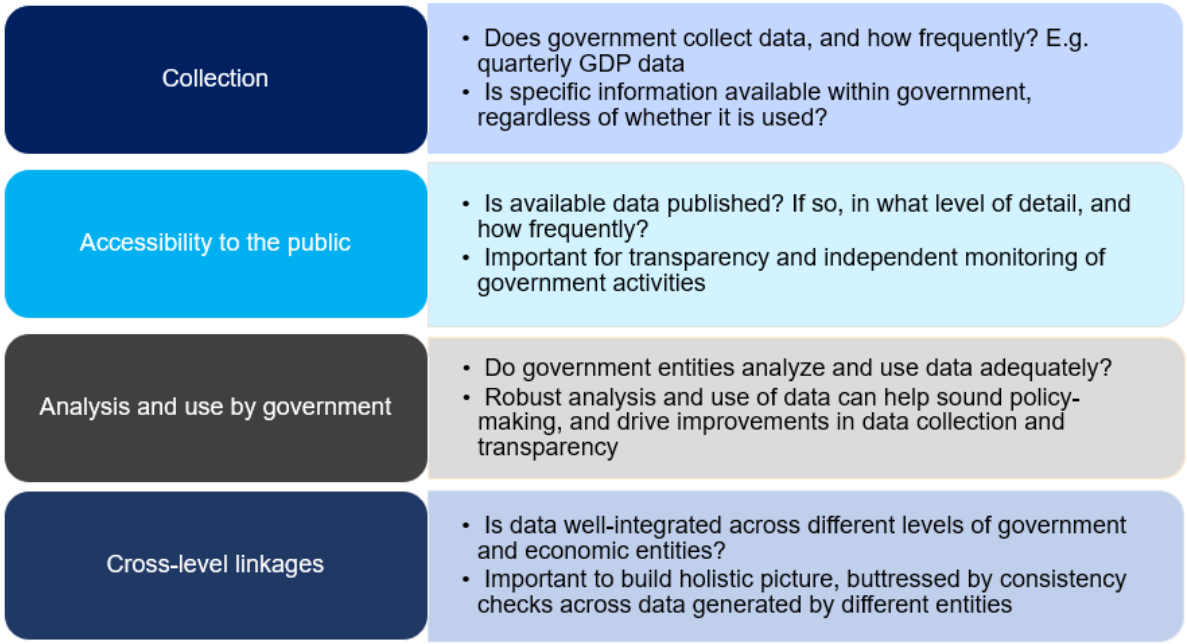
## 5.8 Data foundations for public expenditure management in Nigeria

**Nigeria has made strides in improving the maintenance and transparency of macro-fiscal data over the past decade.** In particular, the collection and dissemination work carried out by the National Bureau of Statistics (NBS), the Office of the Accountant General of the Federation (OAGF), and the Federal Ministry of Finance, Budget, and National Planning (FMFBNP) has sharpened the insight into the economic and fiscal functioning of the federal government. However, gaps remain at the subnational level, where there is a need to harmonize data collection and publication with the standards adopted at the federal level, with a view to building a holistic view of the country's economy. Critically, available data should be analyzed and utilized to make informed policy decisions that result in robust and credible budgets.

**This section assesses Nigeria's macro-fiscal data against four major dimensions:** (i) collection; (ii) accessibility to the public; (iii) analysis and use of data in policymaking; and (iv) ability to link data gathered across different levels of government (FIGURE 5.56).

FIGURE 5.56. Assessing Nigeria's macro-fiscal data




### Collection of key economic data has improved over time, although gaps remain particularly at state level.

**Public collection of economic data in Nigeria has improved considerably over the past decade, especially at the federal government level.** Spearheaded by the National Bureau of Statistics (NBS), the government gathers data on core economic indicators, such as the national accounts and the consumer price index, on a monthly or quarterly basis. Monetary, exchange rate, and balance of payments (BOP) data is collected monthly or quarterly by the Central Bank of Nigeria (CBN). On the fiscal front, the Office of the Accountant General of the Federation (OAGF) monitors federal government expenditure with monthly frequency. FAAC revenue data is

instead tracked by the federal revenue collecting agencies, such as the Federal Inland Revenue Service (FIRS), the NCS, and the Nigerian National Petroleum Corporation (NNPC). Finally, data about debt is produced on a quarterly basis by the Debt Management Office (DMO) of the Federal Ministry of Finance, Budget, and National Planning (FMFBNP).

**States are catching up to the federal government in the scale and quality of their data collection, but certain gaps persist.** Since 2021, states have been producing quarterly in-year budget implementation reports, and state revenue collection information is also available on at least a quarterly basis. However, state-level data in areas such as GDP[110], debt stock and debt servicing is scattered or infrequently updated, with adverse effects on fiscal management. Notably, state debt data needs to be reconciled with the DMO and the CBN on an annual basis, a process that often entails a lag of up to a year.

**Federal and state governments do not regularly obtain performance data by ministry, department, or agency (MDA).** An assessment of MDA performance targets and relevant achievements can help guide financial policymaking, while providing finance ministries at both the federal and state levels with the ability to credibly challenge budget proposals and increase spending efficiency.

### Accessibility of data varies across typologies, and timeliness of publication is a common issue.

**Transparency and accessibility of data have improved in recent years, with a wealth of statistics made available on the websites of the respective collecting agencies.** For example, the NBS publishes data on the national accounts and the consumer price index on a quarterly and monthly basis, respectively. Similarly, the CBN publishes monetary, exchange rate, and BOP statistics either monthly or quarterly, albeit with lag of a few months.

**Against this background, public access to fiscal data remains suboptimal.** Federal budgetary documents are shared promptly on the website of the Budget Office of the Federation (BOF), but other types of fiscal data – such as FAAC revenues or federal budgetary outturns – are published with considerable delay or not at all. Notably, audited financial reports of the federation are published by the OAGF with a lag of almost two years. On a similar note, although most states have recently started publishing their annual budgets, there can be delays between approval of the budget and its publication. Encouragingly, several states produce and share quarterly in-year budget implementation reports.

**Data pertaining to federal and state debt is published quarterly by the DMO, but it is not comprehensive.** Namely, while information about public debt is made available, details of the CBN overdraft that is used to finance the fiscal deficit are not. The DMO does publish its debt diagnostics, including debt sustainability analyses, and annual reports with information on public guarantees and other liabilities. States have also been publishing their own debt diagnostics since 2020.

[110] Official state-level GDP data has so far only been published for the period between 2015 and 2017.

TABLE 5.16. Summary of collection and publication of key macro-fiscal data

| Type of Data | Collected by | Frequency | Published (Y/N) | Detailed or Aggregate |
|---|---|---|---|---|
| GDP (national) | NBS | Quarterly and annual | Y (https://nigerianstat.gov.ng/elibrary) | Detailed |
| GDP (states) | NBS | Annual, but last published in 2017 | Y (https://nigerianstat.gov.ng/elibrary) | Detailed |
| Consumer price index | NBS | Monthly | Y (https://nigerianstat.gov.ng/elibrary) | Detailed |
| Monetary aggregates | CBN | Monthly | Y (http://statistics.cbn.gov.ng/cbn-onlinestats/) | Detailed |
| BOP | CBN | Quarterly | Y (http://statistics.cbn.gov.ng/cbn-onlinestats/) | Detailed |
| Exchange rate | CBN | Daily | Y (https://www.cbn.gov.ng/) | Aggregate |
| Oil price | CBN | Daily | Y (https://www.cbn.gov.ng/) | Aggregate |
| Oil production | Nigerian Upstream Petroleum Regulatory Commission | Monthly | Y (https://www.nuprc.gov.ng/oil-production-status-report/) | Detailed |
| Draft annual budget (federal) | Budget Office | Annual | Y (https://www.budgetoffice.gov.ng/) | Detailed |
| Approved annual budget (federal) | Budget Office | Annual | Y (https://www.budgetoffice.gov.ng/) | Detailed |
| Draft annual budget (states) | Budget Office | Annual | Draft budgets are published by most states on their respective websites. Some states may only publish approved budgets | Detailed |
| Approved annual Budget (states) | Budget Office | Annual | Y (states websites) | Detailed |
| FAAC revenues | OAGF | Monthly | Y (states websites) | Detailed |
| Federal independent revenue | OAGF | Quarterly | Y | Aggregate |
| States independently generated revenue | NBS/JTB | Quarterly | Y (https://nigerianstat.gov.ng/elibrary) | Detailed |
| In-year expenditure (federal) | OAGF | Monthly | Y (https://opentreasury.gov.ng) | Detailed |
| In-year expenditure (states) | States | Quarterly | Y (states websites) | Detailed |
| Debt stock (federal) | DMO | Quarterly | Y (https://www.dmo.gov.ng/) | Detailed |
| Debt stock (states) | DMO | Quarterly | Y (https://www.dmo.gov.ng/) | Aggregate |

| Type of Data | Collected by | Frequency | Published (Y/N) | Detailed or Aggregate |
|---|---|---|---|---|
| Debt servicing (federal) | DMO | Quarterly | Y (https://www.dmo.gov.ng/) | Detailed |
| Debt servicing (states) | DMO | Quarterly | N | |
| Debt sustainability analysis (federal) | DMO | Annual | Y (https://www.dmo.gov.ng/) | Detailed |
| Debt sustainability analysis (states) | DMO | Annual | Y (states websites – 33 out of 36 states in 2021) | Detailed |

## Available data is underutilized for policy-making purposes.

**Although the government has a considerable amount of macro-fiscal data at its disposal, it makes limited use of it in the economic policy-making process.** Budgetary estimates, especially regarding revenues, are often inconsistent with macroeconomic trends evidenced in data. The finance ministry does not have a macroeconomic model that can produce credible forecasts and, in turn, offer a solid foundation to economic policy.

**Delays in the availability of data can also hamper its effective use, especially for in-year expenditure and debt reports that can feed into macroeconomic analyses.** Notably, delays in expenditure reporting can affect cash forecasts and, in turn, exacerbate future fiscal issues, especially in a scenario where the government needs to resort to expensive short-term borrowing to fulfil its cash requirements.

## Cross-level inconsistencies limit the ability to connect data gathered across different tiers of government.

**Nigeria's ability to connect data on expenditure and debt gathered across its different federating units remains weak.** As a federal country, Nigeria needs a holistic grasp of macro-fiscal data generated at all tiers of government and economic entities, in order to ensure that fiscal sustainability goes hand in hand with economic policies that are inclusive and fact-based. Considerable progress has been made in implementing a Treasury Single Account (TSA) and a Government Integrated Financial Management Information System (GIFMIS) at the federal level, but these systems are not widely available at the state level. Cross-level connections of expenditure and revenue data are therefore inadequate, undermining the quality of consolidated information on public finances.

**States have benefited from growing adoption of the National Chart of Accounts as an integrated budgeting and accounting classification system, but they do not yet have access to integrated financial management systems.** Similarly, expenditure at the local level is not fed into GIFMIS, and it is not subject to in-year expenditure reporting in a consolidated format. Moreover, government-owned enterprises (GOEs) are not integrated on the GIFMIS platform; however, work is underway to have GOEs conform to the National Chart of Accounts, and to better align the financial management systems used by GOEs and the government. Finally, shortcomings in the collection and recording of debt data at the state level create the need

for major consolidation and validation by the DMO and the CBN, which in turn results in delays and has adverse fiscal implications.

TABLE 5.17. Heat map summary of macro-fiscal data assessment[111]

| | Collection | Public accessibility | Analysis and use by govt | Cross-level linkages |
|---|---|---|---|---|
| **GDP** | H | H | M | L |
| **Monetary statistics** | H | H | L | N/A |
| **Oil price** | M | L | L | N/A |
| **FAAC revenues** | H | M | L | N/A |
| **Federal independent revenues** | H | M | L | N/A |
| **States IGR** | H | M | L | N/A |
| **Budget information** | H | H | M | M |
| **Federal budget execution** | H | L | L | N/A |
| **States budget execution** | M | M | L | L |
| **Debt data** | H | M | L | L |

## Options are available to enhance Nigeria's macro-fiscal data framework.

**The table below summarizes policy recommendations aiming to improve Nigeria's macro-fiscal data across the four dimensions assessed in this section**. It is important to note that these recommendations prioritize progress at the federal and state level. The collection, publication, analysis and integration of macro-fiscal data from local governments is a significant task that could not be addressed within the scope of this section.

TABLE 5.18. Policy recommendations for data improvement

| Key Challenge | Policy Recommendation | Timeline[112] (ST, MT, LT) | Impact on Fiscal Sustainability[113] (L, M, H) | Financing requirements[114] (L, M, H) |
|---|---|---|---|---|
| Lack of collection/availability of key economic data | Integrate GOEs data into GIFMIS | ST | M | M |
| | Roll out GIFMIS to states and build their capacity to utilize it for fiscal reporting | LT | M | H |
| Lack of accessibility to or transparency of key economic data | Update Open Treasury Portal with federal in-year budget execution data within 30 days of the end of the quarter/month | ST | L | L |
| | NNPC and NEITI to publish updated and disaggregated oil | ST | M | L |

[111] High (H); Medium (M); Low (L).
[112] The timeline horizons are defined as: ST (short-term), 0-12 months; MT (medium-term), 1-3 years; LT (long-term), more than 3 years
[113] The impact of fiscal sustainability can be categorized as: L (low), when the expected reduction in annual consolidated fiscal deficit is <0.3 percent of GDP over the medium term; M (medium), when the expected reduction in annual fiscal deficit is 0.3-0.6 percent of GDP over the medium term; and H (high), when the expected reduction in annual consolidated fiscal deficit is more than 0.6 percent of GDP over the medium term.
[114] Financing requirements consider the capacity of the relevant institution to implement the policy recommendation and the need for additional resources to implement the reform. This is measured as: L (low), usually for "stroke of pen" reforms that do not require additional resources; M (medium), for reforms that require some but not extensive resources over the short term; H (high), for reforms whose implementation requires significant resources and/or financing over the short term.

| Key Challenge | Policy Recommendation | Timeline[112] (ST, MT, LT) | Impact on Fiscal Sustainability[113] (L, M, H) | Financing requirements[114] (L, M, H) |
|---|---|---|---|---|
| | revenues and payouts every month | | | |
| | NBS to publish FAAC revenues within 30 days of the end of the month | ST | M | L |
| | FMFBNP or NBS to publish disaggregated federal independent revenues | ST | L | L |
| | DMO to publish CBN financing data as part of information on federal debt stock | ST | M | L |
| | NBS to collate and publish state budgets, in-year expenditure, and debt reports quarterly, within 60 days of the end of the quarter | ST | M | L |
| Under-utilization of economic data in policy-making | Establish a Fiscal Policy Unit within FMFBNP/BOF | MT | M/H | M |
| | Integrate a macroeconomic model in the federal government framework (preferably within the finance ministry) to help inform budget planning | MT | M/H | M |
| | Update Medium-Term Fiscal Framework quarterly, in line with in-year budget execution and quarterly economic indicators | MT | H | M |
| | Undertake fiscal risk analyses to inform future budget estimates | MT | H | M |
| | Strengthen cash forecasting, update cash forecasts biweekly in collaboration with federal MDAs to potentially lower borrowing costs | MT | H | M |
| | States to develop their own MTFFs, linked to the federal government's MTFF | LT | H | M |
| Weak cross-level linkages between data produced by different tiers of government | NBS to calculate and publish consolidated fiscal accounts (budgeted and actual) on a quarterly basis | MT | M | L |
| | Use GIFMIS to integrate GOEs and state-level fiscal accounts | LT | M | H |
| | Use a debt recording system to collect, collate, and consolidate debt data from federal and state governments | LT | H | H |