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LIST OF ACRONYMS

AfDB	African Development Bank
BDC	Bureau de Change
CBN	Central Bank of Nigeria
CCT	Conditional Cash Transfer
CRR	Cash Reserve Ratio
DMO	Debt Management Office
ECA	Excess Crude Account
ECOWAS	Economic Community of West African States
GIFMIS	Government Integrated Financial Management Information System
GDP	Gross Domestic Product
ICRC	Infrastructure Concession Regulatory Commission
IPSAS	International Public Sector Accounting Standards
IPPIS	Integrated Personnel and Payroll Information System
MDAs	Ministries, Departments and Agencies
MPC	Monetary Policy Committee
MPR	Monetary Policy Rate
NBS	National Bureau of Statistics
NNPC	Nigerian National Petroleum Corporation
ODA	Official Development Assistance
PIB	Petroleum Industry Bill
PPP	Public Private Partnership
PPPRA	Petroleum Products Pricing and Regulatory Agency
rDAS	Retail Dutch Auction System
S&P	Standard and Poor
SURE-P	Subsidy Reinvestment and Empowerment Program
SWF	Sovereign Wealth Fund
TSA	Treasury Single Account
VAT	Value Added Tax
USD	United States Dollars

INTRODUCTORY REMARKS

This special edition of the Economic Report on Nigeria aims at serving a dual purpose. First, it serves as an instrument for engaging the new Administration of the Federal Government on the policy imperatives for sustainably transforming the Nigerian economy. Hence, key focus areas for policy imperatives for the Administration are outlined. Second, it aims to review the current challenges facing the economy and provide a menu of policy options on possible way forward.

The Report is organized into six sections. Section one provides an overview of the report. Section two is a summary of recent macroeconomic developments with analysis of underlying issues behind the numbers. Section three focuses on domestic resource mobilization through tax compliance and broadening tax base. Section four dwells briefly on the issue of security and fragility challenges facing the country. Section five proposes options for national economic policy for the new Administration. Five issues are highlighted here: macroeconomic stabilization; governance and public sector management; jobs and security; infrastructure development; and social sector reform. Lastly, section six concludes the report.

Contributions to this report were made by Zerihun Gudeta Alemu, Chief Country economist and Eric Kehinde Ogunleye (Consultant Macroeconomist) under the overall guidance of the Country Director, Dr. Ousmane Dore and Barbara Barungi, Lead Economist. Most data used in this report were sourced from the Central Bank of Nigeria (CBN), National Bureau of Statistics (NBS), Debt Management Office (DMO), Budget Office, and Federal Ministry of Finance.

OVERVIEW

Global developments resulting in the precipitous fall in oil prices is impinging greatly on Nigeria's key macroeconomic variables. The economy is now on a slow track for the first half 2015 with around 3.14% real GDP growth and 4% projection for the year. Inflation is trending upwards, inching towards double digit as end of the year approaches. Throughout the first half of 2015, economic management has rested largely on the use of monetary policy with limited room for fiscal policy as a result of the change in government and delay in appointing Ministers. The country's external position continues to weaken with foreign reserves falling precipitously from US\$40.7 billion at end-September 2014 through US\$34.5 billion at the beginning of 2015 to US\$29 billion by June 30. Tackling the current macroeconomic challenges facing the economy has seen the monetary authorities adopting both policy and administrative interventions in the money and exchange rate markets. The perceived capital control led to the removal of the country's Bond from the JP Morgan's Government Bond Index-Emerging Markets. A possible outcome of the delisting is withdrawal of foreign investors from the market and consequently capital outflows. It is expected, however, that the affirmation of the country's credit rating by S&P at 'B+/B' long- and short-term foreign and local currency sovereign credit ratings with stable outlook may moderate investor confidence and reduce potential capital outflows.

Nigeria has attempted several tax reforms over the years that have gained momentum with the recent fiscal consolidation policy of the Federal Government. The poor tax compliance and in particular relatively small share of VAT in total

fiscal revenue of around 7.2% on average between 2011 to 2014 remains a concern. Tapping fully into this high potential revenue source would require deepening domestic resource mobilization through tax compliance and broadening tax base, among other actions.

Given that proposed policy priorities for the new Government is one of the objectives of this report, the following priority areas are identified: macroeconomic stabilization; effective governance and public financial management; security and job creation; infrastructure development; and social sector and safety nets interventions. Specifically, the available options for improved policy space for economic growth and better social outcomes should be deeply explored. A choice will have to be made between social infrastructure investments and direct household empowerment in strengthening social safety nets. The fiscal revenue pressures facing the country should necessitate exploring public-private partnership (PPP) strategy for infrastructure provisioning. Three key options for creating fiscal space are available. They include: enhanced domestic resource mobilization through improved tax administration including broadening of the tax base; improved public financial management through reallocation of resources saved from low priority spending; and external financing.

As a way forward, the following recommendations are proposed:

- ◆ increased domestic financial resource mobilization to create additional fiscal space for social protection interventions;

- ◆ accelerate finalization of the NNPC's proposed framework for determining open market price for petroleum products for the purpose of plugging fiscal leakages emanating from the petrol subsidy;
- ◆ effectively deploy the additional fiscal revenues from increased domestic resource mobilization and savings from plugging fiscal revenue loopholes into social protection policies that would strengthen the social contract between government and the people;
- ◆ the current monetary stance of the monetary authorities should be maintained but re-examined with a view to softening the stance once key macroeconomic variables stabilize;
- ◆ and deepen and consolidate infrastructure development reform, especially in power and transport sectors.

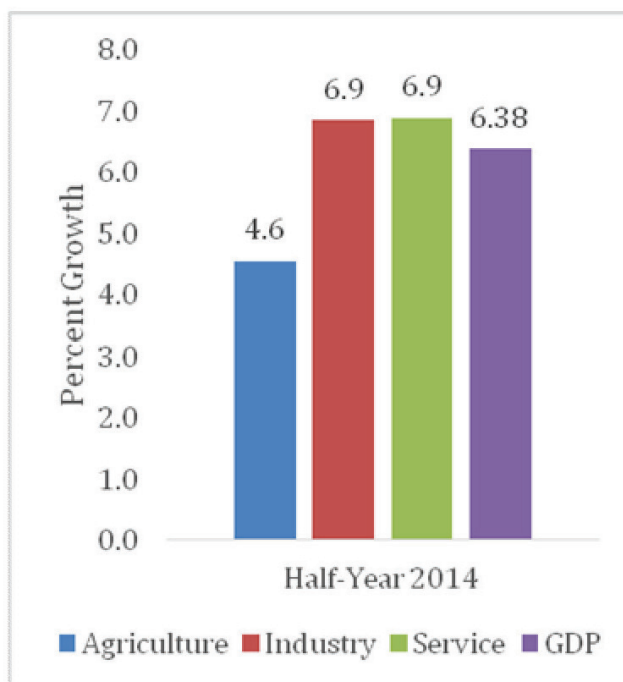
2. Summary of Recent Macroeconomic Developments

Global developments resulting in the precipitous fall in oil prices is impinging greatly on the Nigeria's key macroeconomic variables. These variables include exchange rate, capital flows, current account balance, inflation, and growth prospects. It is obvious that the macroeconomic challenges facing the economy are far from over and are exerting ripple effects on macroeconomic variables.

The economy has been on a slow track for the first half of 2015. Real GDP growth of 3.14% was recorded, falling far short of the 6.38% in the corresponding period of 2014. Non-oil sector, mainly services and agriculture remains the main driver of growth, recording 5.9% and 4.1%, respectively (Chart 1). Industry, on the contrary was a drag on growth; it contracted by 2.9%. The poor performance of the industry sector was as a result of manufacturing (which accounted for -6.8% of the 3.14% GDP growth compared to 23.4% of the 6.38% growth in first half 2014) and mining and quarrying (-23.1% of 3.14% growth as against -1.8% of the 6.38% of the GDP growth in the corresponding period in 2014) (Table 1). This is worrisome and

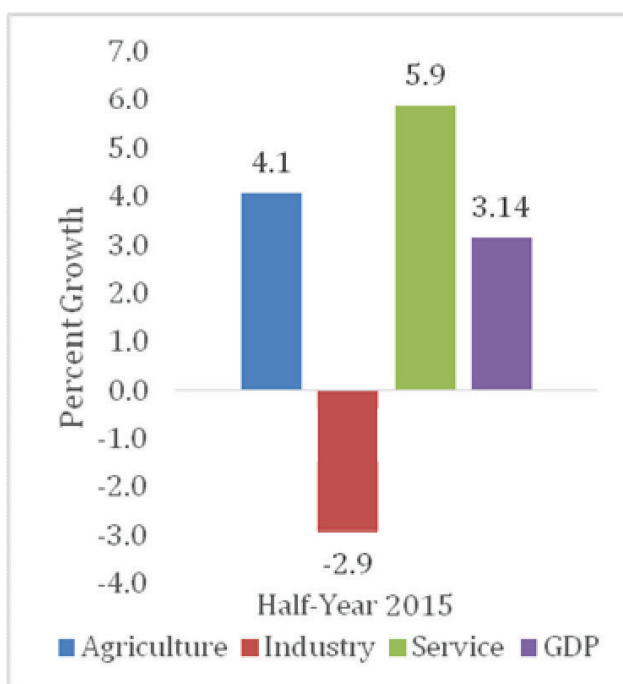
needs immediate policy remediation. Some of the challenges responsible for the slow growth appears to be the outcome of challenges that include lack of liquidity caused by lower oil revenue, tighter monetary policy resulting in higher interest rates, reduced activity in the capital market, naira devaluation that induces higher cost of imported intermediate inputs, limited fiscal space, and structural constraints.

Chart 1A: Half-year growth by sector, 2014



Source: Computations based on NBS data

Chart 1B: Half-year growth by sector, 2015



Source: Computations based on NBS data

Table 1: Sectoral Contribution to GDP Growth, Growth Decomposition

Sectors	First-half 2014	First-half 2015
Agriculture	14.9	27.4
Mining & Quarrying	-1.8	-23.1
Manufacturing	23.4	-6.8
Construction	9.5	12.4
Trade	15.0	31.6
Accommodation and food services	2.9	2.4
Information & Communication	14.1	31.2
Finance & Insurance	4.0	8.2
Real Estate	5.0	7.5
Total	86.9	90.8

Source: Computations based on NBS data

Growth projection for 2015 has been estimated to be around 4.4% compared to 6.3% in 2014 (Table 2). The revision was influenced, by the following considerations, among others. First, the previous 5% projection was premised on the assumption that benchmark oil price would be higher than it is now. However, there are now growing concerns that the price of crude oil could slide below the US\$53 a barrel benchmark oil price. Second, the level of execution of the 2015 budget is quite low. Total approved Federal Government retained revenue for the first-half of 2015 was ₦1.73 trillion. However, as at June 2015, actual retained revenue was ₦1.47 trillion, or 15% lower than estimated. Similarly, total Federal Government expenditure approved for the first-half of 2015 was ₦2.2 trillion. But as at end June 2015, actual expenditure was ₦2.1 trillion, or 5% below estimate.

The decline was significant in the capital expenditure component of the budget to the extent that out of the ₦557 billion Federal Government capital budget approved for the year, only ₦36 billion was disbursed as at the end of May 2015. Third, private sector investment is being adversely affected by uncertainty caused by the delay in unveiling economic program of the new administration. Fourth, monetary policy stance is expected to continue to be procyclical for the remainder of the year. Lastly, external factors, especially sluggish growth of the global economy, and possible increase in the US Fed interest rate.

Table 2: Effect of Reduction in Oil Revenue Receipts on GDP Growth Projection for 2015

	Impact	2014	2015
GDP	-1.9	6.3	4.4
Oil	-6.9	-1.3	-8.2
Non oil	-0.9	7.6	6.7

Source: Computations and NBS

Throughout the first half of 2015, economic management has rested largely on the use of monetary policy. The change in government at the Federal level and non-inauguration of the Federal Executive cabinet has led to limited implementation of the 2015 budget. Non-implementation of the capital component of the budget is currently being probed by the National Assembly where it was revealed that the country has borrowed about US\$4.48 billion to implement the budget. As at May 2015, only ₦36 billion capital allocation has been disbursed. Perhaps, the existence of strong and effective fiscal policy that complements the current monetary policy interventions would have further assuage the existing macroeconomic challenges facing the country.

Inflation continues to creep upwards from 8.2% in January 2015 to 9.4% in September 2015. It appears the upward trend would likely continue and may likely reach double digit by the end of the year as there is no respite for its two main drivers, namely, rising food price as a result of late rainfall and weak exchange rate. The third driver; transport cost resulting from incessant petrol shortage as a result of impasse over outstanding fuel subsidy payments between the government and fuel marketers appears to have moderated the rise in inflation because stability in the supply and price of the refined petroleum products has set in, in the recent months.

The country's external position continues to weaken with foreign reserves falling precipitously from US\$40.7 billion at end-September 2014 through US\$34.5 billion at the beginning of 2015 to US\$29 billion by June 30. This is just enough for about 5.4 months of imports of goods and services. While some respite set in thereafter, reaching a peak of US\$31.63 billion in August 14, 2015, the decline appears to have resumed subsequently, down to US\$30.06 billion by mid-October. One of the major sources of foreign reserves decline is its use to defend the value of the naira in the foreign exchange market. The pressure, though suppressed in the formal market which ranges between ₦196 - ₦198 to a dollar, is highly pronounced in the parallel market with wide margin ranging between ₦220 - ₦240 per dollar.

Export diversification must remain in the policy front burner for the Government at all levels to minimize the country's vulnerability to external shocks. National data from National Bureau of Statistics (NBS) reveals that mineral products (oil and gas) accounted for about 87% of country's export while the non-oil sector accounted for the balance. Exports also appear highly concentrated in destination with Europe accounting for about 39% of total exports followed by Asia (30%), Africa (20%) and America (11%). Export to the ECOWAS market was mere 8% of total exports, revealing weakness in regional trade integration.

The current macroeconomic challenges facing the economy have elicited involvement of monetary authorities through policy and administrative interventions. Some of the key policy interventions involve increasing the Monetary Policy Rate (MPR) from 12% to 13%, cash reserve requirement (CRR) on private sector deposit from 15% to 20%, and moving the mid-point exchange rate at the official window from N155/\$ to N168/USD and increasing its symmetric corridor from ±3% to ±5% in November 2014. More recently, the monetary authorities harmonized the CRR on private and public sector deposits to 31% coupled with active use of the open market operations window. However, in the most recent meeting of the MPC in September 2015, the CRR was further reduced to 25%, thus improving systemic liquidity.

Earlier, a *de facto* devaluation of the Naira to ₦198/USD was undertaken by the CBN through closing the Retail Dutch Auction (rDAS) market window. More recently, about 42 items that include toothpicks, cement and other items that could be produced locally were excluded from accessing foreign exchange at the official market. The aim of this administrative intervention is to protect the fast eroding foreign exchange reserve. However, the pressure persists as revealed in the exchange rate movements in the parallel market. Overall, the stance has been on tightening monetary policy with a view to curbing the excess liquidity that is believed to be the source of pressure on the demand for dollars. To loosen pressure on the naira, in addition to import substitution, the country needs to intensify supply side

interventions (export diversification) in order to increase foreign exchange supply.

The Nigerian Bond was recently removed from the JP Morgan's Government Bond Index-Emerging Markets. This decision was the result of restrictions on foreign-exchange transactions that prompted investor concerns about liquidity shortage. Since the full removal will not take place until the end of October, it is expected that this action would lead to a significant loss of regular portfolio inflows into the country. This may further weaken the country's external position as this would likely put more pressure on exchange rate and upward pressure on domestic bond yields.

Nigeria had the opportunity to correct the observed lapses that led to its removal given the advance notice given it by JP Morgan in January 2015. The country was placed under watch due to factors that include lack of liquidity for transactions, lack of transparency in the determination of the exchange rate, and lack of a fully functional two-way foreign exchange Market. The country's position is attenuated by the over 60% fall in global oil price, the main source of foreign exchange coupled with additional challenges emanating from high propensity for speculative demand, round tripping, and rent-seeking. The use of administrative measures other than policy has succeeded in stabilizing rates in the inter-bank market but with strong and persistent pressure in the Bureau de Change (BDC) market.

A possible outcome of the delisting is an increase in bond yield as a result of withdrawal of foreign investors from the market. The ultimate effect of this will be additional pressure on the naira. Indeed, the inclusion of Nigeria in the Index is a major driver of investment into the economy as investors are provided with strong level of comfort. It is noteworthy that the Nigerian economy has demonstrated strong resilience over the years and may likely continue to show this resilience to the possible effect of the delisting. Since the Index is not a rating framework that could be interpreted to be a downgrade, the response of the investors to the delisting may not be as pronounced and long-lasting as generally envisaged. Furthermore, the affirmation of

the country's 'B+/B' long- and short-term foreign and local currency sovereign credit ratings with stable outlook by S&P may help moderate the perceived investment risks emanating from the delisting. Meanwhile, the CBN is caught between shoring up reserves by maintaining foreign exchange restrictions and bolstering domestic production, on the one hand, or vacate the restrictions and risk weaker exchange, on the other.

3. Domestic Revenue Mobilization

Nigeria has undertaken impressive tax reforms over the years that have gained momentum with the recent fiscal consolidation policy of the Federal Government. However, the need for deeper reform is further heightened by two important factors. First is the low contribution of taxes when measured as a percentage of GDP of 3.2% on average between 2005 and 2012 in Nigeria compared to 16.7%, 14.1% and 14.7% in sub-Saharan Africa (SSA), Cote d'Ivoire and Ghana, respectively. It is noteworthy, however, that some improvements are being recorded with the current level standing at 7% of GDP. Second is the persistent declining trend in global oil prices that underscores the need to enhance non-oil revenue collection measures, which the Government can achieve through initiatives aimed at strengthening tax administration, curtailing exemptions, and reducing fraud and evasion.

A particular concern has been the relatively small share of VAT in total fiscal revenue, which stood at only 13% in second quarter of 2015 showing an upward trend due to fall in oil revenues and resultant increased focus on VAT and other taxes as alternative revenue sources. Strengthening VAT policy must thus be a central element of any meaningful tax reforms aimed at boosting non-oil revenues. Indeed, VAT holds high promise for boosting non-oil revenues in Nigeria because of its relative efficiency as a fiscal instrument. It is effective in raising revenue, cost-effective to administer compared to other forms of taxes, less prone to evasion, and support sustained economic growth because it does not discourage savings, investment and international competitiveness. To realize these benefits, VAT systems need to be well designed and efficiently operated.

There are two issues that need immediate attention in the country's bid to deepen domestic resource mobilization. These are tax compliance and broadening tax base.

Tax Compliance

Nigeria has one of the lowest tax compliance among developing countries in the world. According to *Paying Taxes 2015*, Nigeria has a distance of 39.15 from the frontier and a rank of 179 out of 189 countries on ease of payment. There are estimates that only 30% of corporate organizations are in compliance with payment of taxes in the country. One of the reasons for this is the concentration on large corporates as opposed to small and medium enterprises that form the greatest percentage of corporate firms in the country.

There are several challenges that tend to fuel non-compliance with tax payments in Nigeria. These include: multiplicity of tax jurisdiction and payments; wide prevalence of tax waivers; transfer pricing and illicit financial flows; high tax evasion; prevalence of withholding tax; confusion on the application of tax exemption to the free trade zones; weak tax institutional framework that reduce the probability of being caught and non-application of sufficiently punitive measures; poor tax paying culture and apathy fueled by limited transparency in the tax system; non-recording and improper documentation of financial transactions; incorrect business addresses; and complex tax payment system. These challenges need to be addressed to promote tax compliance.

Broadening the VAT base

Nigeria certainly needs to broaden its VAT base. This is imperative whether the country chooses to increase the VAT rate and adopt single or multiple rates. Broadening the VAT base should be the first step in a short- to medium-term VAT reform process. Since increasing rate and adopting single or multiple rates will require wide public consultations, broadening the base of the existing structure may not require such action. Hence, this is a possible quick win and starting point for the entire reform process. Nigeria's large market and growing middle class are extenuating factors.

Nigeria faces two broad options in its effort to reform its VAT system: increase rate and adopt either single or multiple rates. The key policy decision is whether to increase the VAT standard rate from the current level of 5% and maintain a single rate or change to a regime of multiple rates. Whatever the decision, there is need to cast the reform in the context of a larger fiscal reform that include broadening the base and strengthening tax administration.

Option 1: Rate Increase

Nigeria has large headroom to increase its VAT rate. This emanates from the current very low rate of 5%, the second lowest in Africa following Eritrea at 4%. However, the clear disadvantage of rate increase is that it may fuel evasion. The possible overall effect of such rate increase is ambiguous as the expected higher revenues from increased rate may be moderated by higher evasion. Indeed, it is uncertain that the N802.95 billion realized from VAT in 2014 could be doubled based on the hike in rate. Hence, increase in rate should be undertaken in a careful manner to ensure social and political interests are achieved while simultaneously promoting sustainability. To achieve this requires careful assessment of the costs and benefits of such increase and what rate is efficient. This will require wide public and general consultation.

Option 2: Adopt Single or Multiple Rates

Single Rate: Single VAT rate promotes tax efficiency. Empirical studies have shown that, from a purely economic point of view, a single VAT rate is the best policy choice. The reason being that exemptions and reduced rates involve additional compliance and administrative costs, which tend to reduce tax efficiency. In addition, such regime breeds corruption. Conversely, elimination of exemptions and preferential regimes and promotion of equity through single rate make the tax system simpler, easier to comply with and thus reduces costs for both tax administration and taxpayers. Arguments for reduced rates on the grounds of equity and redistribution are flawed by the fact that they rarely achieve their objective. Usually, the rich benefits more from such provisions since

they consume more than the poor. To achieve the expected benefits of reduced rates, there is need for effective targeting frameworks which are usually not available in developing countries.

Multiple Rates: The argument for multiple rates is anchored on the need for equity and protecting the poor.

Multiple VAT rate system reduces the regressive impact of a single rate because low-income households tend to spend a larger share of their income on basic consumption and social services (e.g. health, education and transportation) and less on luxuries and on savings than higher income households. The argument is that extended zero ratings would make basic goods and services more affordable to everyone, especially the poor. This has high political appeal. As earlier highlighted, this is very difficult to achieve in practice. Multiple VAT rates or extended zero ratings have the tendency to distort consumption and, consequently runs the risk of violating the neutrality principle. Since this system favors some commodities and discriminates against others, it fails to adhere to the principle of equity. To achieve success in implementing this system, government must have direct and carefully targeted mechanisms that ensure that the intended beneficiaries are reached. Cross-country experiences have shown less pass-through in VAT reduction to price level in the absence of proper targeting.

4. Security and Fragility

The Federal Government has adopted a two-pronged approach that includes both military action and development assistance to address the insurgency and its socioeconomic impact in North-East Nigeria.

The Bank has several water and sanitation projects in the North East in Adamawa, Taraba and Yobe with ongoing appraisal for more States. But there are two major programmes in the pipeline that will be particularly beneficial to the region. First is the recently approved programme to rehabilitate and strengthen the resilience of Lake Chad basin and second is the preparation of a strategic action plan for water resource development in the Hadejia-Jama'are-Komadugu Yobe Basin which is at

the centre of major water and environmental issues affecting the lives of over 10 million people in the six North Eastern States of Nigeria. The Bank's approach lays emphasis on investment in social sector infrastructure which is key for sustainable livelihoods. Second is the proposed second phase of the rural water supply and sanitation interventions in more North Eastern States.

5. Proposed Options for National Economic Policy

Issue 1: Macroeconomic Stabilization

Undoubtedly the short-run challenge of macroeconomic stabilization must be confronted as a matter of priority.

The need to hit the ground running given popular expectation from the new Administration may necessitate a possible adjustment in fiscal policy with cut in expenditure to balance the budget. Concomitantly, the Federal Government may need to endorse the set of fiscal measures announced in the 2015 budget aimed at shoring up public revenue. These include, inter alia,

- (i) expanding the tax base through tax policy reform, introduction of a luxury tax on private jet, and luxury foreign travel, yachts, luxury cars, a review of the pioneer tax status extended to some companies; and
- (ii) improving the efficiency of tax administration. However, the change in government has necessitated change in the implementation of some of these measures. For example, the new Administration has revealed that it will not increase the VAT rate from the current level of 5%.

The fiscal stance of the new Administration is very obvious through actions on plugging revenue leakages and loopholes via strong anti-corruption and transparency drive. Implementation of the Treasury Single Account (TSA) that commenced September 16 2015 is expected to help create additional fiscal space. However, these will have to be complemented with measures that include streamlining the petroleum subsidies. There are indications that the NNPC in consultation with the Petroleum

Products Pricing and Regulatory Agency (PPRA) has developed a methodology for determining open market price for petroleum products as mandated by the Petroleum Act. The ongoing dialogue to implement this should be intensified with the twin objective of improving efficiency and reducing the cost of the subsidy. Immediate implementation of the proposed methodology would help recover billions of dollars that could be deployed to other useful development interventions.

Building the basis for application of countercyclical macroeconomic policy is imperative to achieve sustained inclusive economic growth and development in Nigeria. This is important because of the dependence of the economy on oil and gas whose prices are exogenously determined. There is need for deliberate policy drive to build fiscal buffer, mainly the Excess Crude Account (ECA) and the Sovereign Wealth Fund (SWF). The arrangements for the ECA will have to be legalized through Act of parliament to ensure funds in it is ring-fenced to make it serve as true source of contingency saving. A strong cooperation and synergy also needs to be maintained with the State Governors in this respect to achieve effective multi-government fiscal policy coordination.

Ensuring medium-term macroeconomic stability would also require an exchange rate policy that places the Naira on a realistic equilibrium or near-equilibrium pedestal. This will largely instill and assure investor confidence, stabilize investment capital flows and assure healthy foreign reserves position. The naira has been trading around ₦197 to the dollar in the official market since mid-February and the Governor has indicated that it is “appropriately priced”. The CBN may now start considering lifting some of the foreign exchange restrictions introduced since last November and look to minimal use of foreign exchange reserves to smoothen a likely exchange rate adjustment.

Issue 2: Governance and Public Sector Management

Good governance and fight against widespread corruption was a key campaign focus of the new government. The government has, indeed, hit the ground running on this with ongoing probes and revelations of stolen public funds. Also impressive is the reform of the NNPC and implementation of Treasury Single Account (TSA) which began September 16, 2015. There is need to strengthen the anti-graft laws and institutions as a way of conveying the message of renewed focus on ensuring improved governance and effective public financial management.

The use of technology in public sector accounting management should be deepened. The IPPIS, GIFMIS, IPSAS and other technology-based public accounting management system should be further deployed to capture all public financial transactions. Public fund allocations to national and sub-national governments, agencies, and parastatals should be made public and accessible for scrutiny. Strong monitoring mechanisms should be developed to monitor expenditure at both internal and external levels. This will help block leakages and loopholes that will be deployed to achieve other socio-economic goals. The oil sector reform should be a major focus in the short-term as fixing this sector holds high promise for the immediate release of billions of dollars for fiscal expenditures.

Zero-based budgeting is being considered by the Federal Government as a public sector management strategy beginning 2016 fiscal year to assist in the proposed social intervention policy. The advantage of this strategy is that it allows fiscal spending based on needs and costs as opposed to existing income and expenditure. The fact that all budget lines must be justified for inclusion as expenditure item in the budget makes this strategy potentially cost saving. However, capacity is important in its implementation. For example, large documentation ranking each budget item according to its importance and cost is mandatory in the budgetary process. Clear understanding of this budgeting process

is imperative for success. It is doubtful if the public servants who are charged with its implementation have the requisite capacity and understanding needed for seamless implementation. A strong implementation capacity of all public servants, especially the research and development and monitoring and evaluation departments of MDAs is needed for success.

Issue 3: Jobs and Security

The security challenge, particularly in the northeastern part of the country is a major concern for Nigerians and friends of Nigeria. The recent positive turnaround in the battle against Boko Haram is an evident demonstration that this is a priority for the Federal Government. The focus would be on achieving better results with lesser resources, thereby freeing budgetary savings for job creation initiatives and economic

development interventions. Promoting better cooperation with the neighboring countries and consideration of the dialogue option in tackling insurgency should contribute to achieving this. The job creation/security nexus would imply getting Nigerians in these areas back to work, especially the youths through a massive public work program initially, but more sustainably through economic diversification with more reliance on value-added production in manufacturing, agriculture and industrialization. Job creation should be a major policy concern of the government. Developing skills for evolving global market patterns is essential, while paying attention to labor-intensive programs and appropriate skills matching. A search for options to improve the policy space with the ultimate aim of promoting better social outcomes is imperative.

Box 1: Options for Improved Policy Space for Better Social Outcomes

Experiences of developing countries have shown that there are several options available for countries in their bid to increase fiscal space for implementing social protection policy and job creation. The most common of these are: public expenditures re-allocation and re-prioritization; increasing tax revenues from VAT, income, luxury, corporate and natural resource and trade; eliminating illicit financial flows; direct borrowing or restructuring existing debt; increasing use of fiscal and foreign exchange reserves; expanding social security coverage and contributory revenues; lobbying for aid and transfers through ODAs and South-South financial flows; and adopting a more accommodative macroeconomic framework of fiscal and monetary policy.

For the Nigerian government, several issues need to be addressed as the country attempt to create fiscal space for social protection policy and job creation. First, a choice will have to be made between social investments and direct household empowerment. This may require a study that would help to elicit understanding on the measures that would enhance efficiency of social investments, reduce or eliminate corruption and mismanagement in social investment and relative strengths and weaknesses of targeted direct household empowerment spending. The study should also articulate how much greater social protection coverage would cost the country in the short- to medium-term.

Increasing tax revenues to improve fiscal space for social protection spending should not be done arbitrarily. Raising additional fiscal revenues through increased tax rates must be balanced against possible distortionary effects of such increased tax rates on economic activities and private investment. Thus, the objective function of maximizing public revenue should be moderated with minimizing its possible jeopardy on private sector investment and other economic activities. Such taxes must be designed to support equitable societal outcomes.

The recent research support of the African Development Bank in estimating the level of illicit financial flows in Nigeria should be complemented with a study that would initiate a policy design to capture and re-channel these funds into sectors where they would be best utilized to promote social outcomes. Focus should also be on articulating specific implementable policy actions required to curb the different sources of illicit financial flows that include tax evasion, money laundering, bribery, trade mispricing and other financial crimes that deprive the government of the needed revenues that could be deployed to promoting social protection and job creation.

The ongoing debt restructuring for States is an important step in creating additional fiscal space for social protection spending. However, it is imperative that the Federal Government design a mechanism for keeping a watchful eye on the States on how the newly acquired finances are used. Also important is effective fiscal policy coordination among the Federal, State and Local Governments to ensure all are pursuing the same fiscal policy objectives and avoid possible policy contradictions and relapse.

Issue 4: Infrastructure Development

The continued focus should be on building modern infrastructure as one of the main tenets of national development and inclusive growth. Power and transport infrastructure are the two most binding constraints in the Nigerian infrastructure landscape. The crumbling power sector reform has to be put back on track. This will require a review of the power sector reform agenda and road map. An assessment of current status of the reform and challenges undermining progress will be helpful. These will set the tone for a good understanding of the reform, subsisting issues

and pragmatic solutions for dealing with them. There is need for emphasis on transport infrastructure with priority focus on road and rail. Similar to the power sector reform road map, a short- to medium-term road map for road and rail infrastructure development should be distilled from the Nigeria Integrated Infrastructure Master Plan (NIIMP). Tapping into this existing policy initiative will help shorten the process of beginning a new infrastructure development plan. Considering PPP as a strategy for infrastructure development cannot be overemphasized.

Box 2: PPP and Infrastructure Provisioning in Nigeria

It has been estimated that about \$3 trillion in infrastructure investment is required in the next 30 years for Nigeria to make any meaningful progress in closing its infrastructure gap. About \$165 billion is required in the medium-term to achieve this. This huge amount cannot be met solely through fiscal spending, especially in the face of the current fiscal revenue challenges facing the country. Therefore, the use of Public Private Partnerships (PPPs), for infrastructure delivery as a channel for delivering infrastructure and services becomes vital. In fact, it is estimated that private sector would be responsible for about 47% of the needed finance with about \$15-20 billion procured via PPPs.

Recent recognition by the government of the importance of PPP in infrastructure delivery became evident with establishment of the Infrastructure Concession Regulatory Commission (ICRC) in 2005 and subsequent commencement of operations in 2008. The agency has the mandate of facilitating PPP engagements of the Federal Government through initiating, developing, financing and implementing PPP projects in a transparent, competitive and sustainable manner. This was aimed at addressing Nigeria's physical infrastructure deficit that hampers the transformation of the economy. The Commission also guides the 15 State Governments that have PPP units by building capacity and assisting them with best practices as obtained in other jurisdictions. Complementing the ICRC was the development of the National Policy on PPP aiming to provide creative financing and asset management to infrastructure development and strengthening the PPP framework

Infrastructure development through PPPs have the advantage of improving cost effectiveness by taking advantage of private sector innovation, experience and flexibility and through it increase investment in public infrastructure. The risk sharing nature of this method promotes best allocation of resources that improves the chances of delivering a successful project. Examples of infrastructure projects that are in line for delivery through PPPs include the second Niger Bridge, the Lagos-Ibadan Expressway, Lekki deep sea port and the Ibom deep sea port. These projects have had thorough studies carried out which affirms their bankability and viability. Therefore, efforts should be geared toward a logical follow through for success.

Nigeria faces several challenges that limit its ability to deploy PPP as a strategy for infrastructure development. These include: weak regulatory and enforcement powers of ICRC; limited capacity to drive PPP process in Nigeria; weak capacity of MDAs in project preparation through thorough financial, economic and risk analysis; poor negotiation skills; poor planning and coordination between public and private partners involved in PPP projects; risks on return on investment for prospective private sector partner; existence of weak long-term finance for infrastructure; mismatch between PPP transaction life cycle and national budget cycle; and weak cooperation and collaboration among MDAs on PPP-related activities.

To evolve an effective PPP strategy for infrastructure development, the following policy actions are imperative: Government should demonstrate political commitment by assuming leading role at the formative and development stage of PPP projects; the needs of all parties – public and private – should be enshrined in all PPP infrastructure projects to protect all partners involved; effective overall coordination is important to overcome challenges associated with PPP projects; private sector partners should be involved early in project conceptualization and development; all parties, especially the public partner should assure transparency and integrity at the PPP infrastructure planning stages through frank and open discussions with prospective investors; private sector innovation should be encouraged; and need to ensure that projects are demand-driven and highly responsive to specific needs of the society.

AfDB is providing capacity building support for the public sector through the establishment of a PPP hub for West Africa domiciled in the Nigeria Country Office. The hub is at the disposal of all interested parties – public and private – in forging the needed synergy for developing the required capacity for infrastructure development through PPPs.

Given the critical role of private sector in financing of infrastructure development, the new administration should consider creating an enabling framework for deepening private sector engagement and establishing effective PPPs. It should also enhance institutional coordination among Federal, State and Local Governments to ensure effective implementation and delivery of infrastructure plan.

Issue 5: Social Sector Reform

Social welfare is at the core of the development policy of the new administration. Hence, the Administration has spelt out some key social protection programmes that it intends to roll out. The proposed areas of focus are: universal health insurance; introduction of the first phase of direct conditional monthly social security payment for 25 million poorest Nigerians; free school feeding programmes in all schools across the country; and public works programmes aimed at creating jobs. These programmes will be jointly funded by both the Federal and State governments. Several states are proposing to roll out school feeding and free uniform programmes by the end of 2015.

The proposed social sector interventions should focus on three core areas of education, health and social safety nets.

The large youth and graduate unemployment in Nigeria is rooted in the disconnect between the education curriculum and required employability skills. Curriculum revision with strong input from the industry and building strong interface between the higher institutions and the industry is germane. This will require including employability and entrepreneurial skills acquisition courses in the country's university curriculum.

Nigeria needs a more responsive and more comprehensive health insurance as a strategy for promoting basic health indicators. A review of the current operations of the National Health Insurance Scheme is urgent with a view to broadening its base, scope and coverage for Nigerians. One of the major reasons for the failure of past social protection programmes has been the lack of sustainable funding and the rather ad hoc pilot manner in which such programmes were initiated. A national policy framework for social protection that incorporates sustainable financing is therefore imperative .

Box 3: Financing Social protection in Nigeria

A national social protection policy conceived and implemented within a sustainable fiscal framework is essential for successful implementation of the new administration's social welfare thrust. This would require proper costing and sequencing of the specific programmes and realistically combining social assistance programmes with forward-looking labour market interventions that stimulate employment generation. This need is necessitated by the less than desired state of social indicators in the country despite the significant growth recorded over the decades. Poverty, inequality and vulnerability remain rife. Yet, social sector expenditures over the past five years remain low with average expenditure on education, health and social protection at less than 15%, 10% and 5%, respectively.

The new administration in its statement on social welfare has indicated that universal health insurance and introduction of direct conditional monthly social security payment of N5,000 for 25 million of the poorest Nigerians. In addition, free school meals at primary schools and massive public works programme for job creation is also being considered. A fundamental issue is affordability of the social protection programmes. How much fiscal space is there for additional expenditures and what are the implications for the budget as a whole? A back of the envelope analysis indicates that there is room to increase the fiscal deficit by about 1 – 2 percent of GDP. Given the limited financial resources both at federal and state levels, the implementation and scaling up of social protection programmes will require detailed costing, prioritization and staggered approach to extension of coverage across the country. For sustainability a clear financing framework will need to be worked out and this will require careful consideration of options for expanding fiscal space. Secondly, there is need to carefully look at the various ways fiscal space can be created to finance the proposed social protection programmes in an effective manner. Given the ongoing reforms and political will to fight corruption and improve transparency, it is now likely than ever before that a full scale national social protection policy can be supported by savings from plugging leakages particularly in the oil and gas sector.

Three key options for creating fiscal space to finance social protection programmes include the following. One, enhanced domestic resource mobilization through improved tax administration including the broadening of the tax base for example of the VAT. Other sources of increased tax revenue include addressing the issue of under-taxation of land and property, high number of tax exemptions and incentives. Two, improved public financial management through reallocation of resources saved from low priority spending as part of the ongoing public sector reforms focused on cutting cost of governance and rationalization of public sector expenditures. One of the main areas that may be considered is reviewing of the SURE-P interventions and ensuring more effective allocation and utilization of resources for streamlined and targeted social protection programmes like the proposed universal basic education. Three, external financing can be critical to launching and extending social protection and can act as a catalyst for additional domestic efforts. This will require close collaboration and coordination between development partners in support of the Federal Government. However, high or complete reliance on external funding can have implications for policy legitimacy and sustainability over time.

In Nicaragua, the conditional cash transfer (CCT) programme was difficult to integrate into the country's broader social protection system after being set up with external funding outside the national systems. In the end the programme was discontinued due to the short-term nature of donor support. A key lesson learnt is that such programmes should be nationally owned and reflect short, medium and longer-term investments for policy continuity and sustainability. In Ghana, increases in VAT from 12.5% to 15% in 2004 generated fiscal space that was used to finance the new national health insurance scheme, providing estimated additional revenues for the budget of over 1% of GDP per year. In Norway, a considerable part of the country's oil wealth has been transferred to citizens in the form of increased welfare spending on social protection and social services. These country experiences provide valuable lessons for financing social protection interventions in Nigeria.

Encourage other community-based health insurance. At this stage of its development, Nigeria deserves to have a well articulated social safety net policy covering the unemployed, disabled and elderly. Critical to such policy is health insurance. Understanding the nature of the existing inequalities permeating the society would help in developing comprehensive and effective policies to address them.

6. Conclusion

The Nigerian economy is obviously undergoing a turbulent period. Purposeful policy direction is needed to address these challenges. Some of the needed policy directions are outlined below:

Increased domestic financial resource mobilization to create additional fiscal space. This will require improved tax compliance, broadening and diversifying the tax base, and possibly increasing VAT rate from the current 5%. At the root of this policy action is broad-based diversification of the economy. This would involve promoting private sector development through improved business environment supported by effective and complementary monetary, fiscal and exchange rate policies. The proposed zero-based budgeting, on the fiscal policy side, is highly encouraged as it would ensure available resources are prudently utilized. Also highly encouraged is improved intergovernmental fiscal coordination across the three tiers of government. This would help to check potential financial recklessness, thus creating additional fiscal space. Tax reforms and administration and full implementation of public financial management safeguards are necessary. Abuse of tax exemption and tax waivers should be corrected.

Second, **accelerate finalization of the NNPC's proposed framework for determining open market price for petroleum products** for the purpose of plugging fiscal leakages emanating from the petrol subsidy. Efforts should be intensified on attracting investment into the local refinery sector. Therefore, subsidy removal will achieve the dual purpose of attracting investment to the refining of petroleum products as a result of right pricing.

It would also help plug existing fiscal leakages caused by corrupt petrol subsidy regime. Revisiting the passage of the Petroleum Industry Bill (PIB) should be given priority.

Third, **effectively deploy to social protection interventions the additional fiscal revenues from increased domestic resource mobilization and savings from plugging fiscal revenue loopholes.** This would strengthen the social contract between government and the people. Deeper social protection policy is critical to reducing the existing level of poverty and inequality. However, objective assessment of the costs given the macroeconomic, especially fiscal revenue challenges facing the country cannot be overemphasized. Proper prioritization based on global best practices and reality on ground would be important to achieve meaningful results.

Fourth, **the current monetary and capital control policy stance of the monetary authorities should be re-examined.** Given the appreciation of both the nominal and real effective exchange rate outcomes of the current monetary and capital control policies, competitiveness of the non-oil sector are gradually being eroded. Yet, the economy needs to create jobs in these sectors for the teeming youthful population that would promote increased national productivity and improved livelihood. Monetary authorities should consider softening its stance on capital control to boost net capital inflows, ease liquidity and improve credit extension to private businesses. To achieve better results from monetary policy interventions, the CBN should intensify its financial inclusion policy. This would go a long way to closing the country's wide saving-investment gap.

Lastly, **address structural challenges.** This could be achieved through deepening and consolidating infrastructure development reform, especially in power and transportation. The power sector reform could slip and derail if focused and purposeful attention is not given to the sector. The billion of dollars expended on the sector would, therefore, become wasted. A comprehensive review of the status quo is imperative for charting the way forward. This

would take into consideration the objectives of the reform, policy instruments for achieving them, gains made so far, subsisting challenges, and recommendation for moving forward. Similar assessment should be undertaken for the transport sector aiming at achieving an effective multi-modal transport infrastructure in the country. As a long-term strategy, efforts should be intensified on continually and substantially diversifying the country's economic base. Significant investment in agriculture, manufacturing and oil and gas value chain holds high promise for effective economic diversification. The immediate visible benefit of this would be revenue diversification for both oil and non-oil revenues.



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