Nigeria
Competitiveness and Growth
Country Economic Memorandum
(In Three Volumes) Volume I: Executive Summary
May 30, 2007
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Country Department 12
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EXECUTIVE SUMMARY

1. Nigeria's economic potential is well recognized. The country's considerable resource endowment and coastal location should allow the emergence of a strong growth pole for Sub-Saharan Africa. Yet Nigeria has realized very little of this potential. Instead, its history has been marked by economic stagnation and associated with declining welfare and social instability. Over the last few years Nigeria has been experiencing a growth turnaround and conditions seem right for launching onto a path of sustained and rapid growth. The Government is anxious to seize this opportunity to begin to build a diversified economy able to provide jobs and improved welfare for Nigerians. The theme of this report is Nigeria's competitiveness and growth. Chapter 1 sets the context by reviewing recent economic developments and providing a snapshot of the non-oil economy. Chapter 2 analyses the constraints to the competitiveness and growth of the Nigerian economy and prioritizes the areas for government action. The next three chapters discuss the ways in which further progress can be made in tackling these constraints. Chapter 6 discusses how Nigeria could use domestic, international and regional trade more effectively to sustain growth. Key policy conclusions and recommendations are presented in the final chapter.

Nigeria’s Growth and Competitiveness Challenge

2. Nigeria faces two fundamental development challenges that are common to natural resource dependent economies: (i) managing the macroeconomy to build and maintain strong competitiveness of the non-oil sector in the face of considerable external inflows from oil; (ii) addressing the culture of rent seeking and corruption created by access to “easy” oil rents which reduces incentives to create wealth that can be taxed. Dependence on oil rents as opposed to taxation reduces government accountability and therefore undermines the effectiveness of political and economic institutions. Nigeria has historically been less successful than other resource dependent economies in addressing these challenges.

3. In the last few years Nigeria has begun to tackle these challenges more boldly and has made gains in growth. However, at the current pace (an average of just under 6 percent over the last five years) and pattern of growth, the country is not likely to achieve the MDG of reducing the poverty level to about 28 percent. With low rates of formal job creation, the majority of the work force is employed in low productivity, poorly remunerated activities (in agriculture and the informal economy) that limit their contribution to growth and prevent an escape from poverty.

4. While there are pockets of competitiveness, the non-oil economy is still largely uncompetitive. Rankings on both composite and individual sector competitiveness indicators are still low. To achieve sustained and more rapid growth and the creation of productive jobs, this competitiveness gap needs to be closed. Moreover, the economy has a dualistic nature with a large informal economy that has little to do with the formal economy. This hinders efficient resource allocation and reduces the competitive pressure to drive up productivity in the economy.

5. Raising productivity and efficiency at the firm level and also across the economy, including through shifting the structure of production towards higher valued added activities, should be at the heart of Nigeria’s non-oil growth strategy. This cannot be achieved without a
stronger human capital base and improved use of technology. Long-term strategies are urgently needed in both areas to guide action. The Government has begun preparation of a long term plan for education.

6. The analysis of the report suggests that the most immediate constraints that need to be addressed include infrastructure—notably power and roads—and the business environment, in that order. Enhancing access to finance will also allow the economy’s considerable resources to be intermediated more effectively for private sector growth. Policy action in each area will have to pay special attention to the challenge of helping firms make the transition from informality to the formal sector.

7. While the domestic market is relatively large, it is small compared with even small European economies like that of Belgium. Nigeria cannot rely on the domestic market alone to sustain rapid growth over the long term and will need to access regional and global markets as well. Nevertheless, domestic trade needs to and indeed can be used more effectively than in the past to promote firm efficiency and productivity and provide a platform for the emergence of firms able to compete in global markets. In the short and medium term, domestic and regional trade can be important drivers of growth and can help to build international competitiveness. Actions to improve the functioning of domestic markets will therefore also be an important part of the competitiveness and growth agenda.

8. The numerous special programs to support specific areas of activity need to be consistent with the long term objective of strengthening the productivity and competitiveness of the economy. They need to be based on the analysis of the costs and benefits of different options and built on transparency and accountability for results.

9. The Government is already carrying out reforms to tackle the economy’s competitiveness constraints. Going forward, what is needed is a more strategic approach that pays attention to prioritization and to targeting areas for early wins. Appreciable economy-wide improvements are likely to take some time to achieve. The Government could therefore strategically focus its attention on first relieving the constraints to specific high potential growth areas (specific value chains and growth poles). In addition, in some areas, policies need to be fine-tuned to ensure that they enhance productivity. In other areas, new measures are needed for greater impact. Several of the areas of action are under the purview of the federal government but considerable action is also needed at the level of the states. Greater coordination and collaboration is therefore required between the federal and state governments in the context of a framework through which reforms can achieve competitiveness and growth.

10. The analysis in this report suggests the following key elements for a growth strategy for Nigeria:

- Strengthening actions to tackle the most immediate constraints to the competitiveness of the economy presented by infrastructure and the business environment. Improving access to long term finance, will also be important to ensuring that Nigeria’s considerable oil resources are intermediated more effectively in support of non-oil growth. The focus in these areas would need to be first on early wins through successful pilots for competitiveness improvements in selected high potential value chains and high growth areas.

- Using domestic trade more effectively to enhance productivity and competitiveness by strengthening their functioning, and building stronger linkages between the oil and
non-oil sectors, and over time strengthening Nigeria's integration into global markets;

- Ensuring that the poor can participate more fully in growth by placing urgent emphasis on (i) finding ways to give back some of the proceeds of oil windfall directly to Nigerians; (ii) raising agricultural productivity—including through enhanced technology; and (iii) encouraging the transition from informality to the formal sector; and

- Building the human capital and technological base of the economy over the longer term.

11. This strategy must be underpinned by efforts to address the corruption and rent seeking around oil revenues and raise the efficiency with which oil revenues are used.

Recent Economic Developments

12. A number of recent developments present Nigeria with a historic opportunity for growth and economic progress. First, oil prices are at unprecedented levels, thus significantly increasing Nigeria's development financing envelope. Second, with the appointment of a strongly technocratic and reform-minded economic team in 2003, radical shifts have been made in macroeconomic management, allowing better use of these growing resources to leverage growth in other parts of the economy. Third, the implementation of a broad agenda of reforms is changing the policy framework and creating an environment more supportive of growth. As part of these reforms, Nigeria's debt overhang has been addressed through the Paris Club debt deal completed in 2006. Finally, democratic governance in Nigeria is providing the conditions for addressing some of the political economy challenges that have contributed to poor growth outcomes.

13. In contrast to the last two decades, the Nigerian economy has expanded at a rapid pace since 2000. Non-oil GDP has grown at an annual average rate of 5.8 percent. In the past two years non-oil growth accelerated, reaching 7.4 percent in 2004, 8.2 percent in 2005. GDP per capita in current US dollars has more than doubled over the same period. Provisional estimates for 2006, indicate that non-oil growth was about 8.9 percent for the year although overall growth fell to about 5.9 percent and oil sector growth to -0.8 percent because of disruption in oil production in the Niger Delta.

14. Key macroeconomic balances have also improved. The overall fiscal balance strengthened from a surplus of 6 percent of GDP in 2000 to 9.3 percent of GDP in 2005. However the non-oil deficit expanded as a share of non-oil GDP from 30 percent in 2002 to 34.2 percent in 2004 and 38.9 percent in 2005. The increases reflect in part the Government's efforts to settle outstanding claims from several years back, including pension and domestic contractor arrears, as well as the costs of some the ongoing reforms including the monetization of public service benefits. Provisional estimates for 2006 are an overall fiscal surplus of 12.0 percent of GDP, and a non-oil fiscal deficit of 42 percent of non-oil GDP.

15. The external current account balance has improved dramatically from a deficit of 8.4 percent in 1999 to a surplus of 12.1 percent of GDP in 2005, and an estimated 12.5 percent of GDP in 2006. FDI has picked up -- net FDI doubled during a three-year period (from US$3 billion in 2003 to more than US$6 billion in 2005). Non-oil FDI increased from US$0.6 to US$1.7 billion. The overall balance of payments was in surplus in 2004 and 2005, allowing the
accumulation of sizable foreign exchange reserves; these reached US$28.3 billion at the end of 2005 and an estimated US$46.5 billion in December 2006, after the setting aside of US $19 billion for clearing arrears and the buy-back operation with the Paris Club. The recent growth pattern is nevertheless inadequate to achieve the MDG on poverty. Growth will have to be stronger (at least 7 percent annually) and will need to create more jobs.


16. Improvement in fiscal management, in particular the implementation of an oil-price based fiscal rule (OPFR) since the 2004 budget, has been the centrepiece of macroeconomic policy improvements over the period. This rule is designed to link government spending to a notion of a long-run oil price, thereby de-linking government spending from current oil revenues. The budget reference price per barrel for oil was US$25, US$20 and US$35 in the 2004, 2005 and 2006 budgets, respectively, compared with the realized prices of US$38.5 and US$55.3 in 2004 and 2005, respectively, and the estimated price of US$68 for 2006. Several new measures have helped to improve the conduct of monetary policy, and exchange rate management has become more flexible. Since the move to the Wholesale Dutch Auction System in February 2006, the functioning of the foreign exchange markets has improved and, for the first time, the rates have converged.

17. Higher oil income, a more cautious fiscal policy and the recently concluded debt relief agreement with the Paris Club resulted in a substantial decline in Nigeria's external debt position to around US$5 billion in 2006.

18. If the fiscal rule is continued, it is likely that Nigeria would be able to survive a sizeable negative oil shock of at least five years' duration without requiring dramatic fiscal adjustment and with only modest debt accumulation. In contrast, if Nigeria abandons the rule and oil prices return to their historical "base level" (US$25 per bbl in real terms), the non-oil deficit would increase rapidly. Nigeria would exhaust its oil savings very quickly, after which sizable financing gaps would emerge. This would likely lead to a repeat of the past and ultimately to unsustainable levels of public debt within five years of the Paris Club debt agreement.

19. Recent economic progress underscores two important lessons. First, planning on long run expenditure commitments that are low enough to be financed from much lower oil revenues than the current levels is the only way to ensure sustainability and avoid another round of debt overhang induced economic decline. This would mean non-oil deficits that are geared towards a sustainable balance based on oil prices in a range of between US$25-30. The new fiscal policy
rules and the conservative reference price chosen to underpin it are both necessary to ensure that Nigeria's macroeconomic policies are sufficiently robust given the high volatility of the price of oil. The passage of the proposed Fiscal Responsibility Bill which seeks to enshrine this rule in law is critical. In addition, it would be useful to put in place a more formal arrangement for the management of the savings, including clear and transparent governance rules for its operation.

20. Related to this is the need for greater efficiency in the use of Nigeria's considerable public resources. Oil resources can be turned into a blessing instead of the curse that they have been in the past. This will depend critically on how the Government chooses to use its revenues from oil and on how efficiently these resources are used. Public expenditures choices need to target productivity improvements. Mechanisms are also needed to strengthen the quality of public investment projects—especially in the infrastructure sectors where projects tend to be the largest and therefore more prone to waste—and to monitor their implementation and impact. The Government's ongoing budget, financial management and procurement reforms need to be sustained and deepened to achieve this.¹

21. The second lesson is that a cautious move towards greater exchange rate flexibility, coupled with expenditure restraint to reduce pressure towards real appreciation, is essential if Nigeria is to avoid the boom-bust cycles of the past. The extent to which exchange rates rise with rising oil prices is directly related to the degree to which the Government succeeds in smoothing out expenditure levels through the use of oil savings. If such a savings mechanism is instituted, only structural up-shifts in oil income would require real exchange rate adjustment.

**Nigeria's Non-Oil Economy**

22. Nigeria's non-oil economy is essentially a domestic economy, producing to supply domestic demand. Activity in the sector is narrowly focused on and driven by markets for food and beverages. The productivity and competitiveness of the sector has been declining over the years, as is evidenced in consistently declining total factor productivity. The World Economic Forum (WEF) 2006 report ranks Nigeria number 88 out of 117 countries on its Global Competitiveness Indicators (GCI). Despite the large domestic market, only a small proportion of producers have been able to develop into sizeable businesses able to compete internationally. Non-oil exports are negligible, about 1 percent of GDP in 2005. Nigeria has lost market share in several of its traditional non-oil export markets (namely, cocoa, rubber and oil palm) and has not managed to replace these with significant new higher value products.

<table>
<thead>
<tr>
<th>Country</th>
<th>GCI 2005 Rank</th>
<th>GCI 2005 Score</th>
<th>GCI 2004 Rank</th>
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<tbody>
<tr>
<td>South Africa</td>
<td>42</td>
<td>4.31</td>
<td>41</td>
</tr>
<tr>
<td>India</td>
<td>50</td>
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<tr>
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<tr>
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<td>65</td>
<td>3.69</td>
<td>57</td>
</tr>
<tr>
<td>Indonesia</td>
<td>74</td>
<td>3.53</td>
<td>69</td>
</tr>
<tr>
<td>Nigeria</td>
<td>88</td>
<td>3.23</td>
<td>93</td>
</tr>
<tr>
<td>Kenya</td>
<td>92</td>
<td>3.19</td>
<td>78</td>
</tr>
</tbody>
</table>

¹ These issues are discussed in detail in the Public Expenditure Management and Financial Accountability Report (PEMFAR). World Bank Report No. NG-36496
23. The duality between the formal and informal sectors is also an important factor in the lack of competitiveness of the non-oil sector. In each of the major sectors of the non-oil economy there is a sharp divide between a small number of highly productive, internationally competitive producers and a very large number of small producers/service providers with low productivity. The duality of the economy results in a lack of dynamism and competition. A very high proportion of firms are long-established businesses. As in the rest of the world, the longer established a Nigerian firm is the less dynamic it becomes in terms of growing output and employment. Addressing the duality of the economy is therefore vital for strengthening and sustaining non-oil growth.

24. Consistent with the high level of informality and low productivity, job creation is insufficient: only an estimated 5-10 percent of the estimated 6 million new entrants into the labor market find jobs and wages are low. Youth unemployment (15-29 years) is estimated at about 60 percent. Further research is needed to ascertain whether labor laws strike the right balance between the incentive provided to employers to increase employment by increasing the flexibility to hire and fire and reducing personal benefits on the one hand, and the rights of workers on the other.

25. In all sectors of the non-oil economy there is the potential for further growth. In agriculture, which represents 23 percent of GDP, declining yields is a major policy challenge. Productivity has declined for both commercial and food crops in Nigeria over the last 20 years. For commercial crops, production levels have fallen as well. In contrast, production levels of food crops have increased substantially and Nigeria has overcome the extreme import dependence for basic foodstuffs which occurred in the 1980s. However, growth has been driven by a steady and substantial increase in the area cultivated and harvested while yield levels have dropped. In the case of roots and tubers, for example, a fourfold increase in the area planted since the mid-1980s has been accompanied by a decline in yields in excess of 40 percent. Similar but less dramatic outcomes are observed for cereals, beans and groundnuts. In contrast, at the international level yields have been increasing.

Figure 2: Index of Crop Yields (per hectare)
26. It will take time to bridge the international competitiveness gap in agriculture. Thus, the strategic focus for the short term should be on improving the competitiveness of Nigerian agriculture in domestic and regional markets. Growth is likely to continue to be led by smallholder farmers looking to improve their incomes, and therefore measures to enhance their productivity are important. For the longer term the strategic focus should be on restoring the competitiveness of traditional exports and promoting newer, high value exports. Competitiveness in these products would benefit from larger scale investments than smallholders are able to undertake. Therefore, improving the investment climate so that large-scale investment may eventually resume in Nigerian agriculture will be crucial.

27. Nigeria’s manufacturing sector has shrunk from 8.4 percent in 1980, to 5.5 percent in 1999 and 4.6 percent in 2005. It is ranked number 83 out of 117 countries on the UNIDO Competitive Performance Index (CPI). Manufacturing value added per capita has stagnated at around US$17 between 1990 and 2002, compared with increases from US$133 to US$273 for Indonesia and US$600 to US$1066 for Mexico over the same period. Manufacturing firms tend to be small, tend not to invest at all or to invest very little, and have to have low technology intensity. They typically do not engage in exports and also have a lot of unused capacity, averaging 55 percent². Additional manufacturing and industry growth could come from agro-industry, oil and gas based industrial activity and the development of the solid minerals sector. Tourism is also a potential area for growth that could take off over time as the country’s external image improves.

28. The service sector represents close to 20 percent of GDP compared with 60-65 percent for major regional services hubs in Africa. The ongoing liberalization of core infrastructure services, including telecommunications, should allow services trade to play a significant role in the diversification and growth of the economy. Services exports have outpaced other non-oil exports and in 2004 were almost four times as important as non-oil merchandise exports. Key areas for further growth include banking and finance and transportation—particularly air

² This could be due in part to obsolescence of plant and equipment
transportation. In both areas Nigeria could become a regional hub. Nigerian airlines and banks are already beginning to extend services to several neighboring countries.

29. In the domestic market, there is also strong room for growth in the supply of services to the oil and gas sector by Nigerian firms. Nigeria's aspiration is to increase its crude oil reserves from the current level of about 35 billion barrels to 40 billion barrels by 2010 and to almost double production to 4 million barrels per day. The country's gas resources are estimated at about 150 - 160 trillion standard cubic feet (SCF). New large multi-billion dollar projects are under way. Investment is projected to grow to around US$10 to US$12 billion annually, making Nigeria one of the largest oil and gas markets in the world. Investment is expected to total around US$67 billion between 2005 and 2008 as compared to about US$80 billion between 1990 and 2004. This expansion can generate considerable services needs that can be tapped to strengthen the linkages between the oil and the non-oil sectors and to promote higher standards of efficiency in the non-oil sector.

30. The Government has set ambitious targets to raise the Nigerian content in the oil and gas industry from 5-25 percent to 70 per cent by 2010. However, few oil-producing countries have been able to sustain local a content of 70 percent. It will therefore be important to focus on growing the Nigerian content rather than on the targets themselves. In addition, the focus of the local content guidelines needs to shift from the deep water potential, where projects require significant technological competence, to onshore and shallow water projects, where Nigerian firms should have more of a competitive advantage. Contracts for maintenance, modification and operation is also potentially more promising, since local companies are close to the management of the facilities and can train and develop their staff and organizations to handle this work. The market is also more stable. Developing a strategy to promote the local supply industry through R&D programs where the oil majors contribute with funding, expertise or both can help narrow the technology gap between domestic and foreign companies. Disclosing the benefits and costs of local content policies can help to reduce the risk of corruption.

31. These different potential sources of growth could be supported initially by increased domestic and regional demand and eventually strong demand from global markets. Exports of goods and services represented 55 percent of GDP in 2005, a relatively high level for a country of Nigeria's size. This is explained by the considerable oil resources and the dominance of oil in total exports. Non-oil exports have been declining over time, and even during the recent rapid growth of the non-oil economy, they have been falling by about 9 percent annually between 2000 and 2005. Nigeria should be able to increase supply in most of her non-traditional export markets, without potentially putting downward pressure on her earnings. In several other areas in which Nigeria could break into exports, global demand is not constrained. Moreover, Nigerian firms are not significantly unproductive compared to firms in countries such as Ghana or Kenya and should be able to raise export performance to at least similar levels to these comparator countries. Improving competitiveness in regional markets in which several Nigerian goods are already competitive should not be too difficult. However achieving competitiveness in global markets will be more difficult and will take time. Nigeria's large population could in principle be a source of a strong consumption demand that could fuel rapid growth in the short and medium term. Since 2000, real private consumption has grown rapidly. In the short to medium term, domestic demand for human consumption and for the feed industry within the agriculture sector are likely to be more important than the demand for raw materials for deeper processing by the manufacturing sector, which is currently small in relation to sector output and is not growing rapidly.
32. Finding ways to return some of Nigeria’s oil windfall back to Nigerians would also help to stimulate domestic private consumption. This could also allow a larger number of Nigerians to benefit from the oil boom and see improvements in their living conditions in a shorter period and reduce the sense of economic and social marginalization which has fueled rising violence and instability—particularly in areas such as the Niger Delta. This would reduce public sector control of oil resources and in turn limit opportunities for rent-seeking around oil. Nigeria could draw lessons from the experiences of other countries that have instituted successful programs to return some of their resource windfalls to their citizens.

The Binding Constraints to Growth

33. Both savings and investment in Nigeria have historically been low relative to more rapidly growing economies. Investment has averaged 19.5 percent of GDP while savings averaged about 18 percent of GDP between 1980 and 2005. Poor investment efficiency suggests that “effective” investment is even lower. Although savings in Nigeria has been lower than in more rapidly growing economies, this is not the main factor in the economy’s low growth: the low level of external debt (5 percent of GDP) and external current account surpluses averaging over the last three years show that Nigeria is not making extensive use of foreign savings. This is contrary to what could be expected if savings was scarce and the binding constraint on investment. Moreover, Nigerian banks have historically held excessive liquidity. The bank liquidity index is 10 compared to 6 in Sub-Saharan Africa and 5 in low income countries. Low savings therefore does not appear to be the issue. Nevertheless, low access to finance and interest rate volatility appear to be more serious constraints to economic operators. In particular, term financing is scarce. Less than 16 percent of respondents to a 2002 firm survey sample reported having loans longer than one year in duration. Existing loan maturities do not meet the long-term financing needs of enterprises and infrastructure projects. In a financial market characterized by volatile interest rates and short-term funding, banks have historically been willing to take maturity risk only on borrowers with outstanding credit quality. For blue chip clients, some banks are prepared to take a refinancing risk and provide medium-term loans by rolling over short-term funds up to a maturity of 7-9 years. With the exception of the telecommunications sector, loan maturities fall short of the long-term financing horizon of 10-20 years required for investments in infrastructure and project finance.

Banking Sector Liquidity

<table>
<thead>
<tr>
<th>Nigeria</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
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<tbody>
<tr>
<td>Liquid Assets / Total Deposits and Short-Term Borrowing (%)</td>
<td>82</td>
<td>91</td>
<td>86</td>
<td>86</td>
<td>94</td>
<td>87</td>
<td>88</td>
</tr>
<tr>
<td>Liquid Assets / Total Assets (%)</td>
<td>52</td>
<td>61</td>
<td>62</td>
<td>59</td>
<td>62</td>
<td>59</td>
<td>59</td>
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<tr>
<td>Banking Liquidity Index</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>9</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: World Bank Financial Sector Development Indicators

34. Low return on investment appears to be at the root of low investment and low growth in Nigeria. In a few sectors (oil, banking and some segments of the food and beverage industry), there is evidence of high returns. The oil sector operates at a high level of efficiency, matching global standards, and it is not surprising that it achieves high returns. Returns to equity for top notch banks before the bank consolidation reform are estimated at 35-40 percent, but this appears to have been a function of distortions in the sector. Large banks made their profits primarily from foreign exchange transactions and investment in government securities and not from lending.
Moreover, some banks were more privileged than others in their access to foreign exchange. The high return was therefore not a reflection of a well-functioning system. Instead, the system was fragmented and delivered little credit to viable potential borrowers. A privileged tier of banks had superior access to foreign exchange which allowed them to make high returns. In some segments of the food and beverage industry returns are high, and several of the multinational operators (Cadbury, Nestle) are expanding their operations and undertaking new investments. The market average price to earning ratio for firms quoted on the Nigerian stock exchange is high at 22.34 percent, but again this covers less than half of the economy. For the large share of the economy returns are low given the weak productivity of the economy and, in particular, the declining yields in agriculture.

35. Low returns to investment in Nigeria are a function of both low underlying returns and low ability of the private sector to appropriate/access returns. Underlying returns are low in large part because of severe infrastructure bottlenecks. Poor infrastructure reduces productivity and competitiveness on two fronts: it adds to firm costs and it reduces competitive pressure in the economy. Infrastructure access and quality are significantly below the levels in comparators, including countries in Africa. Power and road transport are the most severe infrastructure constraints. Poor access to power forces firms to invest in self-generation, diverting substantial resources from reinvestment in their productive businesses. In some areas of activity, self-provision of infrastructure by firms adds as much as 20 percent to firm costs. High transport costs due to poor roads port and rail conditions, significantly increase the cost of doing business in Nigeria and increases time to market. Given their sunk investments, in proprietary infrastructure, older firms, particularly those that may have fully or substantially amortized their infrastructure service investments are at a significant cost advantage relative to new entrants. Thus, competition for existing businesses from new entrants in any given sector is reduced. Low human capital is also a factor. Nigeria’s large population of over 130 million is an important asset. However, its development lags behind that of several comparators, including even comparators in Africa.

36. Educational quality has fallen over the last 20 years and new recruits typically need a considerable amount of training for their jobs. But data on returns to education in Nigeria are low: private return to primary and secondary education in Nigeria is estimated at between 2-4 percent per year; and return on post-secondary education is estimated at 10-15 percent. These estimates are low compared to the results for Africa, Latin America and Asia as estimated over 20 years ago. The low estimated returns suggest that low human capital might not be the binding constraint to raising underlying productivity. Nevertheless, the fact that the structure of Nigerian industry is skewed towards low technology activities suggests that low human capital is still an important constraint to enhancing firm efficiency and productivity.

| Table 3 Indicators of Size and Quality of Human Capital 1970 and 2003 |
|---------------------------------|-----------------|-----------------|-----------------|
| Literacy rate | Life Expectancy at birth | Mortality Rate |
|----------------|-----------------|-----------------|------------------|
| Indonesia | 20.1 | 66.8 | 43.5 | 44.9 | 140 | 98 |
| Korea | 56.1 | 87.8 | 49.2 | 66.9 | 104 | 31 |
| Mexico | 73.5 | 90.0 | 62.6 | 73.6 | 79.0 | 23.0 |
| South Africa | 69.5 | 86.0 | 53.9 | 45.7 | Na | 53.0 |

Source: World Development Indicators and CBN Statistical Bulletin

37. Nigeria's highly volatile economic environment makes it a risky environment for business and consequently increases the “transactions” costs of doing business. This reduces the
ability of firms to appropriate returns. At the micro economic level risks arise from the corruption and related weaknesses of institution that should facilitate private sector access to key business services (tax, trade facilitation, registration and contract enforcement to name a few). Corruption and weak institutions have increased the cost of doing business for Nigerian firms through “unofficial payments” for access to basic business services, including public service connections, licensing and permit processing, government contracts and customs. The quality, integrity and efficiency of most public institutions is also ranked poorly by the private sector. Several of these indicators are improving but nevertheless this still remains a major area of challenge.

38. At the macroeconomic level, the significant volatility of key economic variables, stemming principally from the poor management of the oil revenue cycle, is the underlying driver. Poor management of windfalls led to debt build-up, appreciating real exchange rates and extreme volatility in key macroeconomic variables that inhibited investment and growth. Using 1970 as a benchmark, Nigeria gained an extra US$390 billion in oil-related fiscal revenue over the period 1971-2005, or close to five times the 2005 GDP, expressed in constant US dollars. Much of this was used to finance the rapid expansion of wasteful capital expenditures by both federal and state governments. While fiscal expansion contributed substantially to debt expansion in the years after the price collapse, the volatility of public expenditures was the more important factor. Public expenditure remained highly correlated with oil fiscal revenue and fluctuated widely as a result of weak fiscal discipline and high oil price volatility. Fiscal policy pushed volatility beyond that stemming from variable oil prices. In effect the Government itself became a source of macroeconomic volatility. Nigeria has been ranked among the most volatile in several macroeconomic indicators, including interest rates, exchange rates, inflation and GDP.

39. The high level of volatility and risk makes it hard for economic agents to plan and acts as a tax on investment. Moreover, it reduces incentives to engage in longer-term productive investments and focuses activity in lower risk areas such as retail trade. At the macroeconomic level, as noted above, the implementation of the OPFR is beginning to address the underlying factor in excessive macroeconomic volatility.

40. The immediate binding constraint to investment and growth in Nigeria appears to be low underlying returns driven in large part by the weak access to and poor quality of infrastructure. The high risk environment also limits the ability of firms to appropriate returns that may exist. The immediate focus of the Government’s growth strategy should therefore be on reforms and investments that will improve investment returns, particularly enhancing the access to and quality of physical infrastructure. The next priority for policymakers’ attention is instituting reforms that will raise the ability of economic agents to appropriate returns. This refers to actions that will address macroeconomic instability, particularly from oil revenue volatility, and microeconomic risks from the corruption and related weaknesses of institutions and regulations to guide investment behavior. Actions that would strengthen the business environment would be generally easier to implement and could help deliver some quick wins. While savings was not the key factor in the past low growth, enhancing access to capital, especially term finance, will be important to ensuring that Nigeria’s considerable oil resources are intermediated more effectively in support of non-oil growth. The recent bank consolidation and the introduction of a contributory pensions scheme provide an opportunity for strengthening financial sector intermediation which must be seized.

41. Without improvement in the quality of human capital, Nigeria cannot successfully change the composition of economic activities toward higher productivity areas. Neither can the
economy eventually integrate more fully into the global market. Successful action in this area will be critical for sustaining rapid growth over the longer term.

Closing the Infrastructure Gap

42. An efficient and competitively priced economic infrastructure is central to raising productivity and increasing growth. Much of Nigeria's public sector infrastructure dates from the 1970s and 1980s. Since then, under-investment in the rehabilitation and maintenance of the existing infrastructure, significant underspending on infrastructure, and the poor quality of this limited spending have resulted in the poor access and low quality of the available infrastructure.

43. Nigeria ranks poorly on several indicators of infrastructure access, cost and quality. In power, the installed generation capacity is 6,000MW compared to available energy output of only about 3,000 MW. Actual demand is estimated to be 10,000 MW. The transmission network is poorly configured for reliability and lines extend over distances that are too long for efficient and reliable load flows. The transmission and distribution networks are in poor condition, causing high energy and financial losses.

44. Nigeria's port services are among the most inefficient and expensive in the world as evidenced by high waiting times, low handling speeds, and high container “dwell” times. As a result of these inefficiencies, the costs of shipping have spiraled upwards. The costs of moving a container through the port are also very high. Port entry charges at Lagos are the highest in the region. Customs clearance and freight forwarding costs vary widely but are extremely high, with average delays of 21 days being considered normal. Nigeria's railways hardly function. The infrastructure is dilapidated and there is a lack of serviceable locomotives and rolling stock. Only about 5 percent of freight is handled by the railways. The Nigerian Railways Corporation (NRC) is virtually bankrupt. In 2003 and 2004, the federal Government provided subsidies of N3.9b and N1.6 billion, respectively.

45. The aggregate network of classified roads has seen a much smaller increase than in comparable countries. About 50 percent of Nigeria's federal roads are in poor condition. No effective action has yet been possible to control excessive axle loads, which has resulted in serious damage to road surfaces and increased expenditure requirements for maintenance/reconstruction.

46. This infrastructure deficit imposes significant additional costs on businesses and reduces their competitiveness. High transport costs due to poor road and rail conditions significantly increase the cost of doing business in Nigeria and increase the time to market. Taking a 30 ton truck trailer from Maiduguri (at the northern tip) to Lagos (on the coast) costs about N320, 000, more than the equivalent sea freight from Europe. The 2001 RPED survey found that a representative business enterprise in Nigeria spent an annual average of N50,703 for electricity, of which 31 percent was payment for public-sector electricity and 69 percent was the running cost of the business-owned generator.

47. Under the reform program, the Government is redefining its role from that of an exclusive provider of infrastructure to a dual role of infrastructure provider and facilitator of infrastructure provision. Additional measures to tackle cross-cutting, as well as specific infrastructure sector issues, could allow further progress. These measures include the following:

- Strengthening medium-term investment strategies for all infrastructure sectors to bring about closer links between strategies and the achievement of realistic
infrastructure targets to ensure proper costing and the inclusion of clear performance indicators. In addition, project preparation should be strengthened and clear criteria for selecting between different infrastructure projects should be adopted. Significant capacity building will be needed to achieve this.

- Adopting a standardized and transparent approach to government support in public-private partnerships (PPPs) with a view to (i) attracting a maximum number of bidders to foster competition and reduce prices, and (ii) limiting fiscal costs to the Government.

- Conducting a detailed electricity demand study to help, the Government conclude power purchase agreements (PPAs) on independent power projects (IPPs)

- Strengthening the capacity of the energy regulator, (NERC), securing a long-term funding base to ensure its independence, and developing an operational framework for the unbundling of the former NEPA companies.

- Effectively implementing the National Policy on Rural Travel and Transport should ensure seamless infrastructural linkage between rural Nigeria and the rest of the country.

- Assessing and rationally apportioning rural road network responsibilities within the three tiers of Government; and enhancing road infrastructure planning and implementation capacity in the States and Local Governments will be important for strengthening rural infrastructure provision.

- Establishing a Road Fund for periodic and routine maintenance of roads, to be funded through a surcharge on fuel. The Fund would be managed by a private/public board and its resources would be provided on the basis of performance.

- Carrying out an economic analysis of the merits of government funding of the large majority of track rehabilitations and future improvements in the context of ongoing railway concessioning. This review should inform the discussion of alternative ways of proceeding with the concessioning.

- Establishing and consolidating an economic and safety regulation function for the transport sector in the Transport Regulatory Commission and building and publishing a database of key performance indicators for each transport concession to stimulate performance improvements.

- Reviewing and adjusting the mandates of the different ministries and agencies in the transport sector to minimize the duplication of effort, and eventually consolidating the three transport ministries into one Ministry of Transport.

**Improving the Business Conditions for Growth**

48. Micro level risks and macroeconomic instability are key factors in explaining low investment and growth in Nigeria. Micro level risks arise from the policies, regulations and laws that guide private sector development and their implementation. These represent core areas in which the Government plays a crucial role in creating an environment conducive to business confidence and investment. The Doing Business Surveys have demonstrated that an
improvement in the institutions that guide businesses can result in an increased growth performance of up to 2.3 percent. There is also considerable conclusive evidence in the empirical analysis of the negative impact of macroeconomic instability on growth. As explained above, a fundamental cause of macroeconomic instability in Nigeria has been poor management of the oil revenue cycle.

**Micro Level Risks**

49. Several aspects of Nigeria’s business and regulatory environment are ranked poorly in the Doing Business Surveys. These weaknesses impose significant costs on economic activity and productivity. Four areas – taxation, trade facilitation, business registration and licensing, and contract enforcement—are repeatedly identified by businesses as among the weakest elements of the business climate. Furthermore, they represent areas where relatively quick progress can be made that would have a positive impact on enterprise performance and would enhance productivity.

50. The four areas also provide considerable scope for government misuse of its monopoly and discretionary powers, thereby inflicting some of the most severe constraints to business growth in Nigeria. Corruption and the predatory behaviour of public servants in these areas has significantly raised “transactions” costs for Nigerian businesses. Nevertheless, they represent areas where relatively quick progress can be made. Three of these indicators – taxation, licensing and registration and trade facilitation – also entail some of the most direct exchange that the different levels of government have with businesses. Thus, progress in these areas provides an opportunity to build confidence in the facilitative role of government for private sector led growth. This could have a major positive impact on enterprise investment and formalization decisions. Lowering the transaction cost of transitioning firms from informality can contribute significantly to Nigeria’s growth goals.

51. As regards reform approach, in order to obtain measurable results within a reasonable timeframe and, taking into account the different constraints across the states and across industries, a strategic option for reform to strengthen the business conditions for growth is to target initially specific states and industries where impact could be greatest. States should opt-in to pursue reforms at their level and benchmarking needs to be implemented in parallel with efforts at the Federal level. In the case of industry targeting, those sectors that offer the strongest potential for non-oil sector employment based growth should be the first to benefit from a reform program. This would suggest strongly that the first generation candidates should include key agricultural crops, particularly those with the greatest value-adding and export potential such as cassava, palm oil, leather and rice. A further sector for particular attention would be tourism covering both service and product (e.g. artisanal products) sub-industries. The solid mineral and construction sectors, which could also play important roles in Nigeria’s non-oil sector, could also be considered.

52. **Taxation.** The tax burden on Nigerian business is internationally competitive with a marginal effective tax rate (METR) of 27.1 percent. But the burden of administration is one of the worst in the world. Multiple taxes levied by the three tiers of government (federal, state and local) have also resulted in a proliferation of taxes, some of which are illegal. Predatory behavior on the part of tax officials—including private tax consultants—has put the integrity of the tax system in question and contributes to high levels of informality. Important actions to reduce this burden include:
• Passing and implementing of the federal Government’s tax policy and administration proposals is a critical first step.

• Resolving the issue of multiple taxation among tiers and abolishing illegal taxes at the state and local government levels. This will need strong coordination among federal, state and local governments. The Joint Tax Board could lead this effort.

• Reviewing (state and local governments) the impact of outsourcing of tax collection to private sector and addressing adverse side effects on business activity.

• Strengthening tax administration efficiency at federal and state levels through computerization and staff skill strengthening

• Raising public awareness of what taxes are payable and to whom, and instituting a mechanism (including clear performance targets) for private sector monitoring of tax agency performance, would empower the private sector to demand better performance from tax agencies and officials.

53. **Trade Facilitation.** The Doing Business Survey of 2006 rated Nigeria among the bottom 20 countries assessed globally on trade facilitation. Delays and high costs at the port, discussed above are further compounded by onerous administrative and customs procedures. The potential for delays is further augmented by an import-export processing system that is almost entirely paper-based, with information technology only partially implemented through the ASYCUDA system. It is characterized by excessive documentation, and repeated checking of the same information. Actions that could strengthen trade facilitation include:

• Simplifying trade documentation requirements and providing public information on procedures.

• Introducing pre-shipping inspections with random or risk-based site inspection

• Enforcing the reduction of agencies with permanent port presence

• Implementing customs reforms, including streamlining customs procedures in line with Kyoto Convention Guidelines. Given the difficult political economy issues in this area, one option might be to begin by exploring possibilities for contracting customs services in targeted business-intense locations such as Tinapa.

54. **Business Registration and Licenses.** Over the past five years significant reforms have been taking place in Nigeria’s business registration process, including the establishment of a “one-stop” shop. Despite this, the process is still slow and cumbersome. To start a business it is estimated that an entrepreneur has to go through nine procedures over a 43 day period. Given that entry and licensing procedures are some of the biggest constraints to doing business in Nigeria today, continued reform is desirable. It is important that the Government continues its ongoing efforts to improve registration access and to streamline licensing. Specific actions could include:

• Further streamlining federal agency involvement in registration to harmonize FIRS and CAC requirements.
• Reviewing and streamlining licensing requirements for key sectors across the three tiers of government.

• Setting benchmarks for official license processing with some private sector monitoring of performance to bring about pressure for improved performance.

55. **Contract Enforcement** Nigeria is one of the worst countries in the world regarding the settling of commercial dispute. It takes 730 days to settle a basic contractual dispute through the court system. With a huge backlog of cases in the formal judicial system, only large firms can afford to use the system. The costs including the time needed to settle, vastly outweigh the potential benefits for the majority of plaintiffs. This is compounded by outdated legislation that inhibits modern business activity and practices. Legal and court reform as well as improvements to ADR are at a relatively early stage. Going forward, the following actions could deliver further improvements:

• Extending the fast track courts model being implemented in Lagos to other states.

• Scaling up successful ADR pilot programs

• Reforming court jurisdictions (e.g. thresholds), civil procedures, practices (e.g. abuse of adjournments).

• Reviewing and revising or repealing key business legislation including the Company and Allied Matters Act, the Investment Decree, sundry access to finance legislation related to hire purchase and related issues, and the Tax Act in respect of accounting procedures affecting taxable amounts between lessor/lessee on leasing arrangements.

• Introducing new legislation including the Competition Act (currently pending at the National Assembly), and a Secured Lending Act

• Building the capacity of judges, registrars and court clerks to lead the reform effort and building a paralegal profession to support contract enforcement objectives over time.

**Macro Level Risks**

56. The Government has already begun tackling the key source of macroeconomic instability through the implementation of the OPFR. To date, the fiscal rule has been applied on the basis of a “political” agreement between the federal Government and the State governments. To sustain this important reform, it will be important to

• Securing the passage of the Fiscal Responsibility Bill which will legally bind all three tiers of government to implementing the oil price based rule.

• Designing a more formal framework for the management of the oil savings. Currently this is held in an account at the CBN. Global experience demonstrates that it is important to formalize savings as a fund under the professional management of an autonomous body as an independent fund. Proper governance of such a fund, including clear rules governing investment and withdrawal from its resources, is needed.
Access to Long Term Finance

57. The limited intermediation capacity of Nigeria’s financial system means that a large share of savings is not channeled into productive investments. Banks are burdened with excess liquidity but are simultaneously very cautious in providing credit to the private sector. Excess liquidity exists because financial intermediaries lack investment opportunities with sufficient returns or perceive the risks in intermediating funds to be too great. Weak financial sector intermediation capacity has limited the access to finance for investments. Firms have been forced to rely to a high degree on self-financing.

58. As the largest financial market in Africa other than South Africa, Nigeria has inherently a better term finance capacity than most African countries. Up until 2004, Nigeria’s banking sector was characterized by a large number of small banks that taxed supervisory capabilities. In July 2004 the CBN increased the minimum capital requirements for banks from N2 billion to N25 billion. The increase is intended to help bring about a diversified, stable financial sector that would ensure the safety of deposits while at the same time contributing to economic development via intermediation. These larger banks are also intended to compete more effectively in the regional and global financial system. A relatively successful outcome has been achieved from the consolidation. While the system continues to be shallow, the consolidation process has increased the capital and deposit base which can be leveraged for term finance and outreach. Ongoing pension reform and the planned consolidation of the insurance industry provide an impetus for increased long-term savings which are a natural source of long-term investment and facilitate capital market development.

59. The future challenge for financial sector development in Nigeria will be to harness the success of banking consolidation and to develop non-bank finance to (i) improve service delivery and the availability of appropriate products for large and medium enterprises, as well as (ii) improve access to financial services on a small scale to meet the needs of households, micro-enterprises and small businesses. Improving access to finance for the private sector, especially small and medium enterprises, will matter for growth. However, to achieve shared growth it will also be important to increase financial sector outreach and access to finance by low-income households.

60. Although any financial sector strategy will rely substantially on private activity, a major policy role exists for government in providing adequate incentives, building financial sector infrastructure and providing an enabling lending environment. Difficulty in obtaining information about the financial health, credit history and identity of prospective clients limits the ability of financial institutions to expand their lending business into new market segments. Inefficient land and property registries stifle the ability of banks to offer secured lending products and mortgage finance. Robust creditor rights and insolvency systems will be necessary to foster greater confidence in commercial contracts and facilitate the management and resolution of default risk.

61. Going forward, the following measures could help enhance financial intermediation and strengthen access to long term finance:

- Augmenting the supervisory capacity of the CBN and NDIC to take earlier, more guidance-based, intervention in the behavior of banks. It is therefore appropriate that the authorities are taking the first steps towards the implementation of risk-based supervision.
• Improving the lending environment through strengthening creditor rights and insolvency frameworks, making investments in credit infrastructure and technology, etc. Without this, financial intermediaries are likely to increase lending to existing customers rather than expand their services to new market segments. In particular, the Government needs to undertake a substantive review of the creditor rights and insolvency framework with a view to providing legal mechanisms to make enforcement less costly. Initiatives for establishing streamlined commercial court procedures in Lagos and the FCT could provide important policy lessons for other states.

• Developing outreach strategies to close the substantial knowledge gap about the size and scope of the demand for financial services outside of the corporate sector and urban middle-income retail market.

• Addressing structural factors in the capital market, including: (i) the lack of a long-term pricing benchmark and high interest rate volatility, (ii) the underdeveloped primary bond market for corporate bond issues, and (iii) the absence of a liquid secondary market for sovereign and non-sovereign bonds. This would support the process of increasing the availability of long-term domestic investment funding. This would help improve the intermediation capacity of Nigeria's capital markets for term finance.

• Creating a public-private facility for infrastructure in Nigeria that would help address market failures and maximize local currency financing for infrastructure. As various infrastructure PPPs in Nigeria are faced with similar risks, a cross-sectoral approach to facilitating private participation in infrastructure would be beneficial. The objective of such a facility would be to provide a coherent framework for investment prioritization private sector participation, and government support through various instruments such as a guarantee facility, a liquidity facility, and subordinated debt and equity funds.

• Addressing structural issues in the capital markets, including: (i) the lack of a long-term pricing benchmark and the high interest rate volatility; (ii) the underdeveloped primary bond market for corporate bond issues; and (iii) the absence of a liquid secondary market for sovereign and non-sovereign bonds. This would support the process of increasing the availability of long-term domestic investment funding.

Harnessing Domestic and International Trade for Growth

62. Several countries have achieved and sustained rapid growth through an export-led approach. Small economies in particular have very little opportunity to achieve productivity and efficiency gains to support growth without tapping larger markets through external trade. Nigeria's relatively large domestic market can support growth but alone cannot deliver sustained growth at the rates needed to make a visible impact on poverty. Nigeria will need to rely on foreign markets as well. Domestic, regional and international trade therefore will need to be harnessed more effectively in support of growth. In the short to medium term, given Nigeria's considerable competitiveness disadvantages, domestic and regional trade in which Nigeria has some natural and tariff protection will need to drive growth. Over the longer term, international trade can and should assume more importance in fueling Nigeria's growth.
63. Nigeria is not making effective use of the advantage of a relatively large domestic market to help improve firm efficiency and productivity. Domestic markets are segmented and fully integrated regional or national markets that will drive competition and efficiency gains have not emerged. Individual segments are also poorly coordinated and participants suffer from poor facilities and the predatory behavior of public officials. Aside from addressing the transport infrastructure issues that contribute to this, several other factors need the attention of policy makers. Specific actions that could be put in place include the following:

- **Addressing property rights over commodity markets by encouraging local governments housing the major commodity markets to give long-term leasehold tenure or freehold ownership over the sites to the market associations. These associations should in turn submit plans for their development including expansion of the market, either at the current site or at a more suitable site if congestion is a problem.**

- **Removing opportunities for predatory behavior by public officials that stands in the way of trading across state boundaries. Police check points and state taxes along the main highways of the country should be removed, and licenses and permits required to trade and manufacture should be simplified.**

- **Changing the tenure of formal wholesale and retail markets from the local government to the market association and giving the latter incentives to manage these markets well.**

- **Improving the approval process for formal wholesale and retail market planning and development in local government also needs to be improved.**

64. External trade is a high share of GDP in Nigeria (84 percent in 2004). But this is largely because Nigeria is a specialized commodity exporter. As production is concentrated on relatively few products, notably petroleum products, trade is a means of validating domestic surpluses. Indeed, over the past decade, growth in Nigeria’s exports of goods and services (20 percent) has lagged behind growth in world exports (70 percent) and therefore Nigeria has been losing world market share.

65. The country has also been unable to achieve diversification of its export base. Exports continue to be dominated by oil, and the agricultural exports that thrived 30 years ago have been largely wiped out. Nigeria has the most highly concentrated export structure in the world. In 2003, the country had only 66 product groups with export values exceeding US$100,000, while five comparator-countries had substantial exports in at least 175 product categories. On a per capita basis, only three countries in the world have lower non-oil merchandise exports, namely, Burundi, Ethiopia, and Rwanda. The dependence on fuels might even increase further in the medium term, as exports of natural gas, of which Nigeria has very substantial reserves, are projected to double within the next four to five years.

66. Nigeria has had one of the highest levels of domestic market protection in the world. High tariffs and pervasive import prohibitions have burdened consumers with high prices and have shielded producers from international competition. The recent adoption of the ECOWAS common external tariff with its substantially lower duty rates promises to spur productivity growth and to make domestic producers more agile in supplying domestic and international
markets. In an effort to promote exports, the Government has put in place several special programs, some of which have suffered from corruption and abuse.

67. Additional actions that could strengthen Nigeria’s participation in regional and international trade include the following:

- Undertaking a systematic review of the existing subsidy and other incentive programs to promote non-oil exports to assess their cost effectiveness in achieving their stated aims. Based on the review, these programs should be cancelled or redesigned to reduce their distorting economic impact to introduce greater cost-effectiveness, accountability and results orientation.

- Outlining and implementing a strategy for phasing out special tariffs on sensitive products and for eliminating import bans by the end of the ECOWAS Common External Tariff (CET) transitional period in 2007. This will bring greater credibility and predictability to trade policy, help businesses plan better and ensure that the transition timetable is followed.

- Ensuring that receipts from the Port Development Levy are administered to the same standards as general budget receipts. In the longer run the port levy which constitutes an additional barrier to trade, should be removed and port activities funded from general government budgets. Ensuring that product specific levies and excise duties are applied in a non-discriminatory way, (i.e. that they apply equally to domestic products and imported ones) will also be important.

- Taking an active role in shaping the outcome of the Economic Partnership Agreement negotiations with the EU and the WTO Doha Round — when this is resumed—in order to maintain and possibly improve the terms of goods and services market access in Western Europe, including with respect to rules of origin provisions and trade standards, and to bring down existing barriers to Nigeria’s exports in middle income countries.

**Embedding and Sustaining Reforms**

68. As explained above, in the last few years Nigeria has made excellent progress on a broad reform agenda. Suggestions for additional reforms have also been provided. Going forward it is important that Government embeds the reform achievements in a manner that enhances their irreversibility. There are four key ways though which reforms could be embedded and consolidated. The first is to build institutions and processes for policy making to support the current reform thrust; the second is to introduce legislation to reinforce the policy changes; the third is to make public information on government policy and performance routinely available; and the fourth is to facilitate the creation of new and well-informed coalitions of interest groups in support of the reforms.

69. Reforming institutions to align institutional incentives with reform objectives and build institutional capacity to articulate and implement reforms is critical. Nigeria’s reforms have so far tended to be driven from the top down. There was little alternative in a complex country with weak institutions and strong vested interests against reforms including in public institutions. This approach has succeeded in kick starting many reforms, but will not suffice to extend and sustain them. Reform of public service institutions is proceeding and needs to be speeded up particularly in the key ministries such as the Ministry of Finance and the National Planning Commission.
leading the reforms. This should help create new institutions that are in tune with the new policy thrust of government and where staff understand and are committed to the new policy shift. Considerable capacity building around policy making, implementation and monitoring will also be needed.

70. Efforts to strengthen institutional and organisational capacities at the Federal level must be replicated at the State and Local Government levels if the reforms are to be embedded. To date, most institutional reforms have taken place at the Federal level, complemented by actions in only a few States, and with little apparent improvement in the great majority of local government areas. As long as this is the case, distortions to economic activity will not be adequately addressed and competitiveness and growth will be elusive. Extending the momentum of reform across Federal, State and Local government levels will reduce probability of reversibility. An appreciable change at all three tiers of government will ensure that the reforms are meaningful to the great majority of Nigerians, in the form of either better publicly-provided services or of broader growth. Some of the reforms at the federal level provide a starting point with opportunity to learn lessons, and to reach out increasingly to those States in which conditions are conducive to improved economic governance and management. Federal government could help by assessing impact of its own reforms and drawing lessons, sharing information with states and local governments and identifying incentives for state and local governments to take on similar reforms at their level. A mechanism for performance based grants from the federal level to states that show commitment and action on reforms could be designed and implemented. Nigeria could draw on experiences from other federal countries in this regard.

71. Second, the fundamental reforms that have been introduced over the past few years on the basis of “political agreements/understanding” need to be institutionalized through the passage of a number of key bills, currently pending approval. As mentioned above, critical legislation that needs to be passed include: the Fiscal Responsibility Bill; The Tax Policy and Administration Bills, The Public Procurement Bill; The NEITI Bill; The Auditor General’s Bill; The Statistical Act and other key regulatory bills.

72. Third, mechanisms of public accountability that create pressure on government and leaders for improved performance need to be strengthened. This should create a dynamic of higher citizen expectations, so that improved performance is widely seen as the norm, generating pressure for further improvement. To achieve durable accountability systems, government must make quality and timely information routinely available on a wide range of government actions, in particular relating to financial management, but also on the performance and impact of public bodies and on key competitiveness indicators. A good start has been made in a number of areas, however the process needs to be institutionalized and widened. Improved transparency will create greater scope for ‘intermediaries,’ including the media and non-governmental organizations to help create a more informed public opinion.

73. To optimize its effect on growth, Nigeria’s ongoing democratic process needs to be accompanied by a set of measures that reward the political leadership for taking actions that promote economic growth, and hold them accountable for poor economic performance. This will include demonstrating how political leadership may benefit from broad-based economic growth (e.g. the political benefits associated with these would include increased employment and income opportunities, increased revenue and a reduction of poverty related conflict). To achieve this Government needs to address the political economy constraints that have hindered growth over the past four decades. At the heart of the vicious cycle that needs to be broken is the need for an economy that diversifies beyond oil. Government’s efforts to achieve this must be deepened across the three tiers of government to ensure that vested interests that have been created around
oil, protected and uncompetitive industries, and the inefficient public and private sectors can be broken. A more diversified economy comprising a more vigorous, competitive and less protected private sector will contribute to more sustainable and equitable growth, and generate a healthier configuration of interest groups, whose incentives would be better aligned with employment based growth.

74. Fourth there is a critical need to widen the range of individuals and organizations that have an interest and commitment in taking the reforms forward. Whilst acknowledging that political leadership will continue to play a pivotal role in driving the reform process, a process must be initiated which moves the policy process from being dependent on individual leaders to becoming more firmly rooted in democratic institutions. The international community can assist Government achieve its accountability objectives by helping to empower and strengthen the capacity of the elements of civil society and the private sector whose interests coincide with a growth and competitiveness agenda. This will facilitate the establishment of coalitions that bring together groups and reformist elements of government around common interests. While the support of parts of Nigeria’s elites has so far been sufficient to launch some of the reforms, sustaining change will require broader support. Jobs and improved public services are critical. There is a need to work with a range of stakeholders, going well beyond the state to include the private sector, as well as elements of civil society, especially those with soundly-based advocacy programs.