AGORA POLICY

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NO. 1, OCTOBER 2022

Executive Summary

Options for Revamping Nigeria's Economy

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With a gross domestic product of $511 billion in 2021, Nigeria has the largest economy in Africa. However, the level of inclusive development is low: 40.09% of Nigerians are poor; the average years of education is 6.1 years; 14.3% of the population have never attended school; 36.8% of children under 5 suffer from malnutrition; the infant mortality rate is 75.7 per 1,000 live births. All these factors combine to give a life expectancy at birth of 52.7 years.

While economic growth has improved in the aftermath of the COVID-19 pandemic, many of the macroeconomic fundamentals have worsened. Inflation increased to 20.52% in August 2022; unemployment increased to 33.28% in the fourth quarter of 2020. The fiscal deficit of the federal government (FGN) grew to N3.09 trillion in Q1 2022. Consequently, FGN's debt stock increased to N35.67 trillion (comprising N20.95 trillion domestic and N14.72 trillion foreign) at the end of Q2 2022; with debt servicing surpassing revenue in Q1 2022.

As the country moves towards the end of an administration and prepares to usher in a new government, the economy will feature prominently in the build-up to the 2023 elections. This is because in addition to the low level of inclusive development and weak macroeconomic fundamentals, there are currently harsh economic realities at the global level. These can be attributed to issues such as the slow recovery from the COVID-19 pandemic, the Russia-Ukraine crisis, disruptions in the global supply of goods, the surge in oil prices, the rapid rise in inflation especially the food and energy components, and the response to hikes in interest rates. All these issues will pose serious challenges to economies across the globe in the next few quarters.

This report provides an analysis of the critical challenges currently facing the Nigerian economy and offers recommendations for overcoming the challenges.

Key Highlights

7000%

Ways and Means increased by over 7000%

✦ **The revenue of the FGN is too low to support expenditure, leading to high debt stock and high debt service payments.** FGN's budgeted aggregate expenditure increased by 179% from N4.484 trillion in 2011 to N12.512 trillion in 2021. Despite this increase, government expenditure in Nigeria is lower than in comparable countries. Between 2011 and 2021, budgeted FGN aggregate revenue increased by 102%, from N3.348 trillion to N6.772 trillion. However, actual revenue increased by 81%, from N2.566 trillion to N4.643 trillion. Thus, with revenue unable to keep pace with expenditure, government has resorted to more borrowing. The total debt stock of FGN has increased by 436% from N6.17 trillion in December 2011 to N33.11 trillion in December 2021. Domestic debt increased by 242%, from N5.6 trillion to N19.2 trillion; while foreign debt increased by 2,435% from N546 billion to N13.86 trillion. The official debt stock statistics do not include FGN's borrowing from the Central Bank of Nigeria (CBN) through Ways and Means which increased by over 7,000% from N265.7 billion in January 2014 to N18.89 trillion in March 2022. Thus, if the debt from Ways and Means as of December 2021 (N17.4 trillion) is added to official debt, the domestic debt stock as of December 2021 rises to N36.6 trillion. From January to April 2022, debt service was the largest component of expenditure; debt service exceeded revenue by N308 billion, meaning that government borrowed to pay back debt.

23.2 million

number of unemployed persons in 2020

✦ **Unemployment is very high, as more than a third of eligible workers are unemployed.** Between 2011 and 2020, the unemployment rate increased by nearly six times, from 5.9% in 2011 to 33.3% in Q4 2020. Consequently, the number of unemployed persons rose to 23.2 million in Q4 2020. Youth unemployment (15–34 years-old) increased from 8.04% in 2011 to 42.49% in Q4 2020. Nigeria's high birth rate suggests that the number of young people will continue to rise for some time. This poses serious challenges for the government in providing jobs. There are more men (39,519,925 or 56.72%) in the labour force than women (30,155,543 or 43.28%). However, unemployment rate among women (35.19%) is higher than the one for men (31.82%), suggesting a strong gender dimension to employment opportunities. There are wide regional disparities in unemployment. Unemployment is highest in the South East (44.54%). This is followed by the South South (43.85%), North East (41.29%), North Central (29.02%), North West (25.49%). The South West had the lowest unemployment rate of 22.07%.

82.9m
number of Nigerians living in poverty

✦ **Human welfare is very low, as four out of ten Nigerians are poor.** 40.1% of Nigerians live in poverty. This translates to 82.9 million poor people. There are spatial disparities in poverty. The prevalence of poverty in Nigeria is more severe in rural areas (52%) than the urban areas (18%). There are also wide disparities in poverty across geo-political zones. Poverty is highest in the North East (71.8%), followed by the North West (64.2%), North Central (43.5%), South East (42.5%), South South (19.1%), and South West (12.1%). There are gender disparities in poverty as well: poverty affects men more than women irrespective of the level of educational attainment. Poverty is associated with lower levels of education as the poorest group had no education or less than primary education. Workers in the agriculture sector are the most vulnerable to poverty, followed by households with diversified income-generating activities and those engaged as apprentices or not working at all.

–N1.9 trn
total trade balance bw export and import in 2021

✦ **The combination of restrictive trade policies, lower oil revenue and cumbersome procedures at ports have stifled investment, trade, and efficiency of operations**. The country has recorded persistent trade deficits in recent years. In 2021, total exports were N18.9 trillion, while total imports were N20.8 trillion, giving a trade balance of –N1.9 trillion. The current account balance decreased from +N13 trillion in 2011 to -N16 trillion in 2020 before moderating to -N2 trillion in 2021. There has been recent heightening of protectionist trade policies as evident through higher tariffs, levies, import bans on some commodities, land border closure, and foreign exchange restriction on the importation of 42 items by CBN. There are cumbersome custom procedures, and these combined with poor port management, infrastructure and congestion have resulted in the country sliding down all indicators of efficiency and trade facilitation: Nigeria was lowest (out of 167 countries) in a ranking for trade facilitation performance indicators; Nigeria ranked 138 in terms of efficiency of the customs clearance process; Nigeria ranked lowest (out of 179 countries) in ranking of trading across borders indicators; Nigeria ranked 116 (out of 140) in overall competitiveness.

20.52%
inflation rate in August 2022

✦ **In recent years, inflation has risen rapidly and the exchange rate has declined in value, needing active intervention by the CBN.** Since 2015, there have been at least three episodes when inflation has topped 18%. In August 2022, inflation rose to 20.52%. The surge in inflation has been driven mostly by food inflation which has exceeded 20% three times in the last decade and is still above 20%. Dwindling oil revenue and the subsequent fall in foreign exchange earnings have put enormous downward pressure on the naira. The parallel exchange rate of the naira has been volatile and rising, and reached a high of 710 per USD in the parallel and 415.72 per USD in the official interbank market in July 2022. Efforts are mainly directed at keeping the exchange rate of the naira as close to the dollar as possible, meaning that the exchange rate is effectively overvalued. Multiple exchange rates have led to big spreads. The loss of oil revenue into the Federation Account has reduced dollar inflows, thereby leading to conscious or unconscious devaluation. The determination to keep the exchange rate at fixed levels is affecting external reserves. Capital restrictions are leading to exit of foreign investment.

Key Recommendations

✦ Blocking leakages in revenue: downstream oil sector reform through ending subsidy on petrol

For January to June 2022, subsidy payments totalled N1.59 trillion, and resulted in the NNPC not remitting any money to the Federation Account in 2022. It is clear that petrol subsidies are no longer sustainable. Expenditure on petrol subsidies are diverting resources from critical socioeconomic sectors. The N1.59 trillion gulped by petrol subsidy in the first half of 2022 exceeded the total annual budgeted expenditure for critical sectors such as Education, Health, Infrastructure, Social Development and Poverty Reduction Programmes. Ending the petrol subsidy will require effective communication by the government of the deleterious effects of the subsidies to the citizenry. In addition, the government will need to design and efficiently execute social transfers to the poorest sections of the population. A major hindrance to this is the lack of trust in government, which needs to be adequately addressed.

✦ Blocking leakages in revenue: upstream oil sector reform through ending oil theft

Nigeria's oil production fell from 2.49 million barrels per day in January 2011 to 1.08 million barrels per day in July 2022. In 2019, 42.24 million barrels valued at $2.772 billion was lost to oil theft and sabotage, while in 2020, 39.16 million barrels valued at $1.63 billion were similarly lost. Ending oil theft will require strong determination from the government and crucially, cooperation from host communities and the military. Recent efforts by the NUPRC (through the National Production Monitoring System) and NNPC (through the Crude Theft Monitoring Applications) should be intensified. Strategic communications and engagement with communities will be critical. The security architecture for combating oil theft should be reviewed.

✦ Blocking leakages in revenue: amendment and enforcement of Fiscal Responsibility Act on remittance of operating surplus by agencies

The Fiscal Responsibility Act mandates revenue generating agencies to remit 80% of their operating surpluses to the Consolidated Revenue Fund and retain 20% in their reserve fund. There are many revenue-generating agencies that either fail to remit any revenue, or remit a very small fraction to the government. The Fiscal Responsibility Act should be amended to stop funding revenue-generating agencies from the Federal budget; and set penalties for agencies that fail to remit their stipulated operating surpluses.

✦ Boosting tax revenue: ensuring compliance and widening the tax net to increase Company Income Tax

The FIRS has admitted that less than 20 million out of over 68 million business actively pay taxes, implying that less than 30% of businesses pay tax. The FIRS should collaborate with the National Bureau of Statistics and the Corporate Affairs Commission to ensure compliance in payment of CIT by companies.

✦ Boosting tax revenue: ramping up automation of VAT and extending to other sectors

The FIRS has started VAT automation, where they carry onsite visits and install software to automatically collect VAT. However, this has been restricted to some large cities and some sectors, largely retail. This VAT automation drive needs to be ramped up to all states and cities. In addition, it needs to be extended to all sectors of the economy.

Increase Value Added Tax (VAT) and Excise Taxes on Luxury Goods, Tobacco and Alcohol

✦ Excise taxes and VAT in Nigeria are amongst the lowest in Sub-Saharan Africa. Excise taxes on alcohol and tobacco can be increased to the ECOWAS average of 50%. Also, VAT can be increased to 10%, and subsequently to the ECOWAS average of 15%.

Sale and Concession of Government Assets

✦ There are many government assets that are either not generating revenue at all, or are generating revenue that is grossly below their potential. Some of the assets can be sold outrightly to provide immediate/short term funds for the government. In addition, some other assets can be offered to private operators who pay a lump-sum fee upfront, and then make payments at agreed regular intervals.

✦ Development of critical infrastructure

With a population of about 200 million, Nigeria has the capacity to generate only 12,000 MW of electricity, and realistically, is only able to distribute about 5,000 MW. Many businesses have to generate power individually and the high running costs of doing this have led to many SMEs shutting down and multinational companies exiting the country for other domains. Many roads are in a dilapidated state and are not motorable. The majority of agricultural produce is wasted due to inability to reach markets on time due to bad roads. Active efforts need to put in place to develop critical infrastructure to facilitate economic activities.

✦ Active Policy on Diversification and Promotion of Small and Medium Scale Enterprises

Diversification from oil has been a central piece of economic reform plans for many years. However, the reform objective remains unrealised, largely because oil revenue has provided easy funds for government. Such diversification can be promoted though active promotion and encouragement of SMEs which create 70% of jobs. More initiatives by government such as the tax concessions provided in the Finance Acts of 2019 and 2020 are needed to encourage SMEs. Insecurity needs to be tackled in rural areas; access to finance needs to be provided; and corruption, bureaucracy and red tape in administrative processes by government officials need to be addressed.

✦ Vocational training and skills acquisition programmes

The critical skills shortage among the youths needs to be addressed. There needs to be an upgrade of employable skills. This can be done through investments in high quality technical and vocational learning centres. Improvements in employable skills, particularly technical and vocational skills, can provide huge impetus to job matching and performance, thereby making more people employable.

✦ Revamping the educational system

Making the education system more responsive to labour market needs can help support recent graduates' employability, reduce skill imbalances, and improve workforce resilience to future changes in labour market demand.

✦ Providing and improving access to critical infrastructure

There is a need to urgently increase investment in digital technology in rural areas to create more jobs and economic opportunities. There is an urgent need to restructure the fiscal profile of MDAs that provide infrastructure (such as ministries of works, power, housing, water resources, etc.) and allied services by ensuring that recurrent expenditures are drastically reduced to boost capital expenditure.

✦ Scaling up social investment programmes and improving the targeting mechanism

The existing social investment programmes need to be scaled up to help address extreme poverty. The conditional cash transfer programme needs to be improved by increasing the amount from N5,000 to N10,000. Improving livelihoods, especially in rural communities, could be attained by developing a robust targeting mechanism that minimizes the risk of moral hazard and adverse selection.

✦ Reforming the trade policy framework and urgently shifting from non-tariff measures to import tariffs

Development of a comprehensive long-term trade policy framework and plan that can sustainably guide trade reforms. This would include robust monitoring and evaluation systems to gauge the implementation of regional and multilateral trade initiatives as well as impacts. Addressing the tariff regime and services restrictions would be critical. This would entail simplification of import duties and a gradual liberalization of the service sector given its pivotal role in job creation and transfer of knowledge required for the non-oil sector.

✦ Replace inefficient and distortionary non-tariff restrictions with import duties

The distortionary non-tariff measures need to be urgently reviewed and/or phased out. These include: (i) the foreign exchange restrictions on 42 products by the CBN; (ii) review of the import prohibition and absolute import prohibition lists and perhaps replacing these trade policy tools with tariff duties or import quotas; (iii) change in government policy on border closure from partial reopening to the full reopening of closed land borders.

✦ Tackle corruption, address informal leakages and cumbersome customs procedures at the ports

This would require standardisation of procedures, strengthening the e-governance portal towards paperless transactions, and establishing a functional grievance and redress mechanism. There is a need for addressing trade facilitation constraints ranging from cumbersome customs procedures to congested ports. This means that bold reforms are required by the Nigeria Customs Service (NCS) such as the implementation of the E-Customs modernization plan and the National Single Window (NSW) platform. Also, critical reforms would be required to help address port congestions and delays.

✦ Develop an overarching policy measure to improve manufacturing, support export diversification and higher value-added export

There is an urgent need to reduce oil sector dominance, counter-productive waivers and informal leakages that reduce public and private investment in export-oriented sectors. This would also entail addressing supply-side constraints that can unlock diversification from oil to high-value-added agriculture and manufactured products. This could be achieved by creating an enabling environment devoid of discretionary measures by the government such as border closure, foreign exchange restrictions, and import bans.

✦ The CBN should redefine its explicit exchange rate objective

The new objective should be one that positions Nigeria as a competitive economy with regards to present and potential non-oil exports. This objective would value the Naira not just against the dollar but against several other peer and competitor currencies (with the dollar just being one of them).

✦ The CBN will have to tighten monetary policy and raise interest rates to tame inflation

The tightening of monetary policy will have to go hand in hand with its implementation in practice by ensuring the market rates move in tandem with the monetary policy rate. The CBN will have to restore the credibility of the MPR such that bond yields and lending rates are reflective of the MPR and that the MPR is not merely a suggestion.

✦ The CBN should work with the FGN to end the "ways and means" financing

Part of this will involve helping the FGN to properly forecast its revenue as well as helping the FGN, on a technical level, identify potential sources of revenue. A strategy will also need to be developed to manage the current stock of FGN debt at the CBN.

About Agora Policy

Agora Policy is a Nigerian think tank and non-profit committed to finding practical solutions to urgent national challenges. We conduct policy research, facilitate frank and purposeful dialogues, and build capacity for governance, policy and advocacy.

About the IIAPP Project

The Informed, Inclusive and Accountable Public Policies (IIAPP) project is designed to achieve three things: one, to maximise the opportunity provided by the electioneering and transition periods and beyond to sustain attention on and further mainstream transparency, accountability, gender equity and social inclusion into policy and governance discourse in Nigeria; two, to generate original and credible evidence before, during and after the 2023 elections to focus the attention of the country on key policy areas and, ultimately, the adoption of sensible, inclusive and effective policies on key national challenges; and three, to deepen the capacity of state and non-state actors to undertake evidence-driven policy analysis, design, implementation and advocacy. The IIAPP is supported by the MacArthur Foundation.

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