

## **Nigeria: Selected Issues and Statistical Appendix**

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NIGERIA

**Selected Issues and Statistical Appendix**

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June 23, 2004

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## List of Acronyms

bl/d oe	Barrels per day oil equivalent
BMPIU	Budget monitoring and price intelligence unit
BOF	Budget office of the federation
CBN	Central Bank of Nigeria
Cft/d	Cubic feet per day
CMC	Cash management committee
CMU	Cash management unit
COA	Chart of accounts
COMD	Crude oil marketing department
CRF	Consolidated revenue fund
DA	Domestic allocation
DAS	Dutch auction system
DfID	Department for international development
DMO	Debt management office
DPR	Department of petroleum resources
EITI	Extractive industries transparencies initiative
EMCAP	Economic management country assistance program
FCT	Federal capital territory
FIRS	Federal inland revenue service
G8	Group of eight
IFEM	Interbank foreign exchange market
IOC	International oil company
JV	Joint venture
kbd	Thousand barrels per day
MoU	Memorandum of understanding
MW	Megawatt
NAPIMS	National petroleum investment management services
NEEDS	National Economic Empowerment and Development Strategy
NEMCO	National economic management council
NEPA	National electric power agency
NGO	Non-governmental organization
NGTC	Natural gas transportation company
NITEL	Nigeria telecommunications
NLNG	Nigeria liquefied natural gas
NNPC	Nigeria national petroleum corporation
NOC	National oil company
NSWG	National stakeholder working group
OAGF	Office of the accountant general
OHCS	Office of the head of the civil service
PPMC	Pipelines and product marketing company
PPPMC	Petroleum pricing and product marketing committee
PPT	Petroleum profit tax
PSC	Production sharing contract

SBA	Stand-by arrangement
SLGs	State and local governments
ToT	Terms of trade
VAT	Value-added tax
WAGP	West africa gas pipeline



## I. INTRODUCTION

1. This selected issues paper and the statistical appendix provide background information to the staff report on the 2004 Article IV consultation discussions with Nigeria.<sup>1</sup>
2. The staff report discusses an improvement in the prospects for meaningful economic and structural reforms since the 2002 Article IV consultation. It evaluates positively the decisive actions already taken in key areas, and draws attention to the challenges ahead, such as the implementation of the 2004 budget, the strengthening of the process for future budgets, the more rational management of public debt, improvements in transparency and good governance, and exchange market reforms. The topics in this paper support the evaluation of these key challenges in the staff report.

### **A retrospective on policies and performance under Fund-supported programs**

3. The second chapter presents an assessment of past economic reform efforts—in particular the program supported by the 2000-01 Stand-By Arrangement (SBA). At the time, expectations ran high that the emphasis on improved governance as well as stabilization and pro-growth policies would deliver a quick turnaround in economic performance and improved living standards. Yet, macroeconomic performance and reform implementation proved disappointing, notwithstanding some encouraging developments—including higher non-oil GDP growth and the strengthening of the due process underlying the capital budget. As valuable lessons from reviewing performance under the Fund-supported SBA, the chapter highlights the importance of (i) institutional and policy formulation foundations, (ii) broad domestic ownership, (iii) consistent and coordinated formulation and implementation of policies, and (iv) prioritization and sequencing of reforms.

### **Fiscal management capacity—issues and options for reform**

4. The third chapter reviews weaknesses in the current fiscal management framework in Nigeria and proposes reforms to further strengthen the budget process. The main challenges continue to be lowering the consolidated non-oil deficit down to a more sustainable level and reducing the vulnerability of fiscal policy to oil market volatility. This is made harder by weak technical capacity across the three tiers of government, and the federal system, with a large share of the oil revenue allocated to the subnational governments. The chapter reviews shortcomings in the current budget process, including budget preparation and execution, fiscal reporting, and the public expenditure system. It also discusses recent reform efforts to strengthen the budget process.

### **Federal government debt management reforms**

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<sup>1</sup> See Nigeria: Staff Report for the 2004 Article IV Consultation, IMF Country Report, [www.imf.org](http://www.imf.org).

5. Over the past two decades, public debt management in Nigeria has not been effective. It has suffered primarily from the absence of a sound fiscal framework, which has led to excessive debt levels and debt servicing difficulties. The government's large borrowing needs have been poorly managed. The fourth chapter describes weaknesses in the current public debt management framework and the government's reform strategy, and reviews the reform implication and addresses further actions that will be needed to put the government's domestic debt reform strategy on a solid foundation.

6. The chapter points out that the reforms will only be successful and sustainable if accompanied by responsible fiscal and monetary policy. The undersubscription in longer-dated bonds in the October 2003 auction was a good indication that in the absence of credible fiscal and monetary policies, investments in longer-dated fixed income products will be highly unlikely. The reform success will also critically hinge on improving cash management capabilities and coordination between the monetary and fiscal authorities, and improving transparency in fiscal and monetary operations.

### **Improving transparency in the oil sector**

7. Improving transparency and good governance in Nigeria has to start in the oil sector because of its dominance in public revenue and exports. Recognizing this, Nigeria was one of the first oil producing countries to commit to improving transparency in the oil sector under the Extractive Industries Transparency Initiative (EITI). The fifth chapter introduces the EITI, and describes the Nigerian authorities' efforts to operationalize the guidelines of the initiative. It then discusses the challenges the authorities are likely to encounter in making good on their commitment. The chapter argues that making information available according to the EITI guidelines would not be sufficient to fulfill the government's own information requirements. More detailed knowledge of the oil sector is needed for the Nigerian authorities to maintain effective oversight of the oil sector and make informed policy decisions.

### **Exchange rate regime—experiences and options for further reform**

8. Notwithstanding changes in the formal exchange rate regime and supporting institutional structures over the past 20 years, Nigeria's foreign exchange market has been characterized by: (i) a relatively inflexible official nominal exchange rate; and (ii) a high degree of market segmentation. Chapter VI focuses on establishing a market structure that allows for the flexible determination of the exchange rate and unification of the foreign exchange market. The chapter argues that the introduction of the Dutch auction system in July 2002 was, in principle, a step in the right direction. Yet, in practice, the first 18 months of its operation witnessed limited success in facilitating greater market determination, stemming the loss of foreign exchange reserves, and reducing market segmentation.

### **The petroleum products market**

9. One of the most useful and at the same time most difficult reforms undertaken by the new economic team was the removal of subsidies from retail petroleum products. Chapter

VII describes the downstream petroleum sector in Nigeria, starting with the Nigerian National Petroleum Company's (NNPC) refineries, pipelines, and depots; the regulation in the recent past with a de facto import monopoly for the NNPC, fixed retail margins and administered retail prices; and the liberalization steps taken in September 2003, with the government's announcement that retailers were henceforth free to set prices. The chapter describes the economic effects of price fixing in the recent past, and looks ahead at the policies needed for the sector's revival under a new liberal regime.

### **Natural gas prospects**

10. Chapter VIII gives an overview of the natural gas sector in Nigeria with a focus on the impact on government revenue and the balance of payments from existing and planned gas production. It presents the two existing natural gas export projects in detail, following an overview of reserves and production, looks at the impact of the gas sector on government revenue and the balance of payments, and discusses possibilities for expanding the domestic market for natural gas.

## II. A RETROSPECTIVE ON POLICIES AND PERFORMANCE UNDER RECENT FUND-SUPPORTED PROGRAMS<sup>2</sup>

### A. Introduction and Overview

11. **Nigeria has reached an important milestone in its modern political history.** In April 2003, the country achieved the first peaceful transition from one civilian administration to another since its independence. President Obasanjo was sworn in for a second term in May 2003 and announced a final-term commitment to implement far-reaching economic and social reforms, with a view to leaving a restructured, more dynamic Nigerian economy as his fundamental legacy. He subsequently appointed a new team of well-respected economic technocrats, who moved quickly to define and begin implementing a comprehensive reform agenda. Nevertheless, the economic and social challenges facing Nigeria remain daunting, and continued policy implementation will be critical to the prospects for successful reforms. Reform implementation itself will face obstacles in weak institutions, technical capacity constraints and resistance from entrenched interests.

12. **In view of these challenges, an assessment of past economic reform efforts—in particular the program supported by the 2000-01 Stand-By Arrangement (SBA)—is timely.** At the time, expectations that the emphasis on improved governance, stabilization and pro-growth policies could deliver a quick turnaround in economic performance and improved living standards ran high. Yet, policy implementation and economic performance fell well short of expectations. The aim of this paper is to review the economic and institutional reasons behind these disappointing results, with a view to highlighting lessons that could reinforce the prospects for Nigeria's current reform agenda.

13. **The paper is structured as follows.** Section B describes the objectives, monitoring and performance of the program supported by the 2000 SBA. Section C discusses briefly the informal monitoring framework adopted after the SBA was allowed to expire. Section D analyzes reasons for the disappointing economic performance under the Fund-supported program and in the subsequent few years. Section E highlights some conclusions and lessons.

### B. The 2000–01 Stand-By Arrangement

#### Objectives and policies under the SBA

14. **On August 4, 2000, the Executive Board approved a 12-month SBA<sup>3</sup> to support the Federal Government's economic reform program.** After more than a decade of economic mismanagement, weakening of public institutions, and isolation from the international community, the government pledged to bring about a lasting improvement in the country's standard of living through higher economic growth and poverty reduction.

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<sup>2</sup> Prepared by Ulrich Bartsch, Thomas Baunsgaard, Jeanne Gobat, and Karen Ongley.

<sup>3</sup> The program period covered July 2000 through June 2001.

### *Program objectives*

15. **The government's main economic reform objectives were to** (i) maintain macroeconomic stability; (ii) reduce poverty; (iii) rebuild public sector institutions and enhance public service delivery; (iv) improve public sector governance; and (v) privatize the majority of public enterprises, especially in telecommunications and power, to help promote the private sector and remove acute infrastructure bottlenecks. As part of the reforms, the government established a poverty reduction initiative aimed at improving the quality of spending through better transparency, accountability and monitoring of the use of public funds. This was also intended to facilitate a more participatory approach to poverty reduction and provide the basis for an interim poverty reduction strategy paper, which the government intended to complete by end-2000.

### *Fiscal policy*

16. **The fiscal program was aimed principally at achieving the prudent management of windfall gains from projected improvements in Nigeria's terms of trade (ToT).**<sup>4</sup> The projected ToT improvement gave rise to concerns that, in the absence of a stabilization mechanism, higher revenue would ratchet spending up to much higher levels. This carried substantial risks: (i) it threatened macroeconomic stability as higher spending would increase aggregate demand and put pressure on the price of non-tradable; (ii) it would result in a real exchange rate appreciation and undermine the growth prospects of the non-oil economy; and (iii) it would not necessarily address the country's pressing social needs, given the public sector's weak institutional capacity, the economy's limited absorptive capacity and severe infrastructure bottlenecks.

17. **Recognizing these risks, the authorities agreed to an informal fiscal rule under which all oil proceeds in excess of a budgeted oil price of US\$20 per barrel would be saved across all tiers of government.** If the oil price was to fall below US\$20 per barrel, the authorities agreed to review their budget accordingly, although no specific downward adjustments were agreed. However, a formal mechanism through which oil windfall savings at the federal as well as subnational level could be enforced was not put in place. The fiscal targets under the SBA were unfortunately based on the Executive's original budget proposal, with spending levels substantially lower than in the budget that was eventually approved by

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<sup>4</sup> Oil revenue was projected to increase by about 15 percentage points of GDP over the program period.

the National Assembly.<sup>5</sup> The authorities argued that, through effective implementation of due process requirements, they could contain execution of the capital budget substantially below the limits approved by the National Assembly (see Table II-1).<sup>6</sup>

**18. After having agreed with trade unions in May 2000 to double public sector wages, the authorities aimed to limit their budgetary impact by eliminating fraud and overpayment.** As the payroll system was manual, and personnel data had not been updated and verified in a systematic manner, there was considerable room for abuse. To eliminate scope for abuse, the authorities intended to conduct a civil service audit and move to a centralized payroll system.

**19. The authorities also planned to increase the efficiency of public service delivery and improve governance of public resources.** The most important reforms were (i) implementing the due process requirements to strengthen project quality; (ii) introducing value for money audits; (iii) conducting an inventory of domestic arrears; and (iv) adhering to new procurement procedures developed with assistance from the World Bank.

Table II-1. Nigeria: Government budgets and outturns, 1999-2002  
(in percent of GDP, unless otherwise indicated)

	1999	2000			2001			2002		
		Budget	Progr.	Actual	Budget	Staff Proj.	Actual	Budget	Staff Proj.	Actual
Oil price (in U.S. dollars per barrel)	16.6	20.0	20.0	28.1	22.0	25.5	24.3	18.0	25.2	25.0
Total revenue	29.4	36.5	36.5	42.5	36.6	39.8	42.1	32.7	37.5	36.2
Total consolidated expenditure	28.6	38.7	35.4	36.5	44.0	41.4	47.0	40.8	41.9	39.6
Overall balance (cash basis)	0.7	-2.1	1.1	6.0	-7.4	-1.6	-4.9	-8.1	-4.4	-3.5
Financing	-1.9	2.1	-1.1	-6.1	7.4	1.6	5.3	8.1	8.0	5.0
Statistical discrepancy	-1.2	0.0	0.0	-0.1	0.0	0.0	0.4	0.0	0.0	1.4
Memorandum item:										
Non-oil primary balance (in percent of non-oil GDP) 1/	-17.3	-37.0	-30.6	-34.7	-44.1	-37.4	-43.2	-35.7	-35.8	-33.2

Sources: Nigerian authorities; and Fund staff estimates.

1/ Excluding oil revenue, cash call payments, and cash interest payments.

### ***Monetary and exchange rate policies***

**20. The monetary program was aimed at maintaining low inflation, building foreign reserves, and developing further the market-based exchange rate system.** The SBA-supported program aimed at maintaining inflation in single digits in 2000, containing broad money growth in line with nominal income, and increasing net international reserves through government savings of “excess” oil proceeds. The Central Bank of Nigeria (CBN) was only to intervene in the interbank foreign exchange market to smooth excessive

<sup>5</sup> Federal government spending was increased by about 20 percent.

<sup>6</sup> Directors stressed that this was a “second-best” solution (BUFF/00/133, 8/11/00).

fluctuations in the naira/dollar exchange rate,<sup>7</sup> while allowing the naira to depreciate if demand for foreign exchange increased significantly due to a sharp deterioration in the balance of payments.

21. **The program also envisaged actions to strengthen the financial system, mainly by continued efforts to bring the banking system in line with the Basel Core Principles.** In late 1999, staff preliminarily assessed Nigeria's prudential norms to be largely compliant with the intent of the principles, but noted that, in practice, supervisory and enforcement gaps existed, allowing many requirements to be circumvented.

### *Structural reforms*

22. **The government's structural reform agenda was extensive and heavily front-loaded, aimed at improving the environment for private sector-led growth.** Strengthening governance and institution building (including judicial reforms) were seen as essential to removing impediments to economic development.<sup>8</sup> The SBA included legal and institutional reforms to establish and enforce accountability, and the government planned to review its Anti-Money Laundering Act to ensure compliance with international standards.

23. **Establishing more effective sectoral regulatory frameworks—in particular for utilities—and privatizing inefficient public enterprises were also seen as critical to facilitating private sector growth.** Implementing privatization programs had already proved difficult, in part because of capacity constraints. The SBA-supported program, therefore, aimed at reinvigorating the privatization program and regulatory reforms, with the World Bank taking a lead advisory role.

- The sale of public enterprises was to occur in three phases between 1999 and 2001. Smaller entities and those already listed on the Nigerian Stock Exchange were to be privatized in 1999 and 2000 under stages one and two. The sale of larger entities—including the telecommunications companies (NITEL/MTEL), the national power company (NEPA), and oil refineries—were to follow by end-2001 under stage three.
- The authorities committed to conducting privatization in a fair and transparent manner, with minimal infusion of public monies.

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<sup>7</sup> In 1999, the authorities abolished the preferential official rate and the CBN moved to daily sales to the interbank foreign exchange market (IFEM). However, these transactions remained subject to significant constraints. Among others, banks acted solely as agents for their retail customers. Banks were allowed to deal in foreign exchange amongst themselves, but could not use foreign exchange obtained for their customers from the CBN.

<sup>8</sup> Prior to the approval of the SBA-supported program, the government had already taken several measures to improve governance practices—namely the adoption of an anticorruption bill and a comprehensive progress report on the government's anticorruption campaign (including investigations of past abuses).

- The government announced its intention to deregulate domestic petroleum prices.
- The authorities were also encouraged to develop a regulatory framework and body for each of the key sectors: power, telecommunications, and petroleum.

24. **Trade liberalization was another important element of the program, aimed at improving competitiveness and reducing distortions.** Nigeria's trade regime had long been characterized by numerous and high tariff rates, import bans and licensing restrictions. This encouraged smuggling and corruption, and fostered an inefficient import-substituting manufacturing sector. The 2000 budget included an average tariff reduction,<sup>9</sup> and the authorities agreed to comprehensively review the tariff regime by December 2000. This was to provide a basis for further liberalization to meet the government's medium-term goals concerning the Economic Community of West African States (ECOWAS).

#### **Program monitoring and risks**

25. **Program implementation was to be monitored through quarterly performance criteria and benchmarks, and three scheduled program reviews.** The three reviews were to focus, respectively, on program financing, developments in fiscal federalism, and the operation of the Poverty Reduction Fund. Some of the quantitative targets were tailored to reflect Nigeria's particular circumstances and statistical weaknesses. For instance, due to unstable velocity, sharp changes in the money multiplier and lags in the availability of data on monetary aggregates, the monetary program was to be monitored through movements in reserve money rather than CBN's intermediate operational target of broad money. To enhance program monitorability, the authorities also undertook to strengthen reporting of monetary and financial data by the CBN and oil-related data by the NNPC.

26. **The implementation risks were significant, but were most pressing in terms of the budget process, limited technical capacity, rising social pressures, and concerns about ownership.** The change to a civilian government and favorable external conditions were seen as an exceptional window of opportunity, and it was hoped that any small reform successes could help build domestic support. The SBA-supported program also provided a vehicle for channeling donor support and for the government to rebuild its credibility with the international community through a demonstrable track record. However, a SBA-supported program was seen as a means to strengthen the government's hand in pursuing difficult policies. There was concern that, without a program, progress on economic reforms would be less likely, leading to further policy drift.

27. **To help address some of the program risks, substantial international technical support—including that of the IMF, UNDP and other development partners—was**

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<sup>9</sup> The budget implied an average tariff of 12 percent in 2000 (compared to 24 percent in 1999), although effective protection on some goods may have increased.



**planned** to build the government's institutional capacities and capacity for macroeconomic policy formulation and implementation.

- A Fund senior representative was assigned to Nigeria to help monitor program implementation and improve the policy dialogue.
- To help address capacity weaknesses, the authorities created the National Economic Management Council (NEMCO) to coordinate economic policy making within the Executive, liaise with the National Assembly, and monitor the implementation of the government's economic program (including understandings reached with the Fund).<sup>10</sup>
- To promote broader awareness of the issues, Fund staff also met with civil society groups, the National Assembly, and state finance commissioners, to discuss the importance of fiscal prudence.
- The World Bank approved a complementary project to strengthen key aspects of economic management in Nigeria (EMCAP). EMCAP was also envisaged as the vehicle to coordinate other donors' technical assistance efforts into a comprehensive, well-integrated program.

### **Performance under the SBA**

28. **Overall macroeconomic performance and implementation of structural reforms under the SBA-supported program were disappointing.** Serious macroeconomic imbalances emerged during the program period—the fiscal deficit widened, inflation accelerated, and the parallel foreign exchange market premium increased sharply—and many policy understandings were not implemented. Progress on privatization was also slower than expected, and the government continued to support several nonviable enterprises, contrary to understandings reached with the World Bank. Technical support to help build institutional capacity had a limited impact. The authorities missed a majority of the quantitative targets, and failed to implement four of the five structural performance criteria and most structural benchmarks. Cumulatively, this precluded completion of the first review and, with continued poor performance, the SBA was allowed to expire.

### ***Fiscal policy***

29. **There were substantial deviations from the fiscal program early on:** the excess oil proceeds were not saved; the limit on borrowing by the federal government was missed; and warrants were issued at the federal level without cash backing. Under strong pressure from the civil service, the government rolled back its earlier decision to centralize wage payments.

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<sup>10</sup> NEMCO was to be chaired by the president, with the vice president serving as alternate, and members included the Minister of Finance, the Minister of National Planning, the Special Advisor to the President on Petroleum, the Governor of CBN, the Secretary to the Government, and other key economic policy makers.

The lack of central oversight and control, along with widespread payments to “ghost” workers and other payroll abuses, resulted in substantial overruns on personnel costs and a much higher wage bill than budgeted. The authorities were only able to partially offset this through lower capital budget execution, by strengthened project review and enhanced compliance with the due process requirements recommended by the World Bank.

30. **The fiscal program was further compromised by the spending of the windfall at the subnational level, and pressures from the National Assembly.** The ability of the federal government to prudently manage oil windfalls became more challenging, given the fiscal federalism constraints set by the 1999 Constitution.<sup>11</sup> Furthermore, the National Assembly was very critical of the nonimplementation of the budget it had approved and the authorities were unable to withstand heavy political pressure to implement further budgetary amendments by the National Assembly.

#### *Monetary and exchange rate policy*

31. **The procyclical fiscal stance undermined the implementation of the monetary program.** While the CBN was able to partially offset the expansionary fiscal policy of the federal and state governments, it tightened its stance too little and too late to forestall inflationary pressures.<sup>12</sup> Political interference on interest rate policy further complicated monetary management.

32. **The expansionary fiscal stance also contributed to pressures in the foreign exchange market.** In response, the CBN reverted to the system of selling foreign exchange at a predetermined price rather than allowing the rate to be market-determined. As a result, the differential between the official and parallel exchange rates widened substantially, and the official exchange rate appreciated in real terms. The CBN’s foreign exchange management included some administrative measures that gave rise to a multiple currency practice.<sup>13</sup>

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<sup>11</sup> The Supreme Court ruled that the federal government could not retain revenue destined for the subnational governments.

<sup>12</sup> The CBN was concerned about the impact of high interest rates on the real economy and the already weak banking system.

<sup>13</sup> With excessive fiscal spending spilling over to the foreign exchange market, the CBN reverted to the system of selling foreign exchange in the IFEM at a predetermined rate. The IFEM and the “open” interbank market (in which banks trade freely amongst themselves) segmented, giving rise to a multiple currency practice. The two markets were merged in December 2000, but transferability of IFEM funds was prohibited again in February 2001.

### *Structural reforms*

33. **Many planned structural reforms were not undertaken, and the government's privatization program experienced several setbacks.** By mid-2001, stage one of the privatization program was largely completed and important progress had been made toward stage two. However, progress was more limited in the strategic sectors. Most difficulty seemed to have been encountered in improving the legal and regulatory frameworks, and NITEL, NEPA, Nigerian Airways, and the oil refineries were not privatized as scheduled. Government spending policies were at odds with the intention to increase private participation in the economy, with a large share of the budget continuing to be allocated toward rehabilitating commercially unviable plants and companies of inefficient parastatals. These actions also conflicted with understandings reached with the World Bank. Measures to improve governance and plans to review the tariff regime stalled, and, under pressure from labor unions, the government rolled back its decision to remove the petroleum subsidy and deregulate downstream petroleum.

### **C. Informal Monitoring Framework**

34. **Following expiration of the SBA, the government's key priority was to correct policy slippages and establish the basis for a medium-term program for growth and poverty reduction.** Staff and the authorities agreed on an informal monitoring framework<sup>14</sup> aimed at restoring macroeconomic stability by (i) establishing fiscal discipline by cutting expenditure sharply in the final quarter of 2001 and implementing a prudent 2002 budget;<sup>15</sup> (ii) tightening monetary policy; (iii) restoring a market-based foreign exchange system and narrowing the parallel market premium to less than 10 percent; and (iv) maintaining a healthy external reserve position by reducing daily sales of foreign exchange.

35. **Some progress was achieved in beginning to restore macroeconomic stability, but ultimately performance under the informal monitoring program was similarly disappointing.** Inflation was kept somewhat in check with a favorable harvest and reasonably tight underlying liquidity conditions, reflected in positive real interest rates and exchange rate stability. Overall federal government spending declined in late 2001, with some improved control over capital spending. However, these improvements fell short of expectations, and spending and monetary aggregates continued to exceed agreed targets.

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<sup>14</sup> This was neither a staff-monitored program nor formal Fund arrangement, but a more loosely defined framework for monitoring economic performance.

<sup>15</sup> As a means to tighten control over capital spending, the authorities lowered the threshold for payments requiring certification by the Budget Monitoring and Price Intelligence Unit (BMPIU) to N100 million at end-2001, and then to N1 million in January 2002. Payments to contractors would also be contingent on both the BMPIU and the spending ministry certifying the satisfactory completion of the work. The government also committed to publish in full value-for-money audits of expenditures incurred in the second half of 2000.

Macroeconomic imbalances widened further and international reserves declined sharply, despite high oil prices. The 2002 budget ratified by the National Assembly during the monitoring period was more expansionary than that proposed by the Executive, and not consistent with what was required to restore macroeconomic stability.

36. **The government decided in 2002 to cease informal monitoring.** They considered it imprudent to commit to policies that could prove difficult to implement, particularly in light of the upcoming presidential elections. Fund staff also did not see a basis for continued informal monitoring, given the fundamental weaknesses in policy implementation.

#### **D. Reasons for Program Failure and the Lack of Progress with Reforms**

37. **The government's reform efforts and ability to meet program commitments were compromised by a lack of domestic ownership and support (both political and social), as well as institutional weaknesses for formulating, executing and monitoring economic policies.** Moreover, support for reforms that did not immediately bear fruit was easily undermined, given elevated expectations for dramatic social and economic improvements following the return to a more democratic society and the support of the international community (the "democracy dividend").

#### ***Institutional and programming weaknesses***

38. **In retrospect, the foundations necessary to implement economic reforms in a consistent and sustained way were not in place.** Both the authorities and international community (including the Fund) underestimated the depth of legal, political and institutional constraints—including resistance by vested domestic interest groups and the erosion of civil service morale—and therefore the time needed to implement reform. In large part, this reflected more than 20 years of military misrule, gross mismanagement of public resources, virtual destruction of the civil service and public institutions, and complete disregard for the importance of sound institutions and the rule of law. Hence, the sense of urgency and implied rapid progress on all fronts (including conditions under the SBA) did not give sufficient regard to capacity and ownership, and, in turn, the appropriate sequencing of reforms.

39. **Domestic ownership of the reform agenda was not sufficiently entrenched or broad-based; in particular, it did not have the full backing of the National Assembly.** The importance of macroeconomic stability was not sufficiently engrained in the political process. Progress, particularly in restricting the level and increasing the efficiency of expenditure, thus became more difficult. Moreover, the public did not have a clear understanding of the role of the Fund, and some perceived it as debt collector for the Paris Club. Further, public pressure for more spending on decaying infrastructure and pressing social needs was mounting, and labor unions began emerging as an effective and vocal force

in challenging government policies.<sup>16</sup> All in all, this made it more difficult for the government to commit to a prudent fiscal framework.

40. **Significant weaknesses in economic statistics made it difficult to set meaningful program targets and impeded monitoring.** The key data problems that hampered monitoring included the absence of a central unit responsible for collating data; general poor quality data; considerable lags in data publication; and lack of data sharing among responsible government agencies.

*Policy coordination weaknesses*

41. **Weaknesses in the framework governing macroeconomic management and policy coordination were also evident.** Aside from the lack of data sharing, policy making proved to be highly fragmented. This was further undermined by lack of leadership to ensure the regular review of consistency between fiscal, monetary and exchange rate policies, and program international reserves targets. Performance was compromised on a number of levels:

- **The stand-off between the Executive and Legislature over the budget also rendered the understandings reached under the SBA difficult to implement.** The authorities' intention to hold spending below the levels approved by the National Assembly—and the Fund's programmed support of this—proved to be highly problematic, raising legal issues and further fueling tensions between the government and the National Assembly.
- **The devolution of substantial budgetary power to state and local governments (SLGs)<sup>17</sup> under the 1999 Constitution also complicated the federal government's ability to control consolidated spending and meet program targets.** There was no formal legal mechanism or binding agreement to help coordinate policy at all levels of government. The federal government was unable to manage or influence the resources distributed to the subnational level, and the authorities failed in their attempts to reach understandings with the SLGs to restrain spending and design budgets to sterilize a significant part of their oil windfall gains. Little progress was also made in establishing accountability and financial reporting requirements of the SLGs.
- **General weaknesses in the budget process and Budget Office of the Federation (BOF) resulted in significant breaches in spending procedures by line ministries (such as issuance of warrants without cash backing), wage bill overruns, and an inability to complete the civil service audit.** The BOF had neither the institutional mandate nor

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<sup>16</sup> In particular, the government's attempts to increase the retail price for fuel were successfully thwarted by strikes coordinated by labor unions.

<sup>17</sup> General weaknesses in public expenditure management and control at the subnational level was compounded by pent-up spending needs following decades of underfunding.

professional staff to formulate a realistic budget consistent with an overall macroeconomic framework and effectively enforce expenditure limits for line ministries. The line ministries' budgets, as a consequence, were allowed to increase without consideration for the impact on public finances and the macroeconomic framework. Estimated personnel costs also proved to be unrealistic, failing to reflect actual staff, pension costs, and outstanding arrears.

- **Fiscal reporting and analysis also proved inadequate**, severely handicapping the authorities' ability to react in a timely fashion to divergent fiscal developments. There was no regular monitoring of monthly revenue and expenditures, and considerable lags in submitting information to the Accountant General's office. The manual, decentralized accounting system slowed the flow of information, and the authorities found it difficult to derive and monitor their overall financial position. Moreover, the absence of regular fiscal reports undermined fiscal transparency and added to the distrust between the National Assembly and the Executive.

### *Economic policy weaknesses*

42. **The expansionary fiscal policy also made it difficult to maintain price stability**, particularly given the dominance of the public sector. The effectiveness of monetary policy in sterilizing excess liquidity from expansionary fiscal operations was also limited by poorly developed and shallow financial markets, and the absence of sterilization instruments. Furthermore, poor coordination on budget execution led to frequent unwarranted "liquidity surprises", which the CBN found difficult to unwind. The CBN's lack of operational independence—exemplified by the practice of granting quasi-automatic extensions of the overdraft facility at end-year<sup>18</sup>—allowed for significant monetization of the fiscal deficit and infringed on the CBN's ability to control money. Weak banks and political constraints also precluded a more aggressive interest rate policy by the CBN by threatening a worsening of banks' bad debt problems. Finally, inflexible and inconsistent exchange rate policies led to distortions—visible in the widening parallel market spread—and made it more difficult for the economy to respond to the oil-driven demand shock.

## **E. Conclusion and Lessons**

43. **Macroeconomic performance and reform implementation under the Fund-supported program, and beyond, proved disappointing.** The high expectations of return to civilian rule were not fulfilled. Difficulties with policy formulation and implementation were a root cause for the poor performance: macroeconomic stability was compromised by a weak budget formulation process and weak expenditure control at all levels of government,

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<sup>18</sup> The statutory limit on the government's overdraft facility with the CBN is set at 12½ percent of current-year expected revenue. Typically the government clears the year-end balance through issuing 91-day treasury bills in the primary market, with the majority purchased by the CBN.

and the sharp increase in government spending undermined price stability. Underlying this were weak institutions, limited technical capacity, and resistance from entrenched interests. Progress on the structural reform agenda was also slower than planned (the government continued to support several nonviable enterprises), and what limited progress was made was often unwound (e.g., reversion to an administered exchange rate).

44. **In retrospect, the minimum foundations necessary to implement economic reforms were not in place.** The authorities and international community underestimated the depth of the constraints, including the quality and morale of the public service. The changes introduced with the transition to civilian rule in 1999, including the move to fiscal federalism, created new realities that were not easy to assess, because the post-independence history of Nigeria—characterized by military dictatorships—offered no basis for comparison. Some valuable lessons can be drawn from reviewing performance under the SBA and the subsequent staff monitoring:

- **Broad domestic ownership.** Economic performance was compromised by the absence of strong domestic ownership of, and commitment to, economic reforms. The importance of macroeconomic stability to economic growth was not broadly endorsed. The new-found fiscal and political freedom for SLGs, and the confrontational rather than collaborative relationship between the Executive and the National Assembly, also complicated fiscal management and stabilization efforts. The latter was particularly evident in the formulation and approval of the federal budget, which led to large increases in spending limits.
- **Consistent and coordinated formulation and implementation of policies.** Weaknesses in the government’s ability to formulate and implement consistent economic policies undermined economic performance. Significant weaknesses in Nigeria’s economic statistics—reflecting decades of underfunding and disregard for data gathering and analysis—impeded timely and accurate monitoring of developments and performance.
- **Prioritization and sequencing of reforms.** In many respects, the structural and institutional reform agenda under the SBA was very demanding and lacked sufficient attention to capacity constraints and sequencing. This stretched the already limited capacity, with many reforms on parallel tracks. While the planned reforms were, and remain, significant to improving Nigeria’s economic efficiency, there was not sufficient regard for the relative macroeconomic importance of reforms and the time likely needed to garner the necessary skills and/or support.<sup>19</sup>

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<sup>19</sup> Arguably, the structural conditions went beyond what might be considered ideal under the subsequently introduced guidelines for streamlining structural conditionality (subject to the extent of the World Bank’s involvement and conditions in areas of overlap).

45. **In many respects, the authorities have recognized these challenges and embarked on a new approach to policy formulation and implementation.** The National Economic Empowerment and Development Strategy (NEEDS) is wide-ranging in scope, but focused on macroeconomic stabilization and management, economic efficiency, transparency and accountability. It aims at establishing the key institutional building blocks for the effective implementation of macroeconomic and structural policies.

46. **A significant step in the right direction has been accomplished with the formulation of the 2004 budget.** The introduction of a formal oil price-based fiscal rule for saving the oil windfall, as well as measures to strengthen the budget process signal a change to past policy formulation. Efforts are also under way to enhance policy coordination among ministries and government agencies to ensure consistency of policy implementation. With a view to building broad-based domestic support, the authorities are taking a consultative approach with both the National Assembly and the SLGs in the budget formulation process, to ensure broad consistency of the approved budget with the authorities' fiscal targets, and more broadly with the public on NEEDS. Reforms have been initiated to strengthen the statistical system and transparency of government policies. The authorities are also trying to balance the desire for "quick wins" to build reform momentum, against the need for reforms to be done selectively with careful prioritization and sequencing in order to avoid overstressing administrative capacity.



### III. FISCAL MANAGEMENT CAPACITY—ISSUES AND REFORM AGENDA<sup>20</sup>

47. The capacity for fiscal management in Nigeria is a key concern for the economic team as it aims at bringing the non-oil deficit down to a more sustainable level, reducing the vulnerability of public finances to oil market volatility and enhancing effectiveness of public spending. There are two main constraints on fiscal management. First, despite the appointment of very capable people to critical positions in key ministries, the technical capacity remains weak across the federal government. This is partly due to capacity constraints and skills mismatches in the civil service, and partly as a legacy of the strings of military dictatorships that have contributed to undermining the integrity of the civil service. Second, a large revenue coparticipation by state and local governments limits the federal government's control on fiscal policy, particularly in light of volatile oil revenue. This was the result of a decentralization process triggered by the democratic transition starting in 1999, a process that was not supported by mechanisms for sharing information and coordinating policies across the three tiers of government.<sup>21</sup>

48. In the last year, there has been an increased emphasis in the identification of weaknesses in the federal government budget process and the implementation of reforms in that area. Substantial technical assistance has been provided by the World Bank and the Fund. Important guidelines have been established to improve the process underlying the formulation, presentation, and implementation and monitoring of the 2004 budget. A well-functioning budget process at the federal government level should, in turn, promote reforms at other levels of government, and allow for an effective fiscal policy management. In this context, the authorities are formulating a fiscal responsibility bill to improve the fiscal framework across all tiers of government.

49. This chapter focuses on the current state of the federal government's budget preparation, budget execution, fiscal reporting, payroll management, and expenditure arrears. It describes the main problems in those areas, the improvements introduced in the last year, and the agenda for future reform. This chapter also proposes ways to strengthen operational aspects of the fiscal federalism system, taking into account the available information's suggestion that state and local governments face similar structural problems in the different stages of their budget processes.

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<sup>20</sup> Prepared by Thomas Baunsgaard and updated by Mauricio Villafuerte. This chapter draws on the recent FAD Country Strategy Brief for Nigeria, various technical assistance (TA) reports prepared by FAD, the World Bank Public Expenditure Review, as well as the Phillips Commission report on the budget process. It has been updated based on recent developments.

<sup>21</sup> For a detailed description of the federal system and intergovernmental finances in Nigeria, see Nigeria: Selected Issues and Statistical Appendix, IMF Country Report No. 03/60, [www.imf.org](http://www.imf.org).

## A. Budget Preparation

### Issues

50. Weaknesses in the formulation of the federal budget have traditionally included (i) a fragmented budget process without clear leadership from a single institution; (ii) technical capacity constraints in the BOF in the preparation of the executive budget proposal; and (iii) frictions in the budget approval process.

51. The 2003 budget preparation, as in previous years, was plagued by those problems, and reflected the bargaining nature of the process. Whereas the BOF originally maintained a quite cautious position in setting spending limits for line ministries/agencies—perhaps even unrealistically so—these were subsequently negotiated upwards (Table III-1). During the budget debate in the National Assembly, amendments were introduced to the proposed budget, leading not only to resource reallocations but also to a sizeable increase in the aggregate expenditure level that was not matched by an increase in revenue. The approved budget was only enacted by the president in midyear, and even then the Executive saw it necessary to introduce a supplementary budget in November, further adding to spending pressure late in the year.

Table III-1. Nigeria: 2003 Federal Government Expenditure <sup>1/</sup>

	Call Circular	Executive Proposal	National Assembly	Supplementary bill <sup>2/</sup>
(In billions of naira)				
Total federal government	1,572.6	1,487.0	1,679.3	278.4
Current expenditure	540.3	508.8	576.1	195.2
Primary expenditure	390.3	434.8	502.1	96.2
Domestic debt service	150.0	74.0	74.0	99.0
Capital expenditure	310.4	256.4	374.6	83.3
Other	721.9	721.9	728.6	0.0
(In percent of GDP)				
Total federal government	20.8	19.7	22.3	3.7
Current expenditure	7.2	6.7	7.6	2.6
Primary expenditure	5.2	5.8	6.7	1.3
Domestic debt service	2.0	1.0	1.0	1.3
Capital expenditure	4.1	3.4	5.0	1.1
Other	9.6	9.6	9.7	0.0
Memorandum item:				
Nominal GDP	7,545	7,545	7,545	7,545

1/ The federal government budget definition. Other expenditure includes external debt service and transfers to the NNPC, the Judiciary and the F.C.T.

2/ Supplementary bill passed in November 2003.

*Fragmentation of the budget process and assessment of budget proposals*

52. Specific problems in these areas identified in previous reports include the following:

- Fragmentation of the budget process across many institutions in the federal government, without clear guidelines, and a single entity assuming main responsibility and oversight of the process. For example, the manpower budget has usually been determined by the Office of the Head of the Civil Service (OHCS), without taking into account the budgetary implications or constraints. In recent years there has been, in principle, an official freeze on new hiring, although in reality this appears not to have been complied with, particularly for lower-level positions. The estimate of personnel cost is very weak and it may not reflect consistently the actual number of staff, pension costs, and outstanding liabilities in the form of wage and pension arrears.
- A dual budget process for recurrent and capital spending. The capital budget is formulated without taking into account the associated recurrent expenditure obligations. Moreover, a large part of the capital budget presently consists of rehabilitation or equipment purchase that may be more meaningfully accounted as being of a recurrent nature. Even if the quality of the capital budget has been strengthened through the due process requirement, it has not been clear how well this has been integrated into the formulation stage of the budget (e.g., by terminating projects that have failed the due process).
- Weak capacity of the BOF to assess line ministry budget proposals and to enforce expenditure limits set in the budget circular when formulating the budget. This has been partly a consequence of insufficient information on the spending programs of line ministries, but it also has reflected a mismatch between skills required and those available, as well as the need for appropriate training of staff in the BOF. In addition, the inadequate classification of expenditure in the budget, and the inability to map this against actual spending, makes it difficult to assess the budget proposals.
- The projection of domestic debt service costs is not always realistic nor consistent with the macro-implications of the budget, in particular following changes to overall expenditure (and financing) levels.

53. Starting with the 2004 budget formulation process, and following recommendations from a joint World Bank – FAD technical assistance mission in August 2003, the authorities have undertaken several reforms aimed at strengthening the budget process and the role of the BOF as leader of the budget formulation process. The main reforms include the following:

- The hiring of qualified professionals to upgrade the BOF capacity.

- Preparation, for the first time, of a fiscal strategy paper that specified priorities and realistic macroeconomic assumptions, and facilitated discussions on trade-offs and priorities during the formulation of the budget.
- Specification of indicative capital budget ceilings within the fiscal strategy paper to help rationalize and streamline capital projects.
- Publication of a budget overview booklet. The budget document included the corresponding 2003 budget allocations (but not actual spending).
- Early interaction with the National Assembly to avoid delays in the process and reduce the risk of unrealistic budgets.
- Design by OAGF of a new chart of accounts (COA) and harmonization of the budget classification with the new COA. The new budget classification will impose more detailed information both at the recurrent and capital project levels. The capital budget for 2005 will not be a single line item as in 2004: it will be broken into controlled allotment for salaries (if any), recurrent spending and types of capital expenditures. In addition, for budget monitoring and reporting, detailed line item recording will be mandatory for all controlled allotments (i.e., if the current component of a capital budget is used, the transaction must show the economic line items such as travel, materials, training, etc).

### ***Budget approval process***

54. Perhaps not surprisingly, given the very limited role played by the National Assembly during the years of military rule, the roles and responsibilities of the Executive vis-à-vis the Legislature have been evolving during the democratic transition starting in 1999. The budget approval process has become a key issue in this regard, reflecting an unclear division of responsibilities between the Executive and the Legislature. The outcome has been a budget approval process with few safeguards, leaving the budget susceptible to capture by vested interest, and with little consideration of the aggregate, allocative, and macroeconomic impact of amending the expenditure proposals during the approval process.

- Whereas the 1999 Constitution tasks the Executive with responsibility for preparing estimates of the revenue and expenditure programs of the federation for the approval of the National Assembly, it is less clear on the role of the latter. During the last few years, rather than only approving changes to the expenditure allocation within the budget, the National Assembly has introduced substantial revisions to the revenue and expenditure aggregates with macroeconomic consequences.
- The legal framework for the budget is provided by the 1958 Finance Act (and subsequent regulations), which is in need of updating. However, it is important that this is done as part of a broader budget reform strategy.

- In addition to the normal budgetary process, during recent years, there have been several supplementary budgets (albeit this is an improvement over the widespread recourse to extrabudgetary expenditure during the military regimes).

## **Recommendations**

55. The economic team has started an important budget reform process spearheaded by the BOF. Given the challenge ahead, strengthening the budget preparation process requires sustained reforms in several key areas. In the short term, (i) the budget formulation process should start earlier under a clearly specified timetable; (ii) the 2005 budget circular should be strengthened by including more transparent line ministry expenditure limits endorsed by the Federal Executive Council, comparable information on actual spending and the request for line ministry budgets at the line item level for recurrent expenditures and at the controlled allotment level for capital; (iii) the capital budget could be strengthened by being more carefully scrutinized, following the due process procedures, to eliminate nonpriority projects; (iv) the “due process” procedures to be applied in the 2005 budget should be fully documented and centralized at the BOF, to allow their fullest integration into the budget process; (v) the technical capacity of the BOF should continue to be strengthened; and (vi) implementation of the new budget classification in line with the new chart of accounts.

56. In the medium term, (i) the government should integrate the recurrent and capital budget processes and replace the dual budget structure by a fully consolidated budget; (ii) the legal framework for the budget could be strengthened by introducing a clearer determination of roles and responsibilities in the approval process; and (iii) it would be desirable to move toward introducing a medium-term expenditure framework, eventually presenting the budget on a programmatic basis with clearly defined outputs.

## **B. Budget Execution**

### **Issues**

57. The execution of the budget and the reporting of fiscal data have improved lately, reflecting the implementation of budget automation reforms in the Office of the Accountant General of the Federation (OAGF). Yet, continued efforts are required to strengthen coordination of budget implementation among key players and overcome weaknesses in cash management. The authorities are taking steps to improve the coordination between the BOF and the OAGF. The recent establishment of a high-level Cash Management Committee, chaired by the Minister of Finance, has been effective in focusing attention on the importance of improving the cash management function of matching cash availability with needs. However, this will need to be supported by improvements at the technical level, particularly in the Cash Management (CMU) Unit in the OAGF, to enable it to fully perform its core function. As effective cash management is important to minimize the cost of borrowing to the federal government, it is also a critical component of sound domestic debt management.

### ***Coordination of budget execution***

58. During the last two years, much attention has been given to strengthening the coordination among the BOF, the OAGF and the Central Bank of Nigeria (CBN) when executing the budget. In principle, the process for authorizing and releasing budgetary funds has appropriate checks and balances. The BOF issues quarterly warrants based on the approved Appropriation Bill; the OAGF, based on the warrants issued, approves monthly mandates; and the CBN, based on mandates issued, releases cash into the line ministry/agency commercial bank accounts (for recurrent expenditure) or in the line ministry project accounts in the CBN (for capital projects). In practice, there are weaknesses in coordination that complicate the execution of the budget.

- The authorities have appropriately focused on developing closer cooperation between the BOF and the OAGF. In particular, to ensure that the BOF is guided by quarterly projections for cash availability from the CMU (located in the OAGF) when it issues warrants.
- In addition to warrants, the BOF also issues authorities to incur expenditure (AIEs) to line ministries and agencies, thus creating unnecessary duplication of spending instruments, and in the process, complicating the recording of expenditures.
- At times, there are lags between a mandate being issued by the OAGF and cash being released by the CBN, and between the issuance of warrants and mandates.
- Line ministries have lacked adequate information on the availability of resources for executing their expenditure policies.

59. With the assistance of the FAD resident technical assistance expert, a computerized system for keeping track of warrants, mandates, and cash releases has been developed in the OAGF. An automated system for recording transactions in the Consolidated Revenue Fund (CRF) account and reconciling the records with CBN banking statements is also now operational. Work is ongoing to implement a computerized cash book/vote book system in selected pilot ministries. It is now critical to (i) ensure that the data input on warrants, mandates, and cash releases are kept up-to-date; (ii) provide for close monitoring of the data flow to the automated CRF system; and (iii) circulate regular reports on the reconciliation exercise particularly to the Cash Management Committee.

### ***Cash management***

60. The implementation of the budget takes place within a larger macroeconomic context considering the overall fiscal stance and drawing on key information on resource availability from agencies such as the Nigerian National Petroleum Corporation (NNPC) and the Federal Inland Revenue Service (FIRS). Institutional coordination should be facilitated by the recently established Cash Management Committee chaired by the Minister of Finance and which includes senior representatives from CBN, OAGF, BOF, and the Debt Management

Office (DMO). The high-level committee relies on inputs from the OAGF and the BOF to facilitate smooth cash management by matching cash availability and needs as the budget is implemented. The establishment of the CMU in the OAGF was a positive development, and starting in 2004, it has begun to prepare quarterly cash flow projections broken down by month, but they are still rather mechanical and derived by prorating budget estimates.

- More progress could be made in improving the seasonality assumptions underpinning the annual, quarterly, and monthly cash plans used by the BOF when issuing warrants, and for the OAGF when issuing mandates.
- The regularity of the reporting of banking data could be improved, to allow the CMU to monitor on a monthly basis the balances of line ministry/agency bank accounts with the CBN and commercial banks. This is important for determining the additional cash needs of line ministries.
- A regular process of forecasting and preparing annual and rolling monthly cash plans, as well as utilizing these plans for budget execution and debt management, has to be developed. Further, it is also necessary to forecast and prepare cash flow projections for the federation account's inflows and outflows, since this account is the main source of revenue of the federal government.

### ***Rationalizing the use of cash resources in the banking system***

61. Even with well-formulated cash plans and projections for the availability of cash resources, budget implementation is complicated by the large number of government accounts. One consequence of this is that idle funds continue to exist in bank accounts, even as the government routinely borrows from its ways-and-means access at the CBN.

62. Line ministries and agencies tend to maintain large unused cash balances in their accounts in both the CBN and in commercial banks (Table III-2). In the CBN, the problem relates to the balances accumulated on the line ministries/agencies capital project accounts. In commercial banks, it relates to line ministries/agencies maintaining large balances in their current accounts. Some unused balances on the recurrent accounts have been remitted to the CRF account at end-year, in compliance with the budget regulations. However, many parastatals seemingly apply different policies for retaining funding for recurrent expenditure.

63. The current banking arrangements and cash management practice give rise to the simultaneous need for the federal government to tap into ways-and-means advances, or seek other financing, while large unused cash balances are maintained in line ministry/agency bank accounts. To rationalize the use of cash resources, a desirable reform would be the introduction of a treasury single account. The authorities have expressed concern that this would be premature at present, and instead are in the process of implementing a central capital account where all line ministry capital accounts will be maintained. The consolidated

Table III-2. Nigeria: Federal Government Deposits in the Banking System <sup>1/</sup>

	2001				2002				2003			
	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
	(In billions of naira)											
Total deposits	880.6	954.5	988.8	924.1	803.5	720.6	623.3	626.3	547.0	313.9	279.1	355.6
Deposits in the CBN	800.5	868.9	930.2	895.8	771.5	661.9	536.5	573.7	486.9	248.9	228.6	275.8
Capital projects	115.8	81.8	130.6	164.1	104.2	110.4	79.6	58.2	58.7	38.1	31.9	42.6
Other accounts	684.6	787.1	799.6	731.7	667.3	551.5	456.9	515.5	428.2	210.8	196.7	233.2
Deposits in commercial bank:	80.1	85.7	58.6	28.3	32.0	58.7	86.8	52.6	60.0	65.1	50.5	79.8

Sources: Central Bank of Nigeria; IMF staff estimates.

1/ Stock reported at the end of each quarter.

available balance in the capital accounts would then be counted as part of the consolidated federal government bank balance in order to avoid additional interest on ways-an-means financing.<sup>22</sup>

## Recommendations

64. Strengthening cash management in Nigeria will require reforms in several key areas. In the short term, (i) develop cash planning, based in the CMU of the OAGF; (ii) maintain recent efforts to strengthen the record keeping and reconciliation of warrants, mandates, and cash releases; and (iii) bring down unused cash balances in the line ministry/agency bank accounts, and in general rationalize the banking arrangements. In the medium term, it would be desirable to move toward introducing a treasury single account, but the interim arrangements the OAGF has been pursuing until such point in time will be helpful. In particular, the OAGF and the CBN should agree on the operational arrangements of the central capital account.

## C. Fiscal Reporting

### Issues

65. The reporting of fiscal data is still quite fragmented with no agency taking a lead role in presenting timely fiscal data in an accessible format to policymakers. The quality of the fiscal data is also poor, partly as there is insufficient reconciliation of expenditure records with banking data, and information on domestic expenditure arrears is inadequate.

<sup>22</sup> The creation of a central capital account was necessary, as the CBN did not recognize the line ministry capital accounts as being under the control of the federal government.



### ***Fiscal reports to policymakers***

66. The ability for policymakers to take informed decisions is constrained by the poor availability of timely and relevant information on budget execution. The BOF has an important role to play in filtering and presenting fiscal information targeted at the needs of policymakers. However, there is currently no regular preparation of fiscal management reports to the Minister of Finance, to the Federal Executive Council, or to the National Assembly.

67. The reporting of fiscal data is quite fragmented with no agency taking an appropriate lead role presenting fiscal data in an accessible format. In other countries, this function is typically the responsibility of the finance ministry. In the absence so far of the BOF fulfilling this role in Nigeria, various agencies have been reporting scattered pieces of information, without consolidating this in an accessible management report. The OAGF presents key data on the CRF and federation account transactions. It also collects monthly expenditure returns (transcripts) from line ministries and agencies, albeit these are not subsequently collated and aggregated in a timely fashion. Other important providers of fiscal data are the NNPC, customs and FIRS (on revenue); the Debt Office (on debt service); and the CBN (on monetary financing).

### ***Reported expenditure data***

68. The fiscal reporting system relies on tracking the release of funds to line ministries and agencies, rather than how the funds are ultimately spent. This is common practice in many countries to ensure timely fiscal data for monitoring purposes. However, it is important to supplement this information with data on actual expenditure reported ex post by line ministries and agencies. Already, line ministries and agencies are required to report on a monthly basis a summary of transactions recorded in their cashbook (the transcript). In addition, major spending ministries have been asked to develop performance indicators to be reported regularly. These reports could be strengthened and the information better utilized.

- The timeliness, coverage and quality of the monthly transcripts from line ministries and agencies are often inadequate.
- The OAGF uses the monthly transcripts as a basis for preparing the annual reports on federal government operations, but in the interim, the returns could be aggregated and used as a basis for a monthly expenditure report supplementing the information on cash releases.
- The format of the returns could be strengthened, for example by including a column on the stock of unpaid overdue bills.

- The manpower budget is formulated with little regard for the fiscal cost to the budget, as appears to be the wage and remuneration policy.<sup>23</sup> There is very little coordination between key players, including the BOF, OHCS, and the Federal Civil Service Commission.

### ***Reconciliation of fiscal data***

69. The quality of the reported fiscal data is affected by the inadequate reconciliation of expenditure and banking data. Line ministries and agencies are required to reconcile their cash book with their bank statements on a monthly basis. While the OAGF reconciles its records of transactions in the CRF with the CBN bank statements, there is less assurance that bank reconciliation is currently satisfactorily carried out in line ministries and agencies, which would affect the quality of the fiscal data reported.

### **Recommendations**

70. Strengthening fiscal reporting at the federal government level will require a number of reforms. In the short term, (i) it would be desirable for the BOF to take a more proactive role in monitoring implementation of the budget, using data reported by other agencies, primarily the OAGF, NNPC and FIRS; (ii) the OAGF should continue efforts to strengthen the timeliness, coverage and accuracy of the expenditure data in the monthly transcripts from line ministries and agencies; (iii) the reconciliation of fiscal data should be strengthened at several stages in the fiscal reporting cycle, particularly at the line ministry level; and, (iv) design a system of regular reporting of fiscal information.

71. In the medium term, (i) the system of regular and timely reporting of fiscal information should be fully operational; (ii) the government accounts should be published on a quarterly or monthly basis; and (iii) these reporting requirements should be extended to parastatals.

## **D. Payroll Management**

### **Issues**

72. The wage bill is a major charge on the federal government budget, yet there is inadequate central control and oversight over it. Total personnel and pension costs amount to one-third of the recurrent federal government budget. Typically, the payroll can be expected to be relatively stable from month-to-month; that has not always been the case in Nigeria

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<sup>23</sup> For example, in June 2003 the presidentially appointed Committee on the Monetisation of Fringe Benefits in the Public Service of the Federation recommended an extension of monetized benefits across the public sector employees without assessing the financial implications.

(Table III-3) reflecting the occasional clearance of arrears and, possibly, funding irregularities.

- The manpower budget is formulated with little regard for the fiscal cost to the budget, as appears to be the wage and remuneration policy.<sup>24</sup> There is very little coordination between key players, including the BOF, OHCS, and the Federal Civil Service Commission.

Table III-3. Nigeria: Cash Releases for Federal Government Personnel and Pensions, 2000-03

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
<b>Personnel and pensions - 2000</b>													
In billions of Naira	16	18	17	17	17	54	7	7	18	53	25	29	279
In percent of monthly average	71	78	73	71	72	234	30	31	78	227	109	127	...
<b>Personnel and pensions - 2001</b>													
In billions of Naira	14	33	35	20	22	22	20	20	26	32	21	22	285
In percent of monthly average	57	139	146	82	90	92	85	85	110	133	88	92	...
<b>Personnel and pensions - 2002</b>													
In billions of Naira	33	29	35	26	45	34	8	47	30	27	29	27	368
In percent of monthly average	106	94	114	86	145	110	27	153	96	88	94	87	...
Personnel cost	19	27	23	22	43	32	7	44	25	27	26	26	322
Pensions	14	1	12	5	2	1	1	3	4	0	3	1	47
<b>Personnel and pensions - 2003</b>													
In billions of Naira	31	28	28	26	22	20	29	61	27	30	33	34	368
In percent of monthly average	100	92	91	84	72	64	95	200	88	96	107	110	...
Personnel cost	25	24	24	22	19	19	25	48	24	26	26	25	304
Pensions	6	4	4	4	3	1	5	13	3	3	7	9	64

Source: Office of the Accountant General

- The processing of the payroll is decentralized under the responsibility of individual line ministries and agencies. There are insufficient central controls and oversight over the monthly payroll. Although the OAGF has personnel placed in many line ministries tasked with monitoring the monthly payroll and other expenditure, the effectiveness of this control function is limited.

<sup>24</sup> For example, in June 2003 the presidentially appointed Committee on the Monetisation of Fringe Benefits in the Public Service of the Federation recommended an extension of monetized benefits across the public sector employees without assessing the financial implications.

- There is a problem with arrears, particularly for pensions. As arrears are being cleared in an ad hoc manner, this may also partly explain the fluctuations in the monthly payroll. However, no consolidated data are available on the stock of arrears, and the clearance of arrears is not being transparently recorded.
- There are limited data available on the actual staff in posts and the approved establishment. Although in recent years both a personnel audit and pay parades have been carried out, continued hiring appears to have made this information outdated.
- The personnel regulations regarding hiring and remuneration are not being enforced for parastatals included in the budget of line ministries; perhaps not even for the regular ministries (particularly for lower-level positions).

73. It is encouraging that the authorities have initiated a civil service reform project in four pilot ministries supported by the World Bank and DFID. Implementation has progressed fastest in the Ministry of the Federal Capital Territory where payroll computerization and a pay parade recently enabled the identification of ghost workers. Removing these ghost workers from the payroll reduced their number from 25,000 to 22,000 employees.

### **Recommendations**

74. In the short term, (i) the institutional coordination of administering the payroll should be strengthened, with the BOF taking a leading role on all issues with financial implications; (ii) the authorities should prepare a baseline position for the payroll to be used for a personnel master database; and (iii) compliance with the regulatory framework should be enforced through credible sanctions, also for parastatals included in the budgetary allocation for line ministries. In the medium term, (i) it would be beneficial to introduce a computerized system for payroll management; and (ii) to implement more comprehensive civil service reforms addressing staffing levels, functions, as well as remuneration policy.

## **E. Expenditure Arrears**

### **Issues**

75. The accumulation of arrears has adverse macroeconomic impact and diminishes the credibility of the government. Although data are not available, there is a widespread sense that the accumulation of domestic expenditure arrears is an issue of concern in Nigeria. There appears to be accumulation of unpaid bills for supplies of goods and services as well as pension (and possibly wage) arrears. Very little has been done to compile consolidated data on the stock of arrears, and even less so to develop and implement a strategy to clear the

arrears in an orderly manner. Nevertheless, funds are provided (in an ad hoc manner) to line ministries for clearing arrears on both supplies and pensions.<sup>25</sup>

## **Recommendations**

76. In the short term, (i) progress could be made by taking inventory of the stock of outstanding arrears for all federal ministries and agencies; (ii) the stock of arrears should be audited (on-site in line ministries and agencies by the Auditor General); (iii) a strategy for liquidating verified arrears, through a centralized budget appropriation line should be designed; and (iv) line ministries and agencies should be required to report monthly on unpaid bills, wages, and pensions (as part of the monthly transcripts). In the medium term, a commitment control system in line ministries and agencies as part of broader efforts to strengthen expenditure controls should be introduced.

## **F. Operational Aspects of Fiscal Federalism**

### **Issues**

77. Fiscal federalism is a critical issue in Nigeria, with implications for macroeconomic management as well as for the stable and predictable service delivery of public goods and services at the subnational level. The fiscal management capacity of the federal government is constrained as about one-half of all revenue is transferred to the state and local governments. As the fiscal federalism structure naturally reflects a political outcome, any changes will also be a result of a political process. But even in the absence of more substantive fiscal federalism reforms, an immediate objective should be to strengthen operational aspects of the current fiscal arrangements, including fiscal reporting, and to prepare for some degree of policy coordination. This could be facilitated by reaching agreement on a fiscal rule through a political compact between the federal government and the states.

78. Tables III-4.a and III-4.b show the actual revenue sharing for 2002-3. Oil and non-oil revenue flows into the federation account, where various deductions are made.<sup>26</sup> The net federation account and the value-added tax (VAT) account are distributed across the three tiers of government, albeit using different revenue sharing parameters. Table III-4.b also illustrates how the revenue sharing parameters have evolved following the same Supreme Court ruling in 2002. The actual transfer of each government's share of the federation account takes place in the month following the distribution (with a lag of one month). The revenue sharing also includes a derivation grant to oil-producing states based on 13 percent

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<sup>25</sup> As a recent example, the supplementary appropriation bill in November 2003 included N 40.5 billion explicitly tagged for arrears clearance.

<sup>26</sup> Since a Supreme Court ruling in 2002, primarily cash call payments are deducted.

Table III- 4a. Nigeria: Revenue sharing, 2002-03

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
(In billions of naira)													
<b><u>2002 revenue sharing</u></b>													
Total receipts	126	128	127	120	118	124	124	114	126	135	131	131	1,503
Oil and gas revenue	108	109	101	94	99	102	93	93	105	108	107	111	1,231
Non-oil revenue	18	18	26	26	19	22	31	21	20	27	24	20	272
Deductions	57	58	6	4	0	0	0	0	0	0	0	0	126
Net Federation Account	69	70	121	116	118	124	124	114	126	135	131	131	1,377
Derivation grants	5	5	8	7	8	8	7	7	8	8	8	9	89
Net Federation Account, after derivation	64	65	113	109	110	116	117	107	117	127	122	123	1,288
Federal government	32	33	59	57	58	63	64	58	64	69	67	67	692
State governments	15	15	29	28	29	29	29	26	29	31	30	30	321
Local governments	13	14	24	23	24	24	24	22	24	26	25	25	269
Funds	2	3	0	0	0	0	0	0	0	0	0	0	5
VAT revenue	8	7	10	9	7	10	13	9	9	9	8	10	109
Federal government	1	1	1	1	1	1	2	1	1	1	1	1	16
State governments	4	4	5	4	4	5	6	5	4	4	4	5	54
Local governments	3	3	3	3	3	3	5	3	3	3	3	3	38
FG federation account share	36	32	33	59	57	58	63	64	58	64	69	67	661
Deductions for debt service	0	0	0	19	17	17	22	4	4	8	7	16	115
Consolidated revenue fund	36	32	33	40	40	41	37	53	48	50	55	45	509
Federal Capital Territory	0	0	0	0	0	0	1	1	1	1	1	1	6
Ecological Fund	0	0	0	0	0	0	1	2	1	2	2	1	9
Statutory Stabilization	0	0	0	0	0	0	1	1	1	1	1	1	4
Residual Transferred to Stabilization	0	0	0	0	0	0	2	3	3	3	3	2	17
<b><u>2003 revenue sharing</u></b>													
Total receipts	175	211	196	180	180	166	191	190	200	225	207	273	2,395
Oil and gas revenue	147	190	170	159	155	141	160	165	173	196	179	239	2,074
Non-oil revenue	28	21	26	22	25	26	28	25	26	29	25	31	310
Drawdown of excess crude	0	0	0	0	0	0	3	0	2	0	3	3	
Deductions 1/	0	34	34	34	42	47	52	61	64	63	59	74	564
Net Federation Account	175	177	162	147	138	119	139	129	137	163	148	198	1,832
Derivation grants	11	12	13	12	11	9	14	10	12	13	14	18	148
Net Federation Account, after derivation	164	165	149	135	127	110	159	119	142	150	160	206	1,786
Federal government	89	90	81	74	70	60	87	65	78	82	87	109	973
State governments	40	41	37	33	32	27	39	29	35	37	39	54	445
Local governments	34	34	31	28	26	23	33	24	29	31	33	42	368
VAT revenue	10	9	10	10	12	12	10	12	11	10	14	13	135
Federal government	1	1	1	2	2	2	2	2	2	2	2	2	20
State governments	5	5	5	5	6	6	5	6	5	5	7	6	67
Local governments	3	3	3	4	4	4	4	4	4	4	5	4	47
FG federation account share	67	89	90	81	74	70	60	87	65	78	82	87	931
Deductions for debt service	16	16	16	16	16	16	16	16	16	16	16	16	194
Consolidated revenue fund	45	65	66	58	51	47	39	63	43	55	58	63	654
Federal Capital Territory	1	1	1	1	1	1	1	1	1	1	1	1	13
Ecological Fund	1	2	2	2	2	1	1	2	1	2	2	2	20
Statutory Stabilization	1	1	1	1	1	1	1	1	1	1	1	1	10
Residual Transferred to Stabilization	3	4	4	4	3	3	2	4	3	3	4	4	40

Source: Office of the Accountant General

1/ Deductions for cash call payments and accumulation of excess crude (subsequently distributed within the year).

Table III-4b. Nigeria: Revenue sharing, 2002-03

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
(In percentage)													
<b>2002 revenue sharing</b>													
Net Federation Account, after derivation	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Federal government	51.1	50.8	52.4	52.4	52.4	54.7	54.7	54.7	54.7	54.7	54.7	54.7	53.7
State governments	23.9	23.9	25.9	25.9	25.9	24.7	24.7	24.7	24.7	24.7	24.7	24.7	25.0
Local governments	21.2	21.1	21.6	21.6	21.6	20.6	20.6	20.6	20.6	20.6	20.6	20.6	20.9
Funds	3.7	4.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4
VAT revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Federal government	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
State governments	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Local governments	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0
Derivation grants 1/	5.0	4.4	7.8	7.6	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.2
FG federation account share		51.1	50.8	52.4	52.4	52.4	54.7	54.7	54.7	54.7	54.7	54.7	51.3
Deductions for debt service		0.0	0.0	16.6	15.6	15.5	18.8	3.7	4.0	6.8	5.9	13.2	8.9
Consolidated revenue fund		51.1	50.8	35.8	36.8	37.0	31.7	45.2	44.9	42.4	43.3	36.9	39.5
Federal Capital Territory		0.0	0.0	0.0	0.0	0.0	0.7	0.9	0.9	0.9	0.9	0.8	0.5
Ecological Fund		0.0	0.0	0.0	0.0	0.0	1.0	1.4	1.4	1.3	1.3	1.1	0.7
Statutory Stabilization		0.0	0.0	0.0	0.0	0.0	0.5	0.7	0.7	0.6	0.6	0.5	0.3
Residual Transferred to Stabilization		0.0	0.0	0.0	0.0	0.0	2.0	2.8	2.8	2.7	2.7	1.6	1.3
<b>2003 revenue sharing</b>													
Net Federation Account, after derivation	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Federal government	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	52.9	54.5
State governments	24.7	24.7	24.7	24.7	24.7	24.7	24.7	24.7	24.7	24.7	24.7	26.5	24.9
Local governments	20.6	20.6	20.6	20.6	20.6	20.6	20.6	20.6	20.6	20.6	20.6	20.6	20.6
VAT revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Federal government	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
State governments	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Local governments	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0
Derivation grants 1/	7.8	6.4	7.5	7.4	6.8	6.2	8.5	5.9	7.0	6.4	7.8	7.6	7.1
FG federation account share	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7	52.1
Deductions for debt service	9.8	9.8	10.8	12.0	12.7	14.6	10.1	13.6	11.3	10.8	10.1	10.8	10.8
Consolidated revenue fund	39.8	39.8	38.9	37.9	37.3	35.5	39.5	36.5	38.5	39.0	39.5	36.6	36.6
Federal Capital Territory	0.8	0.8	0.8	0.8	0.8	0.8	0.7	0.8	0.8	0.8	0.8	0.8	0.8
Ecological Fund	1.2	1.2	1.2	1.1	1.1	1.1	1.2	1.1	1.2	1.2	1.2	1.2	1.1
Statutory Stabilization	0.6	0.6	0.6	0.6	0.6	0.5	0.6	0.5	0.6	0.6	0.6	0.6	0.5
Residual Transferred to Stabilization	2.5	2.5	2.4	2.3	2.3	2.2	2.4	2.3	2.4	2.4	2.4	2.4	2.3

Source: Office of the Accountant General

1/ In percent of oil revenue.

of the onshore production. Since the Supreme Court ruling, the revenue share of various extrabudgetary funds has been deducted from the federal government's enhanced share of 54.7 percent of the federation account, after a deduction for the federal government's contribution to debt service payments into the debt service account.

79. Besides data on revenue sharing, there is very little information sharing between the three tiers of government and no well-developed system for reporting of fiscal developments:

- The states and local governments do not report in a systematic manner on their annual budgets to the federal government.

- The states and local governments do not report any information to the federal government on their budget execution and (domestic) debt issuance, neither during the year, nor at the end of the year.
  - The only consolidated source of information on fiscal activities at the subnational level is an annual survey carried out by the CBN.
  - While the states and the federal government meet monthly in the Federation Account Allocation Committee to finalize the monthly revenue sharing, there is little information being provided to the states on broader fiscal developments, including on the implementation of the federal government budget.
80. There is no coordination of fiscal policy across the three tiers of government:
- The extensive revenue sharing implies that subnational government activities have macroeconomic consequences. While the federal government has the responsibility for determining fiscal policy at the aggregate level, achieving this is difficult unless the subnational governments contribute their share to achieving macroeconomic stability.
  - Despite regular meetings between the federal government and the states to finalize the monthly revenue transfer, there is no attempt at coordinating fiscal policy more broadly.
  - Subnational governments need to pursue public expenditure reforms similar to the federal government's, including reallocating more of their spending toward infrastructure and enhancing the transparency of the budget process. The World Bank has taken the lead in assisting subnational governments strengthen their public expenditure management systems. Work has focused on expenditure reviews, state finances, governance, and overall capacity building.
  - Policy coordination would be enhanced if subnational governments adopted standardized economic and functional classification systems and improved budget reporting. This would also help identify whether expenditure programs are properly targeted to meet the governments' development objectives.
81. The revenue transfers to the subnational governments are highly volatile, in particular between years.
- In the absence of a fiscal rule being adhered to across all tiers of government, the revenue transfer is at the whim of oil market volatility. In practice, this introduces substantial uncertainty to the execution of budgets and public service delivery at all levels of government. This is a particular concern for the subnational governments, to which many social spending responsibilities have been devolved to.



- A fiscal rule extended to all levels of government would provide some “insurance” against this volatility and introduce an element of certainty and predictability that is currently absent from the intergovernmental fiscal relations. The authorities are preparing a Fiscal Responsibility Bill that would introduce a fiscal rule for all government levels.

## **Recommendations**

82. In the short term, efforts should be made (i) to establish a system of fiscal reporting by states and local governments on their budget approval and execution; and (ii) to strengthen information sharing between the BOF and states on budget and revenue assumptions. In the medium term, (i) the coordination of fiscal policies across the three tiers of government should be strengthened; (ii) more oversight of subnational borrowing could be introduced; and (iii) the volatility in state budgets could be reduced by getting agreement on adhering to a fiscal rule and introducing individual savings accounts with the CBN for all states.

## **G. Conclusions**

83. The Nigerian authorities’ reform agenda includes a strategy to improve fiscal management capacity. In the past, shortcomings in fiscal management capacity led to a procyclical fiscal policy stance driven by volatile oil revenue, a relatively high debt level, and waste and misplaced priorities in government expenditure.

84. Many measures have been already implemented in several areas, but key challenges remain. Among other things, the BOF has taken a clear leadership in the budget formulation process, the execution of the budget and the reporting of fiscal data have improved lately, reflecting the implementation of budget automation reforms in the OAGF, a Cash Management Committee was established to facilitate institutional coordination and determine borrowing needs in advance, and a Fiscal Responsibility Bill is being prepared to institutionalize a fiscal rule for all levels of government. The formulation of the 2005 budget should provide another opportunity to set “hard” expenditure limits and spending allocations in line with NEEDS’ priorities. Cash management will need to be enhanced, partly through a rationalization of banking arrangements, and expenditure arrears should be identified, audited, and eliminated over time. Fiscal reporting and payroll management should continue to benefit from the institutional strengthening of BOF and OAGF and the coordination mechanisms with other public entities. All these reforms at the federal government level would need to be extended to the operation of state and local governments in the context of a fiscal rule aimed at bringing the non-oil deficit to more sustainable levels and at reducing the economy’s vulnerability to the volatility in oil exports.

## IV. FEDERAL GOVERNMENT DEBT MANAGEMENT REFORMS<sup>27</sup>

### A. Introduction

85. The government of Nigeria has embarked on a set of reforms aimed at establishing sound and effective public debt management practices as part of its strategy to promote debt sustainability. The main objectives are to commit to market-based financing for the government's budget, lengthen the maturity structure, and promote the development of the government bond market. The aim of this section is to describe weaknesses in the current public debt management framework and the government's reform strategy, review the reform implications, and address further actions that will be needed to put the government's domestic debt reform strategy on a solid foundation.

### B. Background

86. Over the past two decades, public debt management in Nigeria has not been effective. It has suffered primarily from the absence of a sound fiscal framework, which has led to excessive debt levels and debt servicing difficulties. The government's large borrowing needs have also been poorly managed. Scant consideration has been given to the implications of risky debt structures and the extensive reliance on non-market sources of financing on macroeconomic stability and the functioning of financial markets. The central bank's role as debt manager of the government has also undermined its ability to effectively control liquidity. Moreover, shortcomings in monetary management have impeded the development of the government securities market.

#### Debt structure and risks

87. Nigeria's public debt burden is high. Total public debt amounted to N 5.6 trillion, equivalent to 74 ½ percent of GDP and 138 percent of non-oil GDP at end-2003 (Table IV-1). External debt—US\$32.8 billion (57 percent of GDP)—continues to account for the bulk of total public debt, with most of it owed to Paris Club creditors (Figure IV-1).<sup>28</sup> Total domestic debt amounted to N 1.3 trillion (about 18 percent of GDP) at end-2003, and most of it is securitized. Total bank loan advances to the government are rather small. Including federal and subnational deposits with the banking system, net public debt amounted to 71½ percent of GDP at end-2002.

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<sup>27</sup> Prepared by Jeanne Gobat.

<sup>28</sup> Most of the external debt was accrued in the 1980s. The government borrowed heavily to finance large investment projects. It encountered external debt servicing difficulties as oil prices deteriorated sharply starting in the mid-1980s. These payment difficulties were further exacerbated through subsequent exchange rate devaluations. See Lane (2003) for a detailed discussion on the origins of Nigeria's external debt crisis.

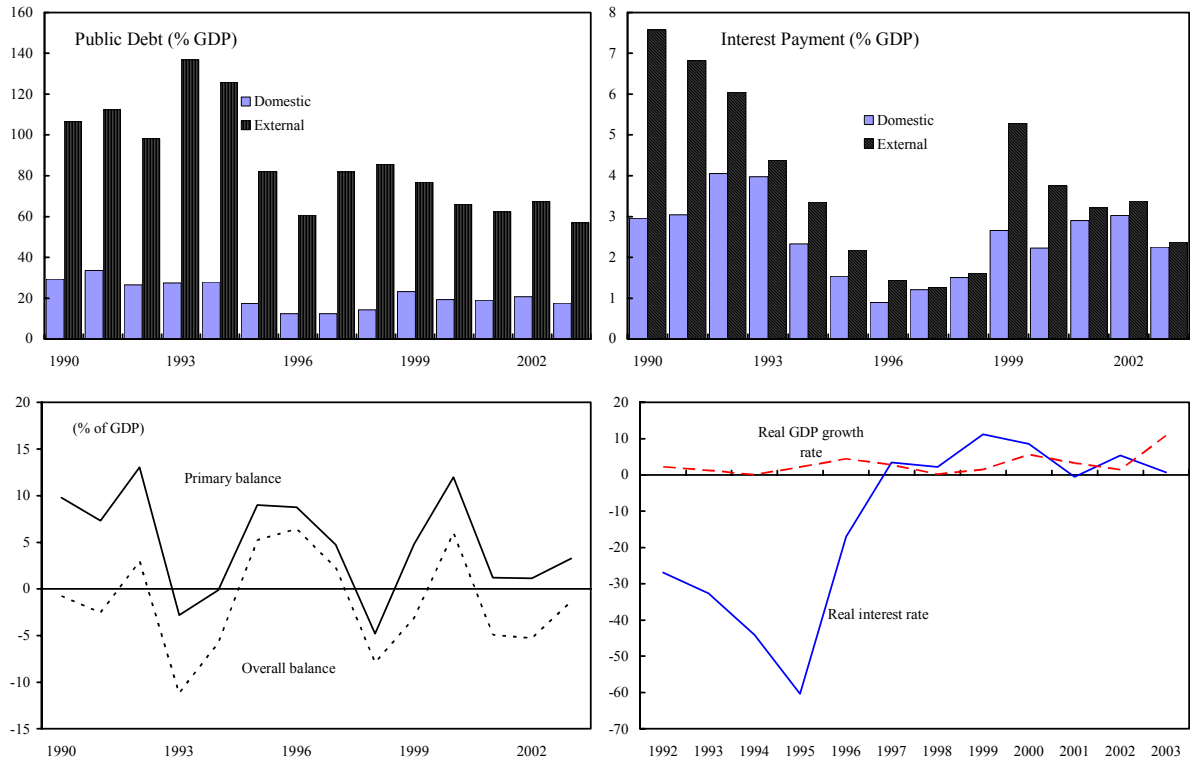
Table IV-1. Nigeria: Public Sector Gross and Net Debt, 1990-2003 1/

	Average 1990- 1995	Average 1996 2000	2000	2001	2002	2003 Est.
(In billions of naira, unless otherwise indicated)						
Public sector gross debt	1,174	3,010	3,998	4,373	4,977	5,624
Public sector net debt	1,437	2,486	3,022	3,422	4,303	5,398
Domestic debt - by instrument	218	560	898	1,017	1,166	1,330
Treasury bills	83	275	466	585	734	825
Treasury bonds	97	283	431	431	431	503
Treasury certificates	34	0	0	0	0	0
Development stock	4	3	2	2	2	1
Other	0	0	0	0	0	0
Domestic debt - by holder	209	560	898	1,017	1,166	0
Banking sector	183	515	856	938	993	0
Central bank	164	410	714	739	532	...
Commercial banks	23	97	133	199	460	...
Merchant banks	5	8	9	0	0	...
Nonbank sector	40	45	42	79	173	...
External public sector debt	955	2,447	3,091	3,324	3,787	4,295
Multilateral	136	316	342	340	362	398
Bilateral	632	1,797	2,393	2,610	3,108	3,589
Commercial banks	187	334	357	374	317	308
(In percent of GDP)						
Public sector gross debt	137.4	90.6	85.5	81.9	88.4	74.5
Public sector net debt	84.9	75.5	64.6	64.1	76.4	71.5
Domestic debt - by instrument	27.1	16.2	19.2	19.0	20.7	17.6
Treasury bills	11.2	7.9	10.0	10.9	13.0	10.9
Treasury bonds	9.2	8.2	9.2	8.1	7.6	6.7
Treasury certificates	6.0	0.0	0.0	0.0	0.0	0.0
Development stock	0.7	0.1	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Domestic debt - by holder	24.5	16.2	19.2	19.0	20.7	0.0
Banking sector	21.9	14.8	18.3	17.6	17.6	0.0
Central bank	20.3	11.8	15.3	13.8	9.5	...
Commercial banks	1.4	2.8	2.8	3.7	8.2	...
Merchant banks	0.3	0.2	0.2	0.0	0.0	...
Nonbank sector	2.5	1.4	0.9	1.5	3.1	...
External public sector debt	110.2	74.2	66.1	62.3	67.2	56.9
Multilateral	14.9	9.7	7.3	6.4	6.4	5.3
Bilateral	70.6	54.1	51.2	48.9	55.2	47.6
Commercial banks	24.8	10.3	7.6	7.0	5.6	4.1
<i>Memorandum items:</i>						
Public sector gross debt (in percent of non-oil GDP)	255	151	170.1	148.0	147.9	138.2
External debt (in millions of U.S. dollars)	30,431	28,787	30,234	29,686	30,993	32,818
Multilateral (in millions of U.S. dollars)	4,095	3,771	3,342	3,037	2,961	3,042
Bilateral (in millions of U.S. dollars)	19,355	21,020	23,403	23,313	25,437	27,422
Commercial banks (in millions of U.S. dollars)	6,981	3,996	3,489	3,336	2,595	2,354
of which external arrears	...	...	...	375	2,275	3,452
Bank Loan Advances	2	4	8.3	32.1	23.5	23.1
Federal Level	0	0	0.8	5.3	6.2	6.4
State and Local government	2	3	7.6	26.8	17.3	16.6
Total Public Sector Deposits	101	524	976	951	674	274
Federal government deposits	65	506	930	924	626	226
State and local government deposits	4	18	46	27	47	47
Nominal exchange rate	17	52	102	112	122	131
Average representative rate	32	85	102	112	122	131
Nominal GDP (in billions of naira)	895	3,329	4,676	5,339	5,632	7,545
Non-oil GDP (in billions of naira)	...	1,981	2,351	2,955	3,365	4,069

Source: Authorities and Staff estimates

1/ Does not include state government securitized debt and domestic arrears of the federal and subnationals.

Figure IV-1. Nigeria: Debt Dynamics, 1990-2003



Source: Nigerian authorities; and Fund staff estimates.

88. The total public debt burden is estimated to be much higher, however. The public debt figure excludes both domestic expenditure arrears, contingent liabilities, and domestic securitized debt of state and local governments.<sup>29</sup> The authorities have indicated that although no official tally has been taken yet, accounting for supply contractor and pension arrears could double the domestic debt level to 40 percent of GDP. The federal government debt also excludes potential liabilities such as the domestic debt of major state-owned enterprises, including that of Nigerian Electric Power Authority (NEPA) which is estimated at about N 350 billion (4 ½ percent of GDP) at end-2003, and expected to be transferred to the Debt Management Office (DMO) by end-2004.

<sup>29</sup> Several states have tapped into the domestic capital market, with bond issuance totaling about N 28-30 billion since 2000.

89. Nigeria's debt burden compares unfavorably with most non-HIPC African countries and most emerging market economies and (Table IV-2 and IV-3). Indeed, the high debt burden has led to periods of debt servicing difficulties. Nigeria has largely been cut off from international finance since the late 1980s when it defaulted on its external debt obligations. It continues to accumulate arrears on its external debt with external debt service in local currency terms equivalent to the size of the federal government's 2004 capital budget. The government also faced domestic debt-servicing difficulties in the late 1980s as market rates rose significantly in the wake of interest rate deregulations. The government, however, bypassed most of these difficulties by borrowing at below market rates and at longer maturities from the central bank.

90. Nigeria's domestic debt is heavily concentrated in maturities of less than one year. Most of the debt is in the form of 91-day treasury bills—the government's main market-based funding instrument. Treasury bonds and development stocks have been issued for specific funding purposes in the past, and, although marketable, are largely held by the Central Bank of Nigeria (CBN).<sup>30</sup>

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<sup>30</sup> The government issued treasury bonds in 1989 mainly to avoid paying market interest rates. Interest rates on those bonds were set at 5 percent, well below market clearing rates. Given the price, investors did not take up the bonds and the CBN was left with absorbing almost the entire issue and continues to face difficulty offloading these bonds. In subsequent years, the treasury bonds were issued to the CBN whenever the government wanted to raise money at artificially low rates. The development stocks, which are listed on the Nigerian Stock Exchange, were issued to finance various capital projects. Both will be retired as they mature (Debt Management Office, 2002).

Table IV-2. Nigeria: Sub-Saharan African Countries, Domestic and External Debt 1980-2000  
(in percent of GDP, unless otherwise indicated)

Country	Type of Domestic Debt 1/	Domestic Debt				External Debt				Total Debt				Domestic/Total Debt (In percent)					
		1980-89		1990-94		1995-00		1980-89		1990-94		1995-00		1980-89		1990-94		1995-00	
ANGOLA	...	0	0	0	0	158	113	81	158	113	81	81	0	0	0	0	0	0	0
BOTSWANA	...	0	0	0	0	5	4	10	5	4	10	10	0	0	0	0	0	0	0
BURUNDI	TB, TC	3	2	6	6	40	96	138	44	98	144	144	8	2	2	4	4	4	4
CAPE VERDE	TB	0	11	34	34	42	42	40	42	53	74	74	0	20	20	46	46	46	46
CONGO, DEM. REP. OF	...	0	0	0	0	50	126	254	50	126	254	254	0	0	0	0	0	0	0
ETHIOPIA	TB, B	16	19	10	10	31	115	109	47	134	120	120	34	14	14	9	9	9	9
GAMBIA, THE	TB, DN, S	3	13	23	23	80	84	104	83	96	127	127	3	13	13	18	18	18	18
GHANA	TB	12	8	24	24	19	55	83	32	64	106	106	38	13	13	22	22	22	22
GUINEA	TB	...	...	...	...	0	0	91	...	...	...	...	...	...	...	...	...	...	...
KENYA	TB, B, S	21	23	22	22	61	77	52	81	100	74	74	25	23	23	29	29	29	29
LESOTHO	TB, B	8	8	5	5	40	49	58	48	58	62	62	17	15	15	8	8	8	8
MADAGASCAR	TB	3	3	3	3	71	120	110	74	123	113	113	4	2	2	2	2	2	2
MALAWI	TB, S	13	8	9	9	65	100	126	78	109	135	135	16	7	7	7	7	7	7
MAURITIUS	TB, S	27	29	33	33	39	21	15	66	50	48	48	41	57	57	69	69	69	69
MOZAMBIQUE	...	0	0	0	0	75	207	121	75	207	122	122	0	0	0	0	0	0	0
NAMIBIA	TB	0	8	19	19	0	4	2	0	12	21	21	...	...	...	89	89	89	89
NIGERIA	TB, B, TC, S	28	29	16	16	49	93	80	77	122	97	97	37	24	24	17	17	17	17
RWANDA	TB, B	8	9	5	5	17	55	70	25	65	75	75	31	14	14	7	7	7	7
SAO TOME & PRIN	...	0	0	0	0	155	422	643	155	422	643	643	0	0	0	0	0	0	0
SEYCHELLES	TB, B, S	14	45	68	68	29	24	20	43	69	88	88	33	65	65	77	77	77	77
SIERRA LEONE	TB, B, S	13	5	7	7	34	94	143	47	99	150	150	28	5	5	5	5	5	5
SOUTH AFRICA	TB, B	30	37	45	45	0	0	0	30	37	45	45	100	100	100	100	100	100	100
SWAZILAND	TB, B, S	4	1	1	1	20	21	16	24	22	17	17	16	5	5	7	7	7	7
TANZANIA	TB, S	26	6	12	12	71	131	100	96	137	112	112	27	5	5	11	11	11	11
UGANDA	TB, S	2	1	2	2	0	73	57	2	74	59	59	100	1	1	4	4	4	4
ZAMBIA	TB, B	25	9	6	6	134	178	196	159	186	202	202	16	5	5	3	3	3	3
ZIMBABWE	TB, B, S	35	29	37	37	27	34	48	62	63	86	86	56	45	45	44	44	44	44
Average		11	12	15	15	49	87	103	62	102	118	118	25	19	19	22	22	22	22
HIPC		9	6	8	8	56	124	156	69	138	169	169	22	6	6	6	6	6	6
Decision point reached 2/		10	7	8	8	58	126	150	73	143	164	164	25	7	7	7	7	7	7
Eligible 3/		2	1	3	3	45	111	196	47	112	199	199	4	1	1	2	2	2	2
Non-HIPC 4/		14	18	23	23	39	40	35	53	59	59	59	30	35	35	40	40	40	40

Source: Christensen (2004).

1/ TB=Treasury certificates; B=bonds; S=Government Stocks; DN=Discount note series

2/ Includes Ethiopia, The Gambia, Ghana, Guinea, Madagascar, Malawi, Mozambique, Rwanda, Sao Tome and Principe, Sierra Leone, Tanzania, and Uganda.

3/ Includes Burundi and Democratic Republic of Congo.

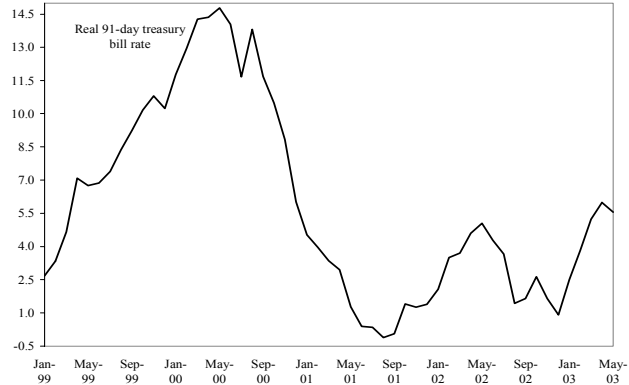
4/ Includes Angola, Botswana, Cape Verde, Kenya, Lesotho, Mauritius, Namibia, Nigeria, Seychelles, South Africa, Swaziland, and Zimbabwe.

Table IV-3. Nigeria: Public Debt Burden for the EMBI Global Countries, 1990-2002  
(In percent of GDP)

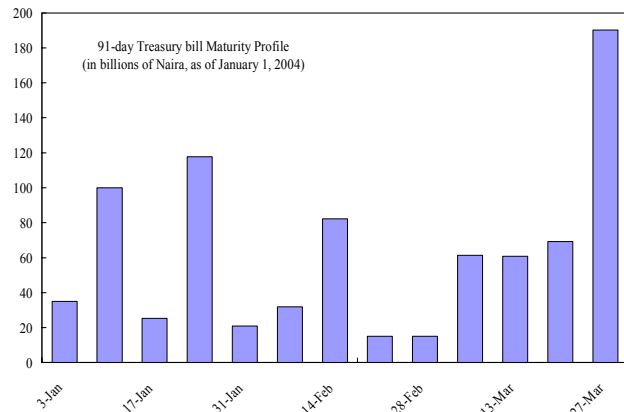
	Average 1990-1995	1996	1997	1998	1999	2000	2001	2002
Argentina	34.5	41.1	38.1	38.0	43.0	45.0	54.0	149.0
Brazil	35.2	34.4	35.2	41.7	48.7	48.8	52.6	56.0
Bulgaria	149.1	117.6	107.5	93.0	84.7	80.5	70.0	61.7
China	9.0	10.5	11.4	17.8	20.9	22.8	24.3	26.1
Egypt				47.7	48.4	47.5	53.0	58.0
Lebanon	68.3	98.9	102.7	113.6	135.2	152.3	169.7	178.0
Malaysia	71.6	50.0	56.1	62.1	64.8	61.7	70.6	69.9
Mexico	39.9	54.4	51.2	54.9	50.8	49.0	48.0	48.0
Peru	61.5	47.2	33.3	42.7	48.1	45.9	46.2	45.0
Turkey	36.8	46.5	42.9	43.7	61.0	57.7	95.0	80.1
Uruguay	33.8	27.5	27.3	27.9	30.1	34.7	41.8	84.1
Venezuela	65.3	57.0	42.0	39.9	38.4	33.4	36.2	46.4
Chile	35.1	17.3	15.6	15.4	18.0	18.0	19.5	20.9
Croatia	19.3	29.2	29.3	34.6	46.0	51.0	52.0	51.0
Hungary	81.7	71.5	62.9	61.1	60.0	55.3	52.3	56.5
Korea	10.1	8.8	12.7	24.7	31.7	32.4	38.6	37.2
Pakistan	90.3	86.2	88.5	92.7	94.2	92.4	104.4	95.9
Russia	42.3	32.6	52.4	68.0	87.9	56.1	42.0	34.7
South Africa	35.5	43.9	48.0	48.3	46.5	43.7	42.9	39.0
Thailand		14.5	36.3	45.3	55.6	57.2	57.6	55.1
Colombia	26.7	24.5	27.3	34.0	42.0	47.0	51.0	56.0
Cote d'Ivoire	171.7	173.0	160.3	112.2	103.4	108.6	104.3	92.1
Ecuador	93.0	68.1	62.1	66.7	101.2	91.4	70.2	58.0
Morocco	80.0	75.6	78.0	74.3	76.9	76.4	74.8	70.7
Panama	84.3	68.0	64.0	59.0	63.0	58.0	63.0	63.0
Philippines	79.6	75.4	83.2	81.3	90.6	99.0	96.0	99.0
Poland	79.1	47.9	46.9	42.9	43.0	39.0	40.0	46.0
Ukraine	27.0	24.4	29.9	41.8	55.5	45.9	37.3	34.7
India	74.9	66.7	67.4	67.7	71.0	74.9	79.7	84.2
Indonesia	35.0	23.2	23.7	79.3	91.8	100.0	91.0	80.7
Jordan	118.1	100.8	90.6	93.3	92.6	78.5	75.2	76.9
Costa Rica	28.4	34.8	31.4	30.2	28.4	31.2	35.3	36.9
Israel	124.4	107.1	104.2	107.1	101.0	91.7	97.0	105.3
Nigeria	137.4	73.2	94.2	99.9	100.1	85.5	81.9	88.4
Average	65.0	56.1	56.3	58.9	64.0	62.1	63.8	67.2

Source: World Economic Outlook (2003); Nigerian Debt Management Office and staff estimates

91. The short-term maturity structure exposes the government to high rollover risk with about N 825 billion (equivalent to 75 percent of end-2003 base money and 40 percent of end-2003 broad money) being refinanced on average every 91 days in 2004. The short-term nature exposes also the budget to high interest rate risk. Changes in money market conditions feed through to higher debt-servicing costs. Indeed, over the past few years, the domestic debt service burden has increased from its lows in the mid-1990s, reflecting the rapid increase in short-term debt in the face of highly expansionary fiscal policies and higher real interest rates (particularly between 1999-2000) in order to make the treasury bills attractive to the market. Domestic interest payments are almost as high as external interest payments (3 percent of GDP) although domestic debt accounts for a smaller share of total debt (Figure IV-1).



92. There is also a pronounced bunching problem, with large volumes maturing at certain dates. This reflects largely the lack of cash management planning and developed issuance strategy to manage the federal government's gross borrowing needs prudently. Instead, the federal government typically finances its borrowing needs by borrowing from the CBN and converts its overdraft balance at year-end into three month treasury bills. In addition, there is an inherent mismatch in the duration of the government's assets and liabilities, with longer-term investment projects being financed with short-term money.



93. These fiscal risks are further accentuated by the shallowness of the domestic financial system, as reflected in the low M2/GDP ratio (26 percent at end-2003), high domestic debt/M2 ratio (67 percent at end-2003), and narrow investor base, with the banking system the main holder of government securities (Figure IV-2). The shallow financial market adversely influences interest rates and risks also crowding out private sector credit in the face of the government's large borrowing requirements. It also complicates the CBN's conduct of monetary policy as more forceful use of liquidity management to pursue price stability would adversely affect the government's debt-servicing costs.



## Sources of funding

94. Cut off from the international markets since the late 1980s, the government has largely relied on the domestic market for funding its borrowing needs. The CBN has been the government's main source of funding, and is also the largest holder of government securities. The government borrows from the CBN through its overdraft account and through CBN's purchases of government securities in the primary market. There is no legal limit on how much the CBN can purchase in the primary market, except that by law it is not allowed to purchase government securities with maturities in excess of 25 years.

95. Advances through the ways-and-means account are intended to be temporary, covering cash shortfalls during the course of the year, and should at any point in time not exceed the statutory limit of 12 ½ percent of the projected government's revenue for the year the advances are granted (equivalent to about 1½-2 percent of GDP) and should be repaid in full by the end of the financial year.<sup>31</sup> In practice, the government typically clears the entire end-year balance by issuing 91-day treasury bills in the primary market at the end of the calendar year rather than periodically throughout the year. This has over time created a serious bunching problem, with the market unable to absorb the large issuance it is offered except at a much higher market-clearing rate. However, the CBN, acting as de facto underwriter and administrator in the primary auctions, has typically purchased most of the issue at a rate that is below the market-clearing rate (i.e., the cut-off price). This has kept the government's domestic borrowing costs artificially low.

96. However, these actions have also had unintended consequences in terms of macroeconomic stability and financial market development. They have resulted in significant monetization of fiscal deficits over the years. Borrowing from the CBN at below-market rates may appear less costly to the government, but such borrowing can result in inflation. Also, the non-market-determined interest rates in the primary market have led to distortions in the cost of capital (as the treasury bill rate is used as benchmark reference rate) and discouraged secondary market trading. Moreover, the soft budget constraint and high access limit on the ways-and-means account have permitted weaknesses in the federal government's cash management practices to perpetuate, as there has been very little need for accurate cash flow projection in order to forecast and schedule the government's borrowing requirement.

97. Commercial banks have been the government's other major source of funding. Banks face a very high liquid asset ratio (40 percent) and hold government paper to meet this requirement. Banks also have, at times, held more government paper than necessary by regulatory standards. This reflects the weak macroeconomic environment but also institutional factors such as the inadequate legal system, including inefficiencies in operating

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<sup>31</sup> One convergence criterion for the West African Monetary Zone, which Nigeria has endorsed, calls for a ceiling on central bank lending to the government of 10 percent of the previous year's revenue base.

the court system (delays and backlogs) and difficulties in foreclosing and collecting nonperforming loans, all which discourage banks from lending to the private sector.

98. The nonbanking financial sector (e.g., insurance companies, public and private pension funds)—typically the natural investors in government securities in most advanced economies—are not large buyers and holders of government securities. They invest primarily in equity and real estate in Nigeria, but have more recently been an active buyer of longer-dated state bonds.

### **C. Public Debt Management Reforms**

99. The main objective of the public debt management reforms is to improve the effectiveness and soundness of overall public debt management in Nigeria. The reforms are focused around three key areas: institutional reforms, external and domestic debt management, and reforms at the subnational level.

100. Institutional reforms are focused on strengthening control, accountability, and oversight over public debt management. As a first step, all functions related to debt management have been consolidated into a newly constituted DMO, which began operations in late September 2001.<sup>32</sup> Previously, debt management was divided between the CBN and the Federal Ministry of Finance, but also scattered across several departments within the government with very little oversight and control over borrowing operations and loan guarantees contracted. Furthermore, a new legal framework that addresses the DMO's role in overall public debt management went into effect.<sup>33</sup> The DMO's formal mandate is limited to making proposals and providing advice to the Minister of Finance who also evaluates its activities, while the National Assembly has the final say on the terms and conditions for the federal government's borrowing program. Organizationally, the DMO is located outside the Ministry of Finance, under the presidency, and has some autonomy regarding staffing and salary policies.

101. Progress has also been made in upgrading external debt management. The DMO has introduced a data recording system to help reconcile all external debt obligations of both the federal and subnational governments, including guarantees, and structuring them by creditor, currency, and terms. Furthermore, a centralized electronic external debt reporting system has been put in place, helping to improve transparency in external debt service.

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<sup>32</sup> Examples of countries with specialized debt agencies include Australia, Finland, Hungary, Poland, Sweden and the U.K., while in African countries they include Malawi, Namibia, Zambia and Zimbabwe.

<sup>33</sup> The DMO Act went into effect in early 2003, while at the same time, the CBN Act 39, which deals with CBN's role as debt manager, was repealed.

102. In close collaboration with market participants, the DMO initiated reforms in the area of domestic debt management.<sup>34</sup> The main objectives of these reforms are to (i) finance the deficit in a noninflationary manner, at least cost, and with minimal risk to the government, (ii) lengthen the maturity structure, and (iii) promote capital market development.

103. At the core of these initiatives is the government's bond issuance program, consisting of a combination of fixed issues and floating rate notes. The bond issuance program would allow for reopening at these maturities so as to gradually build up the outstanding volume to the desired levels and develop a yield curve at key benchmarks. The bonds would be listed at the Lagos Stock Exchange (LSE) to allow for secondary market trading. Clearing and settlement and the depository of the securities are expected to be with the Central Securities Clearing System which is automatically linked with the LSE. The DMO also envisages the development of a primary dealer network to operate as market makers in the primary and secondary market for government securities. The DMO has also reached an agreement with the CBN by which the fixed rate bonds and the floating rate notes could be used as repo collateral as well as be used against banks' liquid asset ratio requirements for those securities with less than two years remaining until maturity.

104. As part of the domestic debt management reforms, the federal government in early August 2003 announced that it would seek to raise N 150 billion through the issuance of long-term bonds—its first issuance since 1986—to finance the 2003 budget deficit. The federal government (FGN) bonds were issued in tenors of three years, five years, seven and ten years. The former two were structured as fixed-rate bonds while the latter two were floating notes (priced at a premium to the 91-day treasury bill rate). The government hoped to raise a total of N 120 billion in five and more years in maturity, and N 30 billion in three-year fixed rates.

105. The overall take-up fell somewhat short of expectations. Subscription amounted to N 72.5 billion. While the three-year fixed-rate bond was oversubscribed, with the government subsequently raising the amount offered on the three-year fixed issue, there was very little interest for the longer-dated FGN bonds, suggesting a continued high perceived default risk. The bond issue, however, contributed little to lengthening the maturity structure and reducing the rollover and interest rate risks, as the government issued an additional N 91 billion in 91-day treasury bills at end-2003 in order to clear its overdraft balance with the CBN.

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<sup>34</sup> A USAID-sponsored resident advisor has been working with the DMO on a full-time basis since late 2001, to provide technical assistance in developing the government securities' primary and secondary market.

106. According to market participants, several shortcomings may have curtailed demand for the October 2003 FGN bond issue. In particular, institutional investors felt that more time should have been given between the announcement (in August) and the closing (in October), to allow them to restructure their existing portfolio in a cost effective manner. Furthermore, several practical issues (such as the establishment of the trading platform, listing on the LSE, as well as regulatory issues of whether the FGN bonds could be counted toward the liquid asset ratio) had not been resolved yet. Finally, the uncertainties in the macroeconomic environment and lack of medium-term budgeting also made it difficult to predict future gross domestic borrowing needs and, hence, risk exposure. Market participants indicated that there was a need to develop a medium-term fiscal framework, with a planning horizon of at least 3-5 years.

Maturity	Coupon rate (in percent)	Type	Total Offered	Total subscription	Bank	Nonbank	Pension Funds	Discount Houses	Individuals
2006	17 3/4	fixed	30	55.7	36.4	4.5	8.1	5.7	1.0
2008	18 1/4	fixed	40	12.3	2.5	1.6	7.9		0.2
2010		floating rate	40	4.0	2.0	0.0	1.7		0.2
2013		floating rate	40	0.6		0.1	0.5		0.0
				72.5	40.9	6.2	17.8	5.7	1.4

107. The DMO has also initiated discussions with the subnational governments on designing rules and guidelines for their domestic and external borrowing. This is an important area, given the growing domestic debt at the subnational level. While the DMO is not liable for debts incurred by subnational governments, increased subnational borrowing in an environment of weak oversight and accountability could endanger macroeconomic stability and debt sustainability. As experience in other countries, such as Brazil, has shown, agreements reached on borrowing limits between the federal, state, and local governments can help achieve fiscal discipline and establish a more sound fiscal regime, and lower in the process the risk premium, and the borrowing cost to the government.

108. The DMO has already tightened external borrowing guidelines, limiting subnational borrowing to concessional terms and for investment purposes only. Subnational governments also cannot borrow externally without the DMO's approval. The DMO and subnational governments are now in the process of developing rules and guidelines for domestic borrowing and reporting requirements. This initiative, which is taking place in the context of the draft Fiscal Responsibility Bill (Box IV-1), will take time to develop. The World Bank is also providing technical assistance in this area. In the meantime, until the bill gets passed, the CBN, for precautionary purposes, has set limits on domestic subnational borrowing from the banking system, requiring banks to provision 50 percent for loans extended to federal and subnational governments.

### **Box IV-1. Nigeria—Fiscal Responsibility Bill**

The government of Nigeria has prepared a draft Fiscal Responsibility Bill that is comprehensive, covering virtually all aspects of fiscal management and fiscal federalism. Among others, it would also introduce guidelines on debt management for the federal, state and local governments and on their borrowing operations. Both the DMO and the Minister of Finance are given a central role in coordinating, gathering, reporting and enforcing the guidelines as spelled out in the Bill. The Bill also addresses the role of the CBN in the financing of the government, and proposes reforms that would address help enhance the CBN's operational independence.

If passed by the National Assembly and enacted, the Bill would go a long way to establishing a sound and prudent framework for asset and liability management at all levels of government. To summarize the key aspects affecting the area of debt management:

- The government (all three tiers) would be allowed to borrow only for investment purposes. All its consumption obligations would have to be met through the current revenue base.
- All levels of government would be subject to a debt limit—defined as a percent of current revenue and net of deposits. There would also be a consolidated public debt/GDP limit for the entire public sector. This ratio should be stable and at a prudent level. There would also be a limit on federal government's securities (e.g., T-bills). Any deviation from these debt limits would need to be explained, and reduced within three quarters with a minimum reduction of 25 percent in the first quarter. The Minister of Finance would have to disclose on a monthly basis those government entities (federal, states and local) in excess the debt limit. The president would have the power to change the debt limits, subject to the National Assembly's approval.
- The DMO is responsible for maintaining a centralized updated electronic record of all domestic and external public debt at all levels of government. The data base is to include terms, conditions, balances, limits, and be made available to the public.
- Parastatals and other government agencies would not be permitted to borrow. State governments would not be allowed to borrow from their own state financial institutions (where they have a controlling stake). Issuing IOUs (borrowing against anticipated tax revenue, against revenue from parastatals in which the government has an ownership stake) is prohibited. Liabilities to suppliers without budgetary authorization would not be permitted.
- All borrowing against cash shortfalls would have to be cleared by the end of every financial year.
- The CBN would be prohibited from purchasing new issues of government securities in the primary market (new borrowing). The CBN would only be allowed to underwrite those securities that are being rolled over by the government to refinance maturing securities. This, however, is somewhat unclear as the CBN could increase its holdings of government securities.
- The CBN would not be allowed to guarantee loans on behalf of the federal and subnational governments.

#### **D. Reform Implications and Sequencing Issues**

109. Overall, the reforms are broadly in line with best practice recommendations as reflected in the Guidelines for Public Debt Management (IMF and World Bank, 2001 and 2003). They would represent a significant break from current practices, address several shortcomings governing debt management in Nigeria and could spur complementary reforms in fiscal and monetary policy and in the financial sector:

- The issuance of government securities at increasingly longer tenors would reduce rollover risk, and the inherent mismatch between assets and liabilities, while the issuance of fixed-rate bonds would help reduce exposure to interest rate risks.
- Accepting market-determined pricing will make the consequences of expansionary fiscal policies more visible to the public, remove distortions in the cost of capital, and improve the allocation of capital in the Nigerian economy.
- Developing a term structure for government securities could spur financial market innovation and encourage longer-term lending which is largely, absent in the Nigerian financial system.
- Consolidating debt management policies and functions within the DMO should help improve overall debt management, while setting borrowing guidelines regarding domestic and external debt for subnational governments should help improve overall fiscal management in the public sector.

110. The debt management reforms are of particular relevance to monetary policy. They would provide a viable alternative for funding of government deficits other than that provided directly by the CBN. This would remove the negative effects of monetary financing on macroeconomic stability. Furthermore, the development of the government securities market would help facilitate the move toward greater reliance on market-based operations for day-to-day liquidity management. It would allow a greater use of repo and reverse repo transactions (with the government security used as collateral) or outright sales and purchases of securities in the secondary market. This would also help improve liquidity in the secondary market and enhance transparency of monetary policy.

111. The reforms are an important step toward achieving separation of debt management from monetary operations. This would be consistent with the recommendations made in the 2002 FSAP report, which called for a discontinuation of the CBN's practice of being the de facto underwriter of the treasury bills in the primary auction and the requirement that all primary issuance of government securities bear market-determined interest rates. For both effective monetary control and financial market efficiency, interest rates need to be market-determined. The DMO Act transfers all responsibility of debt management from the CBN to the DMO. This would also allow the federal government to determine the risk/cost trade-off on its debt structure, and removes the CBN from the primary market. It is expected that the

CBN would continue to administer the primary treasury bill and FGN bond auctions on behalf of the federal government.

112. Notwithstanding these steps, there are several risks with the current reform strategy. Effective implementation will require establishing initial conditions that are conducive to market development as well as addressing shortcomings in the area of monetary policy and regulatory framework.

### **Macroeconomic stability**

113. A critical component, if not a precondition, to developing the bond market, is the need for macroeconomic stability and a prudent fiscal and monetary framework. In an environment characterized by a high degree of macroeconomic instability, investors in Nigeria would prefer to invest in short-term rather than take longer-term fixed positions that will expose them to sharp changes in the value of their investment. Experience shows that extending the yield curve for fixed-rate instruments continues to pose a major challenge for countries with a history of weak macroeconomic policies, and that even well-managed economies have faced difficulties extending the yield curve. Hence, the gradual development of the yield curve, starting with the short end, and supplemented by the issuance of floating rate notes may be more realistic in extending the debt maturity structure in Nigeria, although floating notes do not necessarily protect the government against interest rate risks.

114. However, the government needs to be mindful of the fact or possibility that moving to market pricing and lengthening the maturity structure of the current stock of domestic debt to address the rollover risk, particularly in an environment characterized by a high degree of macroeconomic instability and lack of medium-term oriented fiscal policies, can sharply increase the government's borrowing costs. These costs need to be made transparent, as they can be counterproductive to the objective of promoting capital market development, if they are not offset by prudent fiscal and monetary policies, and if not properly sequenced. Hence, it is critical a gradual restructuring of the domestic debt take place. As stability firmly takes root, the government's borrowing costs would decline, permitting a more sustainable development of the government bond market.

115. In this regard, the implementation of the 2004 budget would go a long way to addressing these macroeconomic risks and fiscal sustainability concerns. With the current favorable outlook for oil prices, the implementation of an oil price-based fiscal rule to guide fiscal policies in 2004 would generate a large cash surplus which could be used towards domestic debt restructuring as well as reduction and/or accumulation of financial assets.<sup>35</sup> This along with an appropriate monetary framework focused on achieving price stability, would help lower the risk premium and, hence, the borrowing costs to the government.

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<sup>35</sup> The expected cash surpluses in 2004 and over the medium term are virtuous as they lower domestic debt which in turn reduces net interest payments.

Going forward, it would be important that the federal government start to formulate macroeconomic policies within a medium-term fiscal and macroeconomic framework and based on the implementation of a price-based fiscal rule. This would help anchor investors' expectations, allow them to better plan their investment decisions, and help reduce the risk premium over time.

### **Treasury bill market**

116. Another critical condition for developing the government bond market is a working treasury bill market (i.e., securities with maturity of less than a year) and an active secondary market.<sup>36</sup> The treasury bill market is underdeveloped in Nigeria with the three month treasury bill the only funding instrument for the federal government. As a matter of comparison, Kenya has two benchmark treasury bills—the 91-day and 182-day treasury bill—and has also developed a bond market in the one- and two-year maturity, and more recently launched a three-year instrument. Furthermore, many regulations and practices continue to hamper more active secondary market trading in government securities in Nigeria.

117. A 2003 MFD TA mission that reviewed the government's domestic reform program recommended that, in line with practices in most countries, the authorities develop the treasury bill market prior to the government bond market and focus on reforming regulations and practices hampering secondary market development. With an already reasonably well functioning market infrastructure in place, the TA mission assessed that if treasury bills of six and twelve month maturities were issued along with the three-month treasury bill, the government's entire stock of treasury bills could be fully restructured within a short period. In addition, the bunching problem could be addressed separately by ensuring that issuance volumes in the maturing debt become more evenly distributed.

118. This would help reduce somewhat the rollover risk while lowering the pace at which the CBN would have to mop up the liquidity injection that comes from redeemed three-month treasury bills. It would also help develop yield curve for treasury bills and lessen the need for the CBN to intervene in the primary market as dates for scheduled repayments would be more evenly distributed. Developing a 3-, 6-, and 12-month treasury bill program would also improve CBN's ability to manage excess liquidity and help accelerate the process of separating monetary from fiscal borrowing operations.

119. Experience shows that secondary market trading has been slow to develop in most developing and emerging market countries (BIS 1996). However, a liquid and active secondary market for government securities is important as it helps lower the liquidity premium. It allows financial institutions to convert government securities into cash at low cost. It provides an avenue for risk management, and thus helps broaden the investor base. All in all, this also helps lower the borrowing costs to the government.

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<sup>36</sup> IMF and World Bank (2001).



120. Greater reliance on market-based operations for day-to-day liquidity management by the CBN would help improve the functioning of the secondary market for treasury bills and increase liquidity in this market. There are, however, a host of other factors that may be affecting trading volume and incentives for banks to actively manage liquidity and interest rate risks in Nigeria, such as (i) lack of market-clearing rate; (ii) high liquid asset requirements; (iii) easy access to the central banks' discount window; (iv) absence of mark-to-market accounting; (v) the presence of excess bank liquidity; and (vi) more generally, weak banks and poor risks management capacity in the financial system.

### **Market-clearing pricing**

121. The manner in which the cut-off price in the primary auction for treasury bills is administered by the CBN undermines market development. A basic requirement for the successful development of the government securities market is accepting the principle that all debt instruments be priced at market-clearing rates in the primary market.<sup>37</sup> While accepting this principle may constitute the most difficult challenge for the federal government as it can lead to much higher debt-servicing costs, over the medium term it would remove the distortions inherent in the financial system. In this regard, the cut-off price should be set at a level that clears the amount offered. Well defined and transparent rules should be developed to address the problem of outliers and collusion. Market-determined interest rates would also stimulate secondary market trading, which would lower the liquidity premium and, hence, the government's borrowing cost over time.

### **Liquid asset ratio**

122. A gradual reduction of the liquid asset ratio would help stimulate secondary market trading, and provide for a better indication of the true cost of capital as the government would have to draw on the market for funding. To achieve the gradual reduction, it will be important to address the main sources of excess liquidity in the financial system, such as expansionary fiscal policies, inadequate real investment opportunities, and ineffective liquidity management.

### **Discount window**

123. The current modalities governing the CBN's rediscount window are not appropriately designed to encourage active secondary market trading in government securities and, more broadly, liquidity management in the interbank market. While the CBN's secondary market window—in place since the early 1990s—served a useful transitional role in helping the development of the government's treasury bill market, it has since become a deterrent. The main problem is that the cost of borrowing from the CBN's discount window—the minimum

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<sup>37</sup> IMF and World Bank (2001).

rediscount rate (MRR), which is the policy rate applied to all transactions within the CBN's discount window—and which is administratively set—has, at times, fallen below the interbank offer rates and primary treasury bill rates. The accommodative policy has made it easy and cheap for banks, in particular weak ones, to transact with the CBN rather than with the market. More restrictive access—by raising the MRR at a premium above the interbank offer rates and treasury bill rate and more frequent adjustment—would require banks to manage liquidity in the market, and strengthen the CBN's control over its reserve money base.

### **Mark-to-market accounting**

124. The Nigerian statement of accounting standards (SAS) applies historical cost accounting for tradable instruments. This implies that government securities held by banks do not reflect on a daily or monthly basis their market value, and that valuation losses and gains are registered only at the point of trading. Adopting mark-to-market accounting—which requires that financial institutions regularly and frequently revalue securities or other assets in accordance with market prices—could encourage more active secondary market trading, as banks would have to more prudently manage their balance sheet exposure to market risk. However, given the highly volatile environment, judgment will need to be used when moving toward mark-to-market reporting requirements, in particular for pensions and insurances which tend to hold to maturity.

### **Weak banks and risks management**

125. A sound government bond market is also built around competitive financial institutions which have adequate financial capital and capacity for managing risks. The 2002 FSAP identified shortcomings in banks' risk management capacity. Since banks are expected to play a dominant role in the government securities market (as dealers, holders, and custodians), their weak risk management capacity could have adverse consequences for the profitability of the banking system. Hence, it is important that the regulatory framework continue to be strengthened, in line with recent efforts by the CBN and the Nigerian Deposit Insurance Corporation, to ensure that banks and other financial institutions have adequate financial and risk management capacity to prudently manage their balance sheet exposure to market risks.

126. For a sustainable development of the government securities market, it will be important to broaden the investor base. A more diversified base—in terms of time horizon, risk preferences, and trading motives—ensures higher liquidity and a more stable demand for government securities, lowering the liquidity risk premium and borrowing costs to the government. In this regard, the government's announced pension reforms—moving from a pay-as-you-go to a fully funded system—would be helpful to foster demand for longer-term government instruments.

### **Cash management and coordination**

127. The success of the domestic debt reforms will also hinge on effective cash management in executing the federal government budget. The capacity to articulate a clear annual and quarterly debt issuance and redemption strategy will depend on the federal government effectively executing the budget, and its ability to develop accurate cash-flow projections during the course of the year. This will also require understanding the seasonality in revenue flows and cash spending, as well as the timing mismatch in government revenue and expenditures. Moreover, a market-oriented funding strategy would require that the DMO and the Office of the Accountant General of the Federation (OAGF) coordinate with the CBN, and give careful consideration to market liquidity conditions in its issuance strategy. This is important to minimize borrowing cost and improve asset-liability management. In this regard, the establishment of the Cash Management Committee in early 2004 has been useful in helping improve coordination between the CBN and the OAGF, and in developing cash flow and borrowing projections for 2004.

128. However, more needs to be done to enhance the transparency of fiscal and debt operations. This would help reduce risk perception and broaden investors' interest in a sustainable manner. The DMO and the CBN should provide the market with reliable and frequent information on all aspects of debt management operations (i.e., size of deficit, sources of financing, composition of debt, maturity and redemption profile). All materially relevant information on government finances would need to be disclosed, in particular any explicit and implicit government liabilities such as expenditure arrears. The government may also want to consider designing a realistic and affordable strategy to deal with any such liabilities so as not to undermine debt sustainability. Furthermore, the DMO would need to start preparing and publishing both an auction calendar for the year and quarterly auction calendar. Finally, the auction results should be made available on a timely basis by reducing the time lag between bid closing and announcements of results (at the moment, more than one working day).

### **Operational autonomy of the central bank**

129. Finally, further reforms are warranted to formally separate debt management from monetary functions. This would help address the investors' concern that the government will resort to inflationary financing, which could expose them to capital losses on their government securities' holdings. It would also help improve effectiveness of liquidity management, and allow the CBN to focus on price stability.

130. Recognizing the importance of price stability to sustainable capital market development, countries have strengthened the autonomy of their central banks. They have introduced restrictions, either by legislation or written agreements, that prohibit or sharply restrict central bank financing of the government. In particular, strict regulations have been introduced in, inter alia, Brazil, Chile, Peru, and Poland where lending to the government is prohibited by the constitution. Moreover, some have passed regulations that set clear rules for the central bank's intervention in the primary market. For instance, in the U.S. and

Mexico, the central bank can replace maturing government paper, but cannot be a net purchaser of government paper.

131. Such provisions should form a core part of the government's overall debt management reforms. This would also reinforce the perception that the government is committed to market-based financing, developing the government securities market in a sustainable manner, and enhancing transparency of government funding operations. In this regard, immediate consideration should be given to sharply reducing the statutory limit on the overdraft facility to no more than 5 percent of the projected tax revenue in the current fiscal year (similar limits are in place in Kenya; in Mexico the limit was set at 1½ percent). In Botswana, a 5 percent limit is set on overall lending to the government, including purchases in the primary market. The overdraft facility should be strictly used to meet short-term cash needs and be cleared within the financial year, to remove any source of inflationary financing. A lower access limit would also facilitate liquidity management and force the government to improve its cash management operations. Moreover, all temporary advances to the government should bear market interest rates. In Kenya, for instance, the central bank law stipulates the use of market-determined interest rates for government borrowing. Similarly, the CBN should stop being a net buyer of government securities in the primary market (similar reforms have been called for in the Fiscal Responsibility Bill). This would also ensure that the CBN cannot influence the interest rate in the government securities market. In line with best practices, once a good cash management system has been put in place, the government should be required to finance all its borrowing needs—short- and long-term—in the market.

## **E. Conclusion**

132. The government's public debt management reforms represent a significant break from past practices of financing and managing public debt. It also addresses several shortcomings in the institutional framework governing debt management. These notwithstanding, the reforms will only be successful and sustainable if accompanied by responsible fiscal and monetary policy. The undersubscription in longer-dated bonds in the October 2003 auction was a good indication that in the absence of credible fiscal and monetary policies, investments in longer-dated fixed-income products will be highly unlikely. In line with best practice guidelines, the authorities' near-term focus should be on developing a working treasury bill market and active secondary market. The implementation of the 2004 budget would go a long way to addressing the macroeconomic risks and fiscal sustainability concerns, and help support the domestic debt management reforms. The reforms' success will also critically hinge on improving cash management capabilities and coordination between the monetary and fiscal authorities. Improving transparency in fiscal and monetary operations and enhancing the operational independence of the CBN will also be critical elements in establishing market credibility. In this regard, the federal government should develop a strategy to deal with its large stock of expenditure arrears. Finally, a well-functioning government securities market can only develop in an environment supported by sound regulations and a healthy financial system.

## F. References

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## V. IMPROVING TRANSPARENCY IN THE OIL SECTOR<sup>38</sup>

### A. Introduction

133. **Nigeria was one of the first oil-producing countries to commit to improving transparency in the oil sector under the Extractive Industries Transparency Initiative (EITI).** President Obasanjo has stated that the government places high importance on the EITI for achieving the objective of a more transparent and corruption-free Nigeria. The authorities believe that greater transparency would enable a democratic debate on fiscal policy and spending priorities, establish accountability by reducing corruption and waste at all levels of government, assist in economic management and forward planning, and improve the investment climate. The authorities acknowledge that the public needed a better understanding of the sources of revenue from oil, and the institutions responsible for revenue assessment, collection, and reporting.<sup>39</sup>

134. **This chapter briefly describes the EITI, and discusses the Nigerian authorities' efforts to enhance transparency in the oil sector, and operationalize the guidelines of the initiative.** It assesses the challenges the authorities are likely to encounter in making good on their commitment: the oil sector is complex, as there are many different revenue streams from a large number of companies, and information on government oil revenue which is currently produced by several different agencies and is not always consistent. Publication of inconsistent data would raise questions. However, following the authorities' public announcements that information would be made transparent, they should move speedily to prepare for publication. In the third part, the chapter argues that making available information according to the EITI guidelines would not be sufficient to fulfill the government's own information requirements. Reporting under the EITI guidelines would allow the public to compare payments made by oil companies with payments received by the government on a yearly basis. More detailed knowledge of the oil sector however, is needed for the Nigerian authorities to maintain effective oversight of the oil sector and make informed policy decisions. Data on payments made and received have to be verified, and reconciled with payments due on the basis of production, prices, and tax arrangements.

### B. Transparency and Accountability

135. **Transparency encourages public debate and facilitates the acceptability of decisions by the public.** In a transparent environment, social tensions over the roles of stakeholders and the distribution of real or perceived benefits from oil and gas can be significantly reduced. At the international level, a transparent investment environment allows

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<sup>38</sup> Prepared by Ulrich Bartsch.

<sup>39</sup> Statements made at the opening of the petroleum revenue management workshop, Abuja, 19 February, 2004.

the lenders of financial resources to better assess country risk. By lowering uncertainty, investors lower the risk premium they expect for engaging in a country. In the same vein, the cost of capital for both governments and companies can be lowered. Therefore, governments, national oil companies (NOCs), and international oil companies (IOCs) stand to benefit from transparency.

136. **Recognizing the need for greater transparency, a broad coalition of 200 non-governmental organizations (NGOs) led by George Soros' Open Society Foundation agreed on a common platform which calls for greater transparency in petroleum sector operations, and launched the Publish What You Pay campaign.** They asked for international regulation requiring IOCs to publish payments to host governments. Such regulations could be in the form of requirements IOCs have to follow when listed in stock exchanges (e.g. the rules defined by the Securities and Exchange Commission in the United States).

137. **Taking the view that host governments should take the lead in promoting transparency, the U.K. Department for International Development (DfID) embarked upon the EITI.** At Evian, in France, in June 2003, the Group of Eight (G8) industrialized countries expressed support for the EITI, reaffirming their commitment “to fight corruption more effectively, including a specific initiative on extractive industries.” They encouraged governments and companies to disclose information on revenue flows and payments from the extractive industries to an agreed third party. The G8 also encouraged the IMF and the World Bank to give technical support to the governments participating in the initiative. To operationalize the EITI, a multi-stakeholder group has been formed, and several countries, among them Nigeria, pledged to participate in the initiative.

138. **The multi-stakeholder group developed templates to be filled by governments and oil companies (see Table V-1).** Reports are requested on all sources of government revenue from extractive industries, including the government production stream in kind and in cash, and payments to governments for profit taxes, royalties, dividends, bonuses, and fees. The group agreed that the reporting of the main revenue concepts is obligatory under the initiative, but that there may be secondary benefit streams, e.g. payments to social funds, that are reported on a voluntary basis only. Because of the multitude of companies and revenue concepts, the initiative proposes that payments be aggregated and published by an independent, trustworthy institution, “the Aggregator”. There is still some debate among stakeholders as to the aggregation, however, with some fearing that it would lead to loss of information and clarity. It should be noted that the initiative proposes that governments report on payments received, and request that companies fill out their own templates with payments made.

### C. The Nigerian Transparency Initiative

139. **The Nigerian authorities are taking a participatory approach to improving transparency.** After declaring the government's intention to publish oil revenue in line with the EITI guidelines in November 2003, President Obasanjo created the National Stakeholders Working Group (NSWG). The group consists of 27 members drawn from a broad cross

section of the Nigerian government, civil society, and oil companies, and is coordinated by Dr. Oby Ezekwesili, Special Assistant to the President on Budget Monitoring and Price Intelligence. Nigeria is also a pilot country for a G8 partnership to promote transparency and combat corruption (Box V-1).

**Table V-1. EITI Government Reporting Template**

140. **To launch the EITI, the NSWG organized a workshop in Abuja in February 2004.** The workshop provided a platform to sensitize and encourage a collaborative and cooperative engagement of all stakeholders in the petroleum industry. The workshop was inaugurated by President Obasanjo and attracted more than 200 participants (see Box V-2).<sup>40</sup>

141. **Following the workshop, the stakeholder group prepared terms of reference for independent audits of oil sector payments to the government,** covering the private oil companies, the Nigerian National Petroleum Corporation (NNPC), the Central Bank of Nigeria (CBN), and the Office of the Accountant General (OAGF). The selection process for the audits is expected to start in the summer, and audit reports would then be available in early 2005. In the meantime, the authorities plan to publish preliminary data on oil revenue received, possibly by August 2004. The authorities have created a unit in the Ministry of Finance to help coordinate the effort. Given weaknesses in technical capacity and data availability, this reporting will most likely be limited in scope at first, but should improve over time, with capacity building and structural improvements following the audit reports.

**A Input template for Host Government Reporting Entity**

Host Country reporting on: \_\_\_\_\_

Reporting Period: \_\_\_\_\_

Scope 1 Benefit Streams				
		Guidelines section 6 ref	Volume	Value
<b>1</b>	<b>Benefit Stream from International Companies only</b>			
1a)	Host Government Production Entitlement from International Companies i) Production Stream - in kind	i		
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) Production Stream - in cash			
<b>2</b>	<b>Benefit Stream from National State-Owned Companies</b>			
2a)	Host Government Production Entitlement from National State-Owned Company i) Production Stream - in kind	i		
	*[specify nature of production and units]			
	*[specify nature of production and units]			
	ii) Production Stream - in cash			
<b>3</b>	<b>Benefit Streams from International and National State-Owned Company</b>			
3a)	Profit taxes	iii		
3b)	Royalties	iv		
	- in cash			
	- in kind			
3c)	Dividends	v		
3d)	Signing bonuses and production bonuses	vi		
3e)	Licence fees, rental fee, entry fees and other considerations for licenses/concessions	vii		
3f)	Other payments to Host Governments	viii		

Scope 2 Benefit Streams			
Line ref		Volume	Value
<b>4</b>	<b>Scope 2 Benefit Streams (voluntary disclosure):</b>		
	_____		
	_____		
	_____		
	_____		

Host Government sign off

We acknowledge our responsibility for the fair presentation of the Reporting Template in accordance with the Reporting Guidelines, with the exception of:

I. \_\_\_\_\_;

II. \_\_\_\_\_;

<sup>40</sup> About 80 of the participants came from the government, 100 from the private sector and civil society organizations, and 30 from international organizations. The workshop aimed at providing a broad overview of technical and political issues in the petroleum sector.



### **Box V-1. Nigeria: G8/Nigeria Partnership**

Nigeria and the members of the G8 announced on June 10, 2004, their intention to cooperate in a 'Compact to Promote Transparency and Combat Corruption', to counter what is seen as a threat to democratic institutions, economic development and to the integrity of the international system of trade and investment.

In the compact, the government of Nigeria commits to continuing implementation of the national anti-corruption strategy, which is part of the authorities' National Economic Empowerment and Development Strategy (NEEDS). Under the strategy, several measures have already been implemented: (i) The reform of the budget formulation process. Presentation, consultation, implementation and monitoring is being done with clear rules, roles and responsibilities, (ii) stringent guidelines for public contracting have been introduced conform to the standards of internationally competitive bidding, (iii) a standing multi-stakeholder group has been set up to implement transparency under the Extractive Industries Transparency Initiative (EITI), (iv) Core institutions to investigate, prosecute and sanction corruption have been strengthened, and (v) civil service reform aimed at improving effectiveness and accountability has started in a number of pilot ministries.

#### **Statement of the G8 Governments**

For their part, G8 countries commit to act together to fight corruption and increase transparency. More specifically, the member countries of the G8 agreed to the following: (i) become parties and call for rapid signature and completion of all necessary steps to ratify and implement the UN Convention Against Corruption, (ii) work with other members to detect, recover and return illicitly acquired proceeds of corruption, (iii) put in place new methods to coordinate G8 asset recovery actions, (iv) seek in accordance with national laws to deny safe haven to public officials guilty of corruption, (v) work with the international financial institutions (IFIs) and UN agencies to encourage anti-corruption and transparency actions by developing countries, (vi) adhere rigorously to an updated peer review schedule for the OECD Anti-Bribery Convention, (vii) implement the Financial Action Task Force (FATF) revised recommendations and promote implementation of the UN Transnational Organized Crime Convention (TOC), and (viii) work towards including in G8 regional and bilateral trade agreements provisions requiring transparency in government procurement and the awarding of concessions, as well as provisions on trade facilitation.

#### **Proposed Actions to Launch a Nigeria Transparency Compact**

A number of G8 countries are prepared to work to find ways to support the efforts of Nigeria to enhance transparency, use public resources wisely and fight corruption. Representatives of the Government of Nigeria and of participating G8 countries intend to meet soon to make the compact operational.

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Sources: Nigerian authorities; and <http://www.whitehouse.gov/news/releases/2004/06/20040610-34.html>.

**Box V-2. Nigeria – Extractive Industries Transparency Initiative (EITI) in Nigeria, Petroleum Revenue Management Workshop**

A workshop was held in Abuja during February 19-20, 2004, to inaugurate the Nigerian efforts to enhance transparency in line with the EITI guidelines. The workshop aimed at providing a broad overview of technical and political issues in the petroleum sector. Sessions covered revenue collection, revenue management, expenditure efficiency, and a stakeholder roundtable and closing discussion.

**Revenue collection.** Speakers discussed the Nigerian fiscal regime and petroleum production costs. Nigerian fiscal terms for crude oil are relatively stringent, with a petroleum profits tax rate of 85 percent. In contrast, work to develop regulation for natural gas needs to be finalized with some urgency. There were calls for strengthening cost control procedures in the National Petroleum Investment Management Services (NAPIMS). Similarly, a participant pointed out that petroleum tax calculations were needlessly complicated and that the technical competencies of the Federal Inland Revenue Service (FIRS) needed to be strengthened in order to effectively monitor tax payments.

**Revenue management.** The Nigerian strategy for macroeconomic stabilization aims at generating savings and smoothing expenditure. The sessions highlighted the importance of prudent oil price projections and the fiscal responsibility pact between the federal, state, and local governments. In order to improve expenditure effectiveness, Professor Soludo, then Chief Economic Adviser to the President and now Governor of the Central Bank, called for improved budget processes, including the involvement of stakeholders in the identification of priorities. Another participant demonstrated that countries had succeeded in maximizing the benefits from oil revenue using clear fiscal rules for delinking spending from oil revenue.

**Expenditure efficiency.** Better budgeting would require the adoption of an oil-price based fiscal rule, setting aggregate spending limits and sub-limits for major expenditure heads, while respecting financing constraints and sustainability of expenditure. Over the medium term, Bode Augusto, Director General of the Budget Office, called for spending on payroll and overheads to be reduced in order to allow for an increase in the capital budget. Speakers admitted that living conditions remained precarious despite increased government spending because of its low efficiency.

**During panel discussions and interventions from the audience,** the need for greater transparency was generally accepted. In this regard, the recent publication in the media of revenue allocations to state and local governments was lauded as an important step to improve accountability. However, the discussions highlighted the tensions that exist between the federal government and some regions, and frustration over widespread poverty. The international oil companies were criticized repeatedly for not doing enough to minimize environmental damage and increase local content, and for alleged non-transparent behavior and involvement in corrupt practices.

## D. Oil Revenue Reporting Issues

142. **The data currently produced by various government agencies and the NNPC are not always internally consistent and cannot be easily interpreted.** The oil industry is complex, and the Nigerian oil sector is no exception (see Table V-2 for an overview of fiscal regimes in selected oil-exporting countries). Government revenue derives from many companies that pay several different taxes. The EITI templates are not designed, at this stage at least, to reflect these complexities. This section presents some of the issues that will need to be addressed in order to enable the government to provide timely and credible oil revenue reports.

Table V-2. Nigeria and Selected Oil Exporting Countries: Fiscal Regimes  
(in percent)

Country	Royalties	Production Sharing	Income tax rate	Resource rent tax	D.W.T. (nonres.)	State equity
Abu Dhabi	12.5-20	None	55-85	Product.	...	60
Algeria	10-20	50-85	None	None	20	51
Angola	16-20	50-90	50	None	...	25
Cameroon	Negotiable	None	57.5	None	25	50
Ecuador	12.5-18.5	None	25-44	Formula	25	None
Egypt	10	70-87	40.55	None	...	None
Gabon	10	65-85	None	None	...	15
Indonesia	...	80-90	35	None	13	10
Libya	16.67	Yes	65	None	...	...
Malaysia	10	50-70	38	70%	None	25
Mexico	None	None	35	None	7.7	None
Oman	None	80	55	None	None	None
Nigeria	0-20	20-65	85	None	10	Variable
Qatar	...	80-90	None	None	None	None
Trinidad&Tobago	...	Variable	50	0-45	...	None
Venezuela	16.7	None	67.7	None	None	0-35

Source: Baunsgaard (2001).

### Background

143. **More than 90 percent of Nigerian oil is produced by joint venture companies.** The government participates in these joint ventures with a 55-60 percent share managed by the National Petroleum Investment Management Service (NAPIMS), a subsidiary of the NNPC.<sup>41</sup> The Nigerian government receives oil revenue from the joint ventures through (i) royalties calculated as a percentage of gross production, (ii) petroleum profit tax (PPT),

<sup>41</sup> With the exception of the joint venture with Royal Dutch/Shell at 55 percent, all JVs have 60 percent government participation. The JV production-weighted average government share is 57 percent.

and (iii) dividends (equity oil) for its equity participation in the oil fields, as specified in a 2000 memorandum of understanding (MoU) amending the standard licensing and operating agreement of 1992. In principle, NAPIMS functions as an oil company, i.e. it incurs costs, and pays royalties, PPT, and dividends. In practice, however, gross export proceeds from the NAPIMS share of production are paid to the OAGF, which in turn allocates funds to NAPIMS for its contribution to operating and investment costs (cash calls) in the oil fields.<sup>42,43</sup>

144. **In addition to the joint ventures, oil is produced by “indigenous producers”,<sup>44</sup> under production sharing contracts (PSCs), and under “carried interest”.** The production under PSCs is projected to increase during 2004-05 as new fields come on stream. These are located in offshore areas, where greater incentives and easier cost recovery schemes were deemed necessary to attract the large upfront investment needed to develop the resources. Under PSCs, international oil companies initially pay only royalties until production offsets initial investment outlays; after cost recovery, production value of costs and royalties is shared between the IOC and the government. Cost recovery is expected to take three to four years under the current high oil prices. Royalty rates depend on water depth; for fields in water deeper than 1000m, no royalties are payable, which means some of the new developments will pay no government revenue until initial costs have been recovered.

145. **Due to funding constraints, Nigeria has developed some fields under joint venture arrangements, but with carried interest.** This implies that the IOC partners in the field finance NAPIMS’ share of the cost. The IOCs are repaid out of the government’s equity share of production (see Box V-3).

146. **The projected increase in production under PSCs in 2004 would be offset by a decline in production by “indigenous producers”.** The government’s equity share is therefore projected to reach 52 percent of total production in 2004.<sup>45</sup>

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<sup>42</sup> This difference in concepts means the auditor-certified annual accounts for NAPIMS cannot be compared to government revenue receipts.

<sup>43</sup> For a more detailed description of the Nigerian fiscal regime, see IMF (2002).

<sup>44</sup> “Indigenous producers” are Nigerian companies operating small marginal fields at their sole risk. They pay royalties and petroleum profit tax, but the government has no equity participation.

<sup>45</sup> The government’s overall equity share changes from year to year, as production under alternative arrangements changes. It was 47 percent in 2003.

### **Box V-3. Nigeria: Carried Interest Arrangements for Oil Projects**

To implement projects in the oil sector that are not funded by the government budget, the NNPC entered into carried interest arrangements with foreign oil companies. These arrangements are not uncommon in the oil industry. They allow governments to participate directly in oil project revenue without an initial capital investment. Such arrangements are often used in countries where government equity participation is mandated by law, and production sharing arrangements, or production under license with taxation of profits, are illegal.

In the Nigerian arrangements, IOCs cover initial investment outlays, and ongoing operating and capital costs for a specific project over the life of the project. The equity shares in the project are 60 percent for the government, and 40 percent for the IOC. The total revenue stream from the project is divided according to the equity shares. The IOC pays its share of costs, royalties, and PPT on taxable income (gross revenue minus costs and royalties).

In addition, the arrangement contains profit sharing clauses. The IOC pays the NNPC's share of costs and is reimbursed by the NNPC. The NNPC's share of costs is therefore deducted from NNPC's gross revenue and paid to the IOC (cost oil). The NNPC's net revenue (profit oil) is then shared between the NNPC and the IOC, with the latter receiving 40 percent. This profit sharing represents remuneration for the IOC for the initial capital investment. The IOC pays PPT on the profit oil it receives from the NNPC.

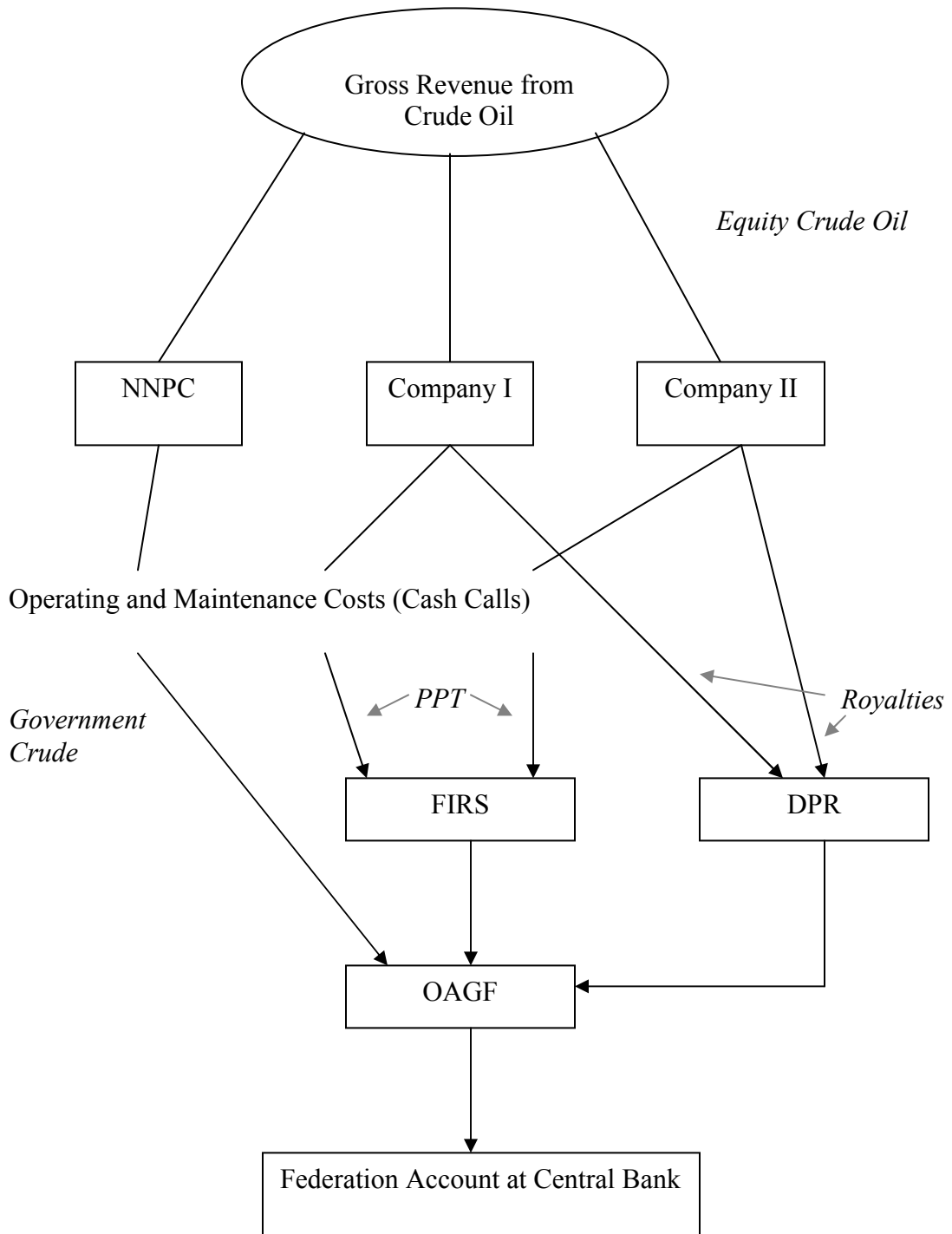
### **Revenue flows**

147. **The collection of government revenues from the oil sector involves various agencies.** All government funds pass through central bank accounts. Figure V-1 shows the flow of revenues from an oil production license owned by several joint venture companies in which each sells its share of crude oil production; NAPIMS' share is 55-60 percent, depending on the joint venture. Gross proceeds from exports of the NAPIMS share go to an oil proceeds account at the CBN, and from this account the OAGF pays cash calls for operating and maintenance costs, and for investment. Net proceeds are paid into the Federation Account in the CBN, from which distributions to the federal and state and local governments are made.

148. **The IOC joint venture partners pay royalties to the OAGF, through the accounts of the Department of Petroleum Resources (DPR).** They also pay PPT to the Federal Inland Revenue Service (FIRS) based on their share of costs and the MoU formula.

149. **The NNPC buys crude oil from the government's equity share for domestic refining.** The domestic allocation (DA) is fixed at 445,000 barrels per day and was, until

Figure V-1. Nigeria – Flow of Funds from the Oil Sector



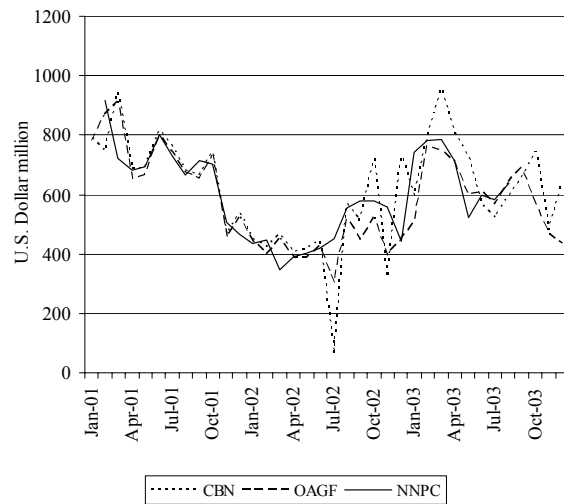
October 2003, sold at a price substantially below the international market price.<sup>46</sup> The volume of crude oil from the government's equity share in the joint ventures available for export was therefore reduced, and the government received a more limited amount of revenue for the DA from the NNPC instead. Since October 2003, the NNPC pays market price for the DA, and the DA has no impact on government revenue anymore.

### Reported oil revenue

150. **Data on oil revenue are collected by the NNPC, the CBN, and the OAGF.** The NNPC provides data on equity crude oil exports and the DA in U.S. dollars. The CBN reports both U.S. dollar and naira amounts for equity crude proceeds, PPT, and royalties. The OAGF reports all receipts in naira. Discrepancies routinely emerge between revenue as reported by these three sources, which may, in some months, be significant. Such discrepancies are mostly due to time lags in registering payments, exchange rate movements, and difficulties in reconciling differences in definition. Discrepancies, however, may also persist over longer periods.

151. **For illustration purposes, Figure V-2 shows proceeds from the sales of government equity crude between January 2001 and March 2004 in millions of U.S. dollars as reported by the three institutions.** The series have been adjusted for the one-month time lag between NNPC revenue reporting and the payments recorded by CBN and OAGF.<sup>47</sup> Despite this adjustment, significant discrepancies between the three series exist, and they become much more pronounced after July 2002. The cumulative discrepancies between the series are significant: the OAGF reported revenue of US\$20.5 billion, whereas the CBN recorded US\$22.3 billion and NNPC US\$21.9 billion for the three-year period.

Figure V-2: Nigeria - Revenue from Sales of Government Equity Crude, 2001-03

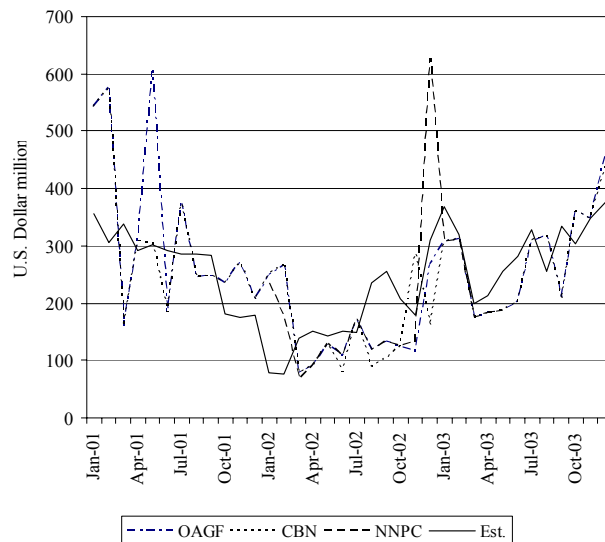


<sup>46</sup> The price was significantly below the market price in order to subsidize the NNPC's downstream operations, which were incurring losses because the official retail price for petroleum products did not cover costs of refining, imports, and distribution at market price (see chapter on Petroleum Products Market for more details).

<sup>47</sup> The NNPC series has been shifted by one month to the right.

152. **Since PPT depends on costs of production that are known only at the end of the period, payments during the year are posted according to estimates made towards the end of the preceding year.** FIRS is charged with monitoring the parameters that determine PPT payments, and revising estimates accordingly during the year. The joint venture partners are required to submit final cost accounts at the end of the current year by May of the following year. FIRS then makes an assessment of under- or overpayment, and in case of the former, the companies are given 60 days to make a final payment. As shown in Figure V-3, the CBN and the OAGF are relatively consistent during much of the period shown, with a few exceptional months that are not easily explained. The NNPC numbers are less consistent, and they are not available for the whole period.<sup>48</sup> Surprisingly, the OAGF reported higher receipts than the CBN, namely US\$10.8 billion as against US\$10.2 billion over the January 2001-March 2004 period.

Figure V-3: Nigeria - Estimated and Reported PPT Revenue, 2001-03



153. **As a further demonstration of difficulties in following-up on oil related flows, staff estimates of payments due and actual payments received differ significantly on a monthly basis, as could be expected.**<sup>49</sup> However, the sum over the three-year period of staff estimates and payments recorded by the central bank differ “only” by about US\$100 million (about 1 percent of PPT paid). The data reported by CBN and the OAGF on royalties match rather closely.

### Implications for revenue reporting under the EITI

154. **The available data raise questions.** The publication of such data could cause confusion and add to the public mistrust in petroleum revenue management in Nigeria.

<sup>48</sup> It should be noted that the NNPC is not concerned with the collection of PPT, but that it calculates PPT for the joint venture partners to register payments for NAPIMS’ accounts.

<sup>49</sup> Staff estimates are based on actual production and cost data, and the formula specified in the MoU. In contrast, payments reported by the CBN and OAGF are based on ex ante estimates of production data, and the agreed work program for the year. Tax assessments are made on the basis of actual production and cost data at the end of the tax year (April-March), and adjustments are paid during April-May.



However, a delay of publication until after these issues have been resolved, would not be useful. First, delays would probably raise more suspicions than careful publication (with the admission of shortcomings in the data and some accompanying explanations) following the authorities' public announcements of their commitment to transparency. Second, the publication of preliminary data would show the government's commitment to transparency, and public interest could help promote reforms to improve oil sector oversight.

155. **There is an urgent need for reconciliation between data sources.** NNPC, CBN, and OAGF should be able to explain discrepancies by reconciling different definitions, and accounting for time lags between export shipments, payments made, and payments registered. The data series then need to be independently verified by the planned external audits of oil sector accounts. It will still be difficult, however, to present the different revenue concepts and sources in a way that can be easily understood by the public. The revenue flows from alternative licensing arrangements are even more difficult to present than those from the joint ventures. The carried interest arrangements are particularly complicated. The NSWG has to note that a careful aggregation of data and some measure of public awareness campaign may be needed to establish credibility. Information on the financial consequences and an explanation of the reasons for entering into the alternative licensing arrangements will have to be provided.

156. **To help facilitate the reconciliation of oil data, the authorities could work more closely with IOCs to receive assistance in data reconciliation and to build technical capacity.** The authorities have also requested technical assistance for revenue collection agencies and the NSWG from the Fund, the World Bank, and bilateral donors. Technical assistance in tax administration is being provided by the Fund, while the World Bank and DfID have agreed to finance training of Nigerian officials in oil taxation issues.

### **E. Oil Revenue Transparency for Policy Making**

157. **The EITI templates are designed to inform the public of the amount of oil revenue paid by oil companies to the government, and the amount received by government.** While the availability of information required by the EITI templates would constitute an important improvement over the current situation in many oil producing countries, it is not sufficient for decision making. A wider set of information is needed for the government oversight of the oil sector: the government needs to be able to not only compare payments made with payments it received, but also with payments due on the basis of production volume, prices, and tax arrangements. The government also needs more frequent updates on developments in the oil sector than the yearly publication cycle proposed by the EITI. A detailed understanding of the oil sector is also needed for adequate budgetary projections.

#### **Oil revenue monitoring and projections**

158. **Monitoring of revenue from the oil and gas sector is weak in Nigeria due to the complicated tax rules and limited technical and institutional capacity.** Weaknesses in the information sharing system between the different agencies involved hamper the

government's ability to determine payments made and received at any given time. Individual oil companies may be tempted to take advantage of the weaknesses and this possibility creates mistrust of all oil companies with frequent allegations of fraud.<sup>50</sup>

**159. Out of the three main sources of oil revenue, government equity crude and royalties are relatively easy to monitor, whereas PPTs are much more difficult.** Some of the main challenges are as follows:

- The need to follow up on payments. Information collected by the DPR and NAPIMS on crude oil liftings, realized prices, expected payments, payments made, and payments outstanding has not always been available to the Ministry of Finance and the OAGF on a timely basis, although the recently formed Cash Management Committee has improved the situation.
- The ability to assess PPT liabilities, payments made, and payments outstanding. This is technically difficult because of the complicated formula in the MoU (the definition is 15 pages long), the time lags between monthly payments and year-end adjustments, and the fact that the fiscal year for oil companies is not the same as the Nigerian fiscal year.
- The need to understand and control costs of production to be offset against tax liabilities. It has been noted that costs of production in Nigeria increased each year since the mid-1990s, despite a trend in the opposite direction in the international oil industry.<sup>51</sup> While NAPIMS is a member of the joint venture operating committees that define work programs and cost structure, it cannot effectively be both equity partner and regulator of joint venture companies. Nigeria, therefore, lacks an independent evaluation capability of the cost structure.
- The need for more information on operations under alternative licensing arrangements. NAPIMS is not an equity partner in arrangements such as production sharing or sole risk licenses, and information on operations is therefore weaker than in the joint ventures.
- The authorities need more information on gas production and use in Nigeria. Gas exports are becoming increasingly important as the Nigeria Liquefied Natural Gas (NLNG) company is expanding. The company is a joint venture between the NNPC (with

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<sup>50</sup> Oil company executives are often asked to testify before parliamentary committees to clear misunderstandings; in addition, numerous partly overlapping committees are charged with overseeing the oil sector, which delays decision making in the sector and increases production costs.

<sup>51</sup> World Bank (2000).

49 percent equity) and foreign oil companies. It enjoys tax breaks but is expected to start paying dividends in 2004, despite ongoing investment out of retained earnings.<sup>52</sup>

160. **While the templates for oil revenue reporting provided under the EITI may not be sufficient to alleviate oil sector monitoring weaknesses in Nigeria, audits would contribute to enhancing the knowledge of revenue agencies about the industry, and reduce the potential for fraud.** The current weaknesses stem mainly from the lack of an effective system of information gathering and sharing between the many different agencies. Regarding government equity share exports, payments can be tracked on a per-shipment basis with the information available from the Crude Oil Marketing Department (COMD) of NNPC. Crude oil liftings are monitored by the DPR, which gives it the information needed for assessing royalties. The DPR and NAPIMS collect all relevant information on cost. Regarding PPT, however, even with information on the cost and export proceeds, the assessment formula is complicated, tax reassessment only comes at the end of the tax year, there are no penalties and interest on late payment of taxes, and the oil industry tax year does not coincide with the official fiscal year. Effective oversight is technically difficult.

161. **The enhanced understanding of the oil and gas sector activities expected from audits and better systems of information sharing would also help in the preparation of realistic budgets for the government.** Detailed information on production from different fields, contractual arrangements, and price forecasts are necessary to prepare the annual federal and SLG budgets. Budgeting so far has relied on simple approximations of the government equity share (the JV share of 57 percent has been used), and the PPT formula. In a more transparent environment, this may not be sufficient. An oil and gas policy unit has been created in the ministry of finance to provide oil sector intelligence. The unit intends to utilize a computer model of the Nigerian oil sector that would enable it to make accurate simulations of government revenue under different scenarios. Members of the unit will also benefit from the training financed by the World Bank and DfID.

## F. Conclusions

162. **The Nigerian authorities have committed to full oil sector transparency.** Their approach is based on the involvement of civil society and consensus building in order to overcome the public's mistrust of the government after decades of military rule. The EITI aims at making available to the public a set of data to compare payments made by oil companies to the government with payments received. The chapter has discussed the challenges that lie ahead given data discrepancies, which are mostly due to reconciliation issues (time lags, exchange rate issues, and definitions that differ).

163. **At the same time, the authorities will need a wider set of information than proposed under the EITI for policy making.** This chapter has suggested that information

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<sup>52</sup> See chapter on Natural Gas Prospects for staff estimates of dividends.

would be needed for comparing payments made with payments due for effective oil sector oversight and projections of oil revenue for budgeting purposes. The chapter has identified a weak system of information sharing between NNPC and government agencies, and the portrayed complexity of the PPT regime as a source of weaknesses in oil sector oversight. While the formula in the MoU cannot be easily modified (as it would necessitate renegotiation of the oil licenses), the government can address information sharing issues, more frequent tax reassessment, and incentives for early tax payments. It could also align the petroleum profit tax year with the Nigerian fiscal year.

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## **VI. NIGERIA'S EXCHANGE RATE REGIME—EXPERIENCES AND OPTIONS FOR FURTHER REFORM<sup>53</sup>**

### **A. Introduction**

164. Despite numerous attempts at reform over the past two decades, Nigeria's foreign exchange market continues to be characterized by (i) a relatively inflexible official nominal exchange rate, (ii) a high degree of market segmentation, and (iii) significant administrative and documentation requirements. Nigeria is among a select few countries that still maintain multiple foreign exchange markets. While the introduction of the Dutch auction system (DAS) in July 2002 represented an improvement over the previous system, it has had limited success in facilitating greater market determination and reducing market segmentation.

165. The effectiveness of previous reform efforts has been undermined by a host of factors, including (i) the challenges in selling the government's oil revenues to the market in a non-distortionary manner, (ii) the fear of floating and an inherent desire for a strong and stable nominal exchange rate, and (iii) inconsistent monetary and exchange rate policies alongside fiscal dominance.

166. This paper aims to identify the reforms that need to be considered in unifying and improving the efficiency of the foreign exchange market, and allowing for more flexible determination of the exchange rate. This issue has recently gained importance. During the 2004 Article IV consultation discussions, the authorities indicated a desire to consider further steps in liberalizing and unifying the foreign exchange market. By reviewing the main lessons from past attempts to reform Nigeria's foreign exchange market (Section B) and reforms undertaken by selected comparator countries that have successfully achieved unification (Sections C and D), this paper aims to identify key institutional structures, reform options, and sequencing issues that the authorities may need to consider (Section E).

### **B. Lessons from Nigeria's Foreign Exchange Market Reform Attempts**

167. Nigeria has experimented with various exchange rate systems and undertaken several liberalization measures over the past two decades (Box VI-1). While some effort was made to improve the functioning of some segments of the foreign exchange market (such as introducing an interbank foreign exchange market and liberalizing surrender requirements), the reforms had limited success in unifying the foreign exchange markets and facilitating greater market determination of the exchange rate.

168. The reform efforts, more broadly, were undertaken in an environment in which fundamental macroeconomic imbalances and governance issues were not addressed. Inconsistent fiscal and monetary policies resulted in periods of exchange rate misalignment. Also reflecting an inherent fear of floating, the authorities resorted to non-market measures—

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<sup>53</sup> Prepared by Karen Ongley.

## **Box VI-1. Evolution of Foreign Exchange Markets in Nigeria (1986-2002)**

### **1986-1992: Dual Exchange Rate Transitional Arrangement and Unification:**

The dual exchange system, introduced in September 1986, comprised an administered exchange rate (for oil exports and certain public sector transactions) and a second composite market, of both a central bank auction for commercial banks and a floating interbank market. The interbank exchange rate was initially limited to a 1 percent margin above the previous auction,<sup>1</sup> but was liberalized in 1987 to allow the interbank rate to diverge from the auction rate. At the same time, the auction changed from a marginal, to a discriminative, bid system. The informal market merged with the interbank market, with the 1989 licensing of foreign exchange bureaus.

The legal foreign exchange markets were eventually fully unified in March 1992, when banks and other authorized dealers were freed to determine the interbank rate, and the Central Bank of Nigeria (CBN) participated as a direct supplier of foreign exchange to the interbank market.

### **1993-1995: Administered Exchange Rate:**

Following a brief return to an auction system in March 1993, the authorities reimposed a quantity allocation mechanism in April 1993 and abolished the interbank market in January 1994. Initially, the official rate was pegged at Naira 24.9 per US dollar, revaluing from the latest auction rate of naira 30 per U.S. dollar. It was then repegged at around Naira 22 per US dollar in April-July 1993, before settling at naira 21.9 per US dollar. The CBN's weekly foreign exchange allocations were distributed among authorized dealers on the basis of sectoral shares.<sup>2</sup>

### **1995-2002: The Autonomous Foreign Exchange and Interbank Foreign Exchange Markets:**

In February 1995, the authorities introduced another dual system, consisting of an autonomous foreign exchange market (AFEM) and an official exchange rate fixed at Naira 21.886 per US dollar. The official rate applied to CBN purchases of the government's foreign exchange receipts and selected public sector transactions. All other transactions occurred at the AFEM rate. AFEM demand was restricted by documentation requirements on uses of foreign exchange, and supply was administered to effectively 'set' the AFEM rate close to the interbank and parallel market rates. In early 1999, the official rate was abolished and the CBN moved to daily interbank sales. However, transactions remained subject to significant constraints: banks acted only as intermediaries between the CBN and retail customers, foreign exchange bought from the CBN could not be sold among banks, spreads were constrained to one naira, and banks were required to report to the CBN on the utilization of foreign exchange.

<sup>1/</sup> Individual banks' participation was limited—5 percent of total funds offered for the 3 largest banks and 3 percent for other banks—to address concerns about large banks cornering the market.

<sup>2/</sup> 50 percent (later 60 percent) for manufacturing inputs, 10 percent for agricultural inputs, 30 percent (later 20 percent) for finished goods, and 10 percent for service payments.

such as administrative controls and restrictive foreign exchange regulations—when the exchange rate came under pressure. Excessive reliance on controls and restrictions, as well as other distortionary and intransparent intervention practices by the Central Bank of Nigeria (CBN), precluded the exchange rate from responding to underlying market conditions and created widespread incentives to transact outside the official market, providing significant scope for rent-seeking and abuse. Weak governance practices in the banking system, such as systemic misreporting and violation of foreign exchange controls and prudential regulations as well as regulatory forbearance, also undermined the reform efforts.

## **Early attempts at foreign exchange market reform, 1986-2002**

169. The reform process began in the mid-1980s after the naira had become increasingly overvalued under the fixed exchange rate regime following a successive period of expansionary macroeconomic policies (Table VI-1). Initially, the authorities responded by tightening exchange and import restrictions (import prohibitions and discriminatory import licensing rules). However continued large macroeconomic imbalances, increasingly segmented foreign exchange markets,<sup>54</sup> and a weakened international reserve position prompted the authorities to announce a medium-term structural adjustment program in early 1986,<sup>55</sup> a major component of which was to establish a new exchange rate system. This commenced a more than two decade period in which there were essentially three attempts to reform the foreign exchange market in Nigeria before introducing the DAS in mid-2002.

170. While the **dual exchange system introduced in September 1986** fostered a rapid depreciation of the real and nominal effective exchange rates (Figure VI-1) and a narrowing of the parallel market premium (Table VI-1), it had two significant shortcomings. First, the auction rate for selling the government's foreign exchange earnings to the interbank market was prone to being officially administered by the CBN, hampering market competition. Second, as the majority of government-related transactions occurred at the more appreciated administered exchange rate, this impeded interbank market development. Documentation requirements and regulatory restraints also inhibited interbank market competition,<sup>56</sup> which constrained adjustment of the official rate beyond the initial depreciation and the scope for unifying the official and auction rates.<sup>57</sup> Limited progress on liberalizing external transactions did not permit a more rapid reduction in the parallel market premium. While some capital and current transactions were liberalized as planned, import and export restrictions were retained for a number of items, and most capital transactions remained subject to the approval of the Ministry of Finance.

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<sup>54</sup> The existence of several legal exchange rates besides the parallel rate complicates the picture substantially. Data for all rates in the early 1980s is not available. Moreover, the existence of multiple foreign exchange markets, with official transactions typically conducted at a more appreciated rate, provided significant scope for rent-seeking and abuse.

<sup>55</sup> The adjustment program was supported by a 14 month Stand-by Arrangement with the Fund, approved in November 1986 following introduction of the new exchange rate system.

<sup>56</sup> Banks' access to the auction was essentially guaranteed based on market share rather than their bids.

<sup>57</sup> Independently sourced foreign exchange was transacted at the market-determined interbank rate, but the resale of foreign exchange bought in the auction was restricted to a 1 percent margin over the auction price. This led banks to bid conservatively to avoid excessively depreciating the auction rate.



**Table VI-1. Macroeconomic Indicators, 1981—2002**

	1982	1984	1986	1988	1990	1992	1994	1996	1998	2000	2002
	(in percent unless otherwise indicated)										
Real GDP Growth Rate	-0.6	5.8	-1.8	9.4	7.5	2.6	-0.4	6.5	0.3	5.8	0.5
Consumer price inflation	7.7	17.8	5.7	54.5	7.4	44.6	57.0	29.3	10.3	14.5	12.9
Month growth rate (money plus quasi money)	2.0	32.9	32.7	63.3	34.5	16.2	22.3	48.1	21.6	...	...
Non-oil primary balance/Non-oil GDP	-21.6	-11.4	-20.2	-25.1	-30.1	-22.0	-19.4	-8.7	-18.5	-35.8	...
Petroleum Price (US\$/bbl; WEO average)	31.5	28.5	14.2	14.8	23.0	19.0	15.9	20.4	13.1	28.2	25.0
Current Account Deficit/GDP	-13.9	-3.1	-16.5	-8.4	7.4	-4.6	-6.8	6.8	-5.7	10.1	-7.0
Real Import Growth Rate											
GNFS	-26.3	275.1	-27.6	-7.2	14.3	4.8	-12.6	2.4	-7.4	13.8	13.7
Goods	-15.0	622.6	-27.9	-12.5	11.5	6.6	-24.2	5.4	-17.7	16.4	9.4
Gross International Reserves											
months of imports of GNFS	1.1	1.6	1.6	1.2	5.1	1.0	1.8	4.2	7.5	7.4	4.5
in millions of US dollars	1,639	1,486	1,111	684	3,899	1,000	1,421	4,110	7,135	9,942	7,364
Exchange Rates											
Official Rate (Naira per US dollar)	0.67	0.81	3.32	5.35	9.00	19.65	22.00	21.89	21.89	109.55	126.40
Parallel Rate (Naira per US dollar) 1/	...	...	7.69	10.00	11.11	23.96	67.25	80.00	89.00	120.50	138.50
Parallel Market Premium	...	...	131.91	86.80	23.43	21.97	205.72	265.53	306.65	10.00	9.57

Sources : IFS, WEO and staff estimates.

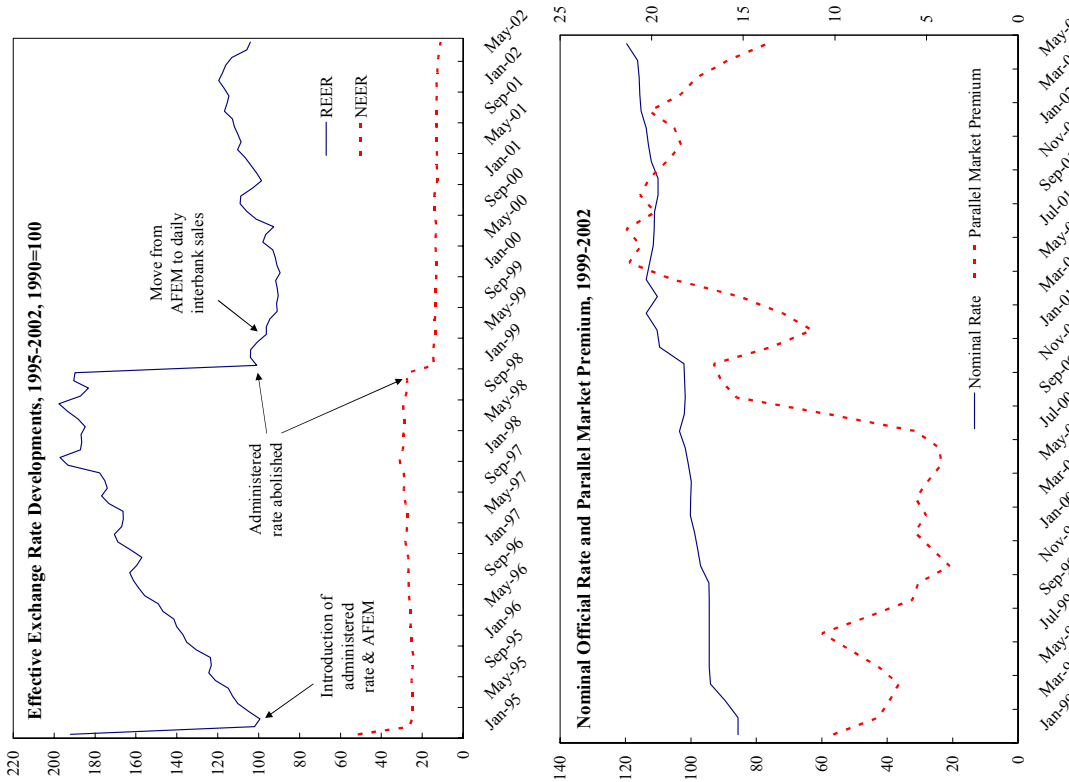
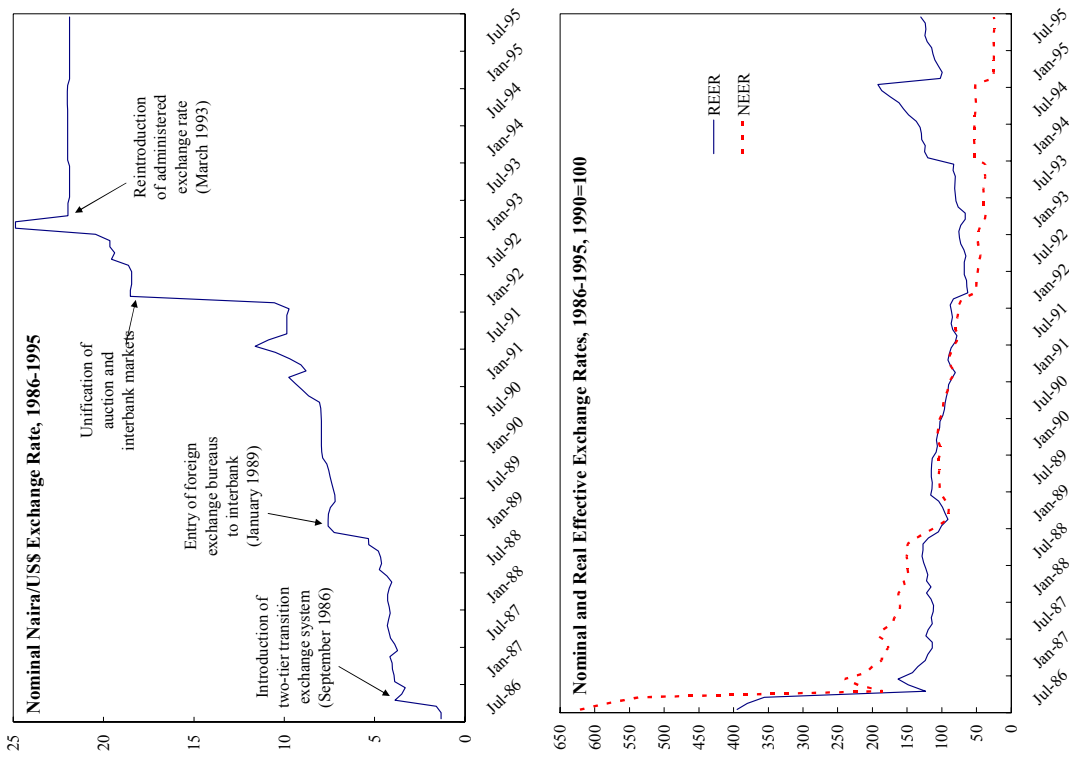
1/ Data on parallel market rates are patchy and constructed from different sources. Data through 1991 are based on WP/93/36. Data for 1992-97 are based on period average data recorded in the staff's database. Data for 1998 onwards are end of period data recorded in the staff's database.

171. The period of **exchange market unification in 1992** was short-lived. In the face of ballooning inflation, declining non-oil export volumes and renewed pressure on the external accounts, the authorities returned to an **administered exchange rate (1993-1995)**. The major objective was to minimize importation costs by administratively determining the exchange rate, and strictly controlling both quantity and type of imports and exports through import bans, high tariffs, and a licensing mechanism.<sup>58</sup> However, inflation continued to accelerate, the real effective exchange rate appreciated substantially (Figure VI-1), the current account remained under pressure and reserves stagnated. By 1994, the parallel market premium exceeded 200 percent; more than 10 times the premium in 1992 and a level not seen since the mid-1980s (Table VI-1). While some measures were introduced in an attempt to direct demand away from the parallel market,<sup>59</sup> this system presented numerous opportunities for rent-seeking and abuse. Behavior in the parallel market reflected both a spillover of unmet legitimate market demand as well as illicit transactions (including suspected abuses for capital flight). In early 1995, the authorities concluded that attempts to stabilize the naira by administrative means had been ineffective.

<sup>58</sup> Sogunle (2003).

<sup>59</sup> For example, foreign exchange bureaux, which had been dealing at freely negotiated rates since 1989, were limited to buying foreign exchange as agents of the CBN at the official rate.

**Figure VI-1. Nominal and Effective Exchange Rate Developments, 1986—2002**



172. The return to a **dual exchange system (1995-2002)** was similar to the experience of the late 1980s. Regulations and accepted practices limited dealings among market participants and impeded the effective functioning of the market. The autonomous foreign exchange market (AFEM) was not a “market” in a typical sense. Documentation requirements restricted demand and the CBN, as the sole recipient of the government’s oil receipts, was in a position to administer supply of foreign exchange. The interbank market was quite small, but continued to operate, aided by non-oil export surrender requirements and periodically allowing transferability. At the same time, banks were frequently precluded from dealing amongst themselves using foreign exchange obtained from the CBN, thereby formally segmenting the interbank market. Purchases of foreign exchange for both current and allowed capital transactions required supporting documentation (for which banks were responsible), and retail customers who did not satisfy reporting requirements could only deal legally with foreign exchange bureaus<sup>60</sup> or illegally through the parallel market.

173. The more depreciated AFEM rate initially facilitated a moderation of import volumes, which—complemented by an improvement in non-oil primary fiscal deficit in 1995-96—allowed some rebuilding of foreign exchange reserves (Table VI-1). However, non-oil export volumes faltered as the real exchange rate continued to appreciate (Figure VI-1). Despite some reduction in access to foreign exchange at the official rate, its overvaluation proved highly distortionary.<sup>61</sup> Continued advocacy of the official rate and intransparency of transactions afforded by the multitude of rates, implied considerable opportunities for economic rents. There were also continuing concerns about capital flight using foreign exchange derived mainly from public resources. Although the margin between parallel market and AFEM rates was typically 5 percent or less, a premium in the order of 250-300 percent still existed between the official and parallel/AFEM rates.

174. The elimination of the official rate and move to daily AFEM sales in early 1999, supported by the restoration of transferability of funds, helped improve the functioning of the AFEM and interbank market, as reflected in a dramatic narrowing of the parallel market premium. However, this too was undermined by a return to more imprudent macroeconomic policies. The real effective exchange rate also began to lose ground as lax fiscal and monetary policies once again allowed inflation to accelerate. After narrowing to around 5 percent in 1999,<sup>62</sup> the parallel market premium again climbed to over 20 percent in mid-2001 reflecting both the spillover of demand pressures and the continued regulatory incentives to divert transactions to the parallel market to circumvent the high level of market

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<sup>60</sup> Up to a maximum of US\$2,500 and later US\$5,000.

<sup>61</sup> For example, there was considerable bias in favor of foreign procurement at the expense of local content and value added.

<sup>62</sup> At the time, the authorities considered a 5 percent differential between the official and parallel rates as a “normal” premium for those seeking to avoid documentation requirements or import goods without incurring customs duties.

regulation. With the CBN reluctant to allow the exchange rate to depreciate in the face of demand pressures, gross international reserves came under pressure.

### **The current Dutch auction system (July 2002 to present)**

175. Faced with persistently high demand for foreign exchange and rapidly declining international reserves, the authorities ceased direct sales to the interbank in July 2002. The new official retail DAS was intended to allow the exchange rate to adjust to market pressures and safeguard international reserves. Three other submarkets—the interbank, the bureau de change and parallel markets (Box VI-2)—continued along with the DAS.

176. In the second half of 2002, the decline in international reserves abated and the nominal exchange rate depreciated by around 7 percent, helping essentially halve the parallel market premium to below 10 percent by end-2002. Despite the nominal appreciation, the real effective exchange rate was relatively stable as inflation stayed in double digits, on account of expansionary fiscal policies and accommodative monetary policies.

177. However, for much of 2003, the CBN demonstrated a reluctance to let the nominal exchange rate adjust in the face of mounting demand pressures fueled by still lax fiscal and monetary policies. Consequently, the real effective exchange rate showed signs of turning upwards in line with inflationary pressures. In response to rising demand, the CBN increased supply to the auction, resulting in a drain on international exchange reserves at a time when all other major oil exporters were building reserves.<sup>63</sup> However, as demand pressures continued to build in the second half of 2003, further increases in sales had only limited success in resisting the depreciation.<sup>64</sup> Although pressure eased somewhat in December, the marginal DAS rate ended the year more than 8 percent depreciated relative to end-2002.<sup>65</sup> Yet with increased supply to the DAS, the parallel market premium remained relatively stable at around 8-9 percent for much of 2003.

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<sup>63</sup> By mid-2003, demand and supply per auction were both around 30-35 percent higher than the year before, and the nominal exchange rate had depreciated by less than 1 percent since January 2003.

<sup>64</sup> Demand and supply rose to unprecedented levels in November, and the marginal DAS rate depreciated sharply in November. Much of the demand pressure is thought to be driven by fiscal expenditure (including related to one-off events such as All Africa Games in October and the Commonwealth Heads of Government Meeting in December), but other likely factors include liberalization of the domestic retail petroleum products market and speculative pressures following a reduction in average daily sales in October.

<sup>65</sup> Notably the spread on successful bids in the DAS widened late in the year. After remaining below 2 percent for much of 2003, the spread between the highest and lowest successful bids widened significantly to around 7 percent, exceeding the generally accepted multiple currency practice threshold (2 percent). However, spreads subsequently narrowed in December.

### **Box VI-2. The Current Structure of Nigerian Foreign Exchange Markets<sup>1</sup>**

There are currently four foreign exchange markets in Nigeria: (i) the official Dutch auction system (DAS), (ii) the interbank market, (iii) the Bureau de Change market, and (iv) the parallel market. In addition to these markets, the CBN also opened its Travelex window<sup>2</sup> in mid-2002.

The **Dutch Auction System** is a sealed bid, multiple price auction. Auctions take place twice a week, with the CBN announcing the offer amount the day before the auction and results the day after. Successful bids are satisfied at the bid price and the marginal rate is the market clearing rate. The DAS only supplies the retail end of the market, with funds purchased from the CBN to be used for eligible transactions only, and banks required to submit documentation establishing their clients' eligibility.<sup>3</sup> Funds obtained in the DAS are not transferable to the wholesale interbank market. In 2003, participating banks averaged around 60 (on occasion, as many as 75 banks participated) and sales amounted to US\$9¼ billion.

The **Interbank Foreign Exchange Market** (IFEM) exchange rate is freely negotiated among authorized dealers, with no margin or restrictions over the DAS rate. Foreign exchange is obtained from sources other than the CBN, including foreign oil companies and non-oil exports. The IFEM grew rapidly—by around 30 percent—after the surrender requirement for private oil companies to the CBN was abolished and IFEM sales rose from US\$¾ billion in 1998 to over US\$1 billion in 1999. Most recent estimates put IFEM sales in 2001 at US\$1½-2 billion and between US\$2-3 billion in 2002 (or around 20-30 percent of DAS sales). This appears well below the rate of interbank relative to retail turnover even in those countries where the interbank market is considered relatively small (at less than 50 percent of bank-customer level turnover).

The **Bureau de Change (BdC) Market** is a relatively small spot market, dealing with foreign exchange obtained from the private sector only. No documentation is required for buying or selling. There are around 250 registered BdC, although less than 15 were thought to dominate the market in 2002. Sales are not reported formally, but were estimated at US\$250-500 million in 2000. Individual transactions are officially limited to US\$5,000, although the limit is often circumvented and there have been reports of transactions in excess of US\$100,000.

**Parallel Market:** This is an illegal, but tolerated, market used to finance undocumented imports (to avoid customs duties or import bans) and restricted capital transactions. Given its informal nature, estimates of the market's size are subject to a wide degree of uncertainty. However, banks involved in the market are thought to range between 10 and 30 (and, as a sanction, the CBN had periodically suspended banks' foreign exchange operations) and most common estimates put annual sales around US\$4-6 billion, but other estimates are as high as US\$7-8 billion.

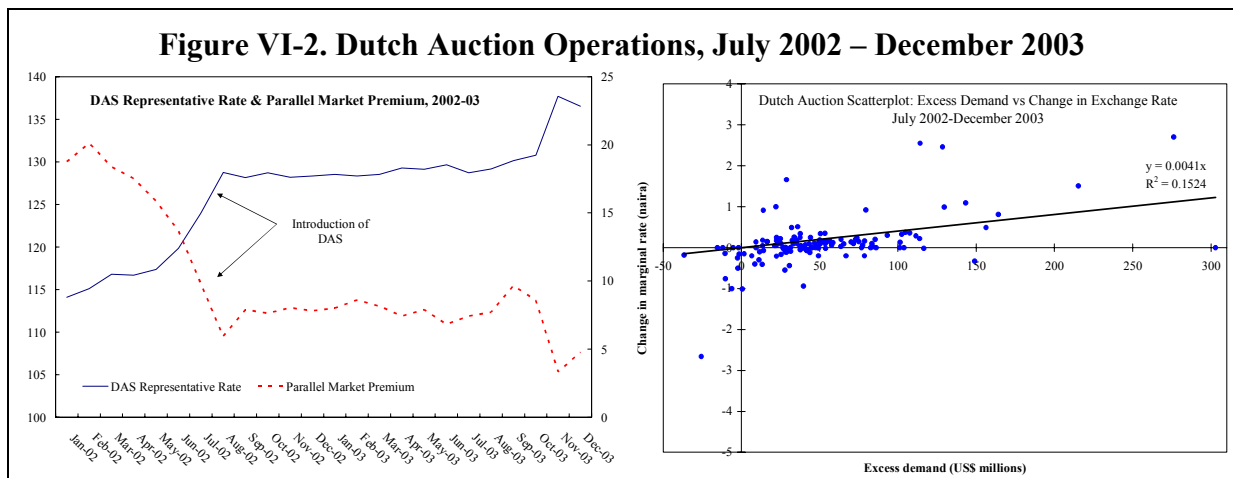
<sup>1/</sup> CBN Annual Report (2001), Moser (2003), Canales-Kriljenko (2004), and Geadah and others (2001).

<sup>2/</sup> The **'Travelex' window** covers legitimate foreign exchange demand related to overseas travel expenses, with sales of around US\$240 million in 2003.

<sup>3/</sup> For example, the official foreign exchange form for authorized imports (Form "M") must be registered with an authorized dealer (in duplicate) and certified by the negotiating bank. Exporters must submit original copies of the bill of lading, with evidence of payment of the relevant administrative charges, to the collecting bank.

178. Reflecting the reluctance to let the nominal exchange rate respond to market pressures, there has been a weak relationship between excess demand and changes in the marginal rate (Figure VI-2). Therefore, in practice, many of the limitations of the earlier reform attempt and incentives for operating in the parallel market persist:

- transferability of funds between the DAS and interbank markets is prohibited;
- export proceeds for non-oil exporters must be repatriated within 90 days from the date of shipment of the goods;
- documentation requirements for purchases of foreign exchange for both current and allowed capital transactions are highly burdensome;
- the authorized maximum sale of foreign exchange by Bureaus de Change is limited, but often circumvented in practice; and
- trade restrictions, namely import bans, have increased over the last 12-18 months.



179. The DAS also suffers from the same fundamental limitation as the 1986 hybrid system. As the sole supplier to the market, the CBN has scope to de facto administer the rate. This departure from stated policy was evidenced by the behavior of the marginal DAS rate for the first 8-9 months of 2003, and the decline in international reserves despite near record oil receipts. Continued divergences between the various foreign exchange markets in Nigeria, therefore, reflects both the conduct of macroeconomic policies and institutional factors that segment the market. Moreover, the prevalence of multiple exchange markets and rates in Nigeria leads to inefficiencies and disincentives, imposing direct and indirect costs on the economy.

### C. Motivation for Exchange Market Unification and Reform

180. During the 1980s and 1990s, many Fund members—developing countries, in particular—undertook reforms to facilitate foreign exchange market unification and the adoption of more market-determined exchange rates.

181. While nearly half the Fund’s membership maintained dual markets or had active parallel markets in the early 1970s, the number has fallen significantly since. At end-1997, 43 member countries had multiple exchange rate systems, of which 30 were classified as giving rise to multiple currency practices under the Fund’s jurisdiction.<sup>66</sup> Results of the 2001 Survey on Foreign Exchange Market Organization revealed that “multiple foreign exchange markets exist in only four” of the 91 respondent countries.<sup>67</sup> Other reports suggest that, by 2001, only 9 of the Fund’s member countries maintained multiple exchange markets.

182. A key motivation underlying these trends has been to enhance an economy’s ability to deal with shocks and promote allocative efficiency of the foreign exchange market by reducing or eliminating market segmentation and the incentive to transact in parallel markets. A recent study<sup>68</sup> found that macroeconomic performance was weaker in countries with dual or multiple exchange rates, irrespective of the type of regime—fixed or floating. Between 1979 and 1999, annual average per capita growth in countries with dual or multiple exchange rates was about 0.6 percent, compared with 1.8 percent for countries with unified rates.

183. In addition, developing countries have tended to move to market-determined exchange rate regimes.<sup>69</sup> The share of developing countries with flexible exchange rate regimes is estimated to have increased from around 10 percent in the mid-1970s to more than 55 percent by the end of the 1990s.<sup>70</sup> Experience suggests that the desire for a strong and stable nominal exchange rate has often contributed to a loss of external competitiveness, balance of payments difficulties, distortions in the allocation of foreign exchange, and the emergence of parallel markets and administrative foreign exchange control.<sup>71</sup> In recognition, countries have moved toward more market-determined exchange rate regimes, which has facilitated the economy’s ability to adjust to external or domestic stocks. It has also helped countries reduce their dependence on exchange and trade restrictions, while at the same time

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<sup>66</sup> Swinburne and others (1999). For the 13 countries with multiple exchange rate regimes not classified as multiple currency practices, the spread between rates remained within 2 percent.

<sup>67</sup> Canales-Kriljenko (2004).

<sup>68</sup> Rogoff, et. al. (2003).

<sup>69</sup> There is a large body of research examining the relative merits of fixed and floating exchange rate regimes. This paper does not attempt to re-litigate the issue.

<sup>70</sup> Moser (2003).

<sup>71</sup> For example, Quirk and others (1987), Aghevli and others (1991), Kovanen (1994), McDonald and Lum (1994), and Swinburne and others (1999).

allowing authorities to undertake reforms and put policies in place that help improve the country's economic performance and external competitiveness.

#### **D. Issues for Oil-Exporting Countries**

184. Oil-exporting countries have followed the same trend. Their experience in unifying their foreign exchange markets and their mechanisms for supply of foreign exchange are particularly instructive for Nigeria. Most of these countries have to contend with dominance of oil export receipts, yet multiple or segmented markets have virtually ceased to exist. In 2001, of the 19 major oil-exporting countries, only Nigeria, the Islamic Republic of Iran, and The Socialist People's Libyan Arab Jamahiriya had multiple exchange markets. The latter two have subsequently unified their exchange rates leaving Nigeria as the only major oil exporter with multiple exchange markets.

185. Of those countries that are similarly placed in terms of reliance on oil export proceeds (Box VI-3), the unification processes in Iran and Algeria (Box VI-4) provide useful examples of particular challenges—and potential pitfalls—in supplying foreign exchange to the market where the vast majority of oil proceeds accrue to the government or are surrendered to the central bank. Reforms were introduced in both Iran and Algeria with the aim of foreign exchange market unification (Box VI-4).

- In both countries, the central bank now sells the government's oil export proceeds directly to the interbank market and there are no surrender requirements for non-oil exports. The administrative allocation of foreign exchange for authorized imports was eliminated and all import-related foreign exchange demand channeled through the interbank market. Also, separate bureau de change markets were eliminated, with all travel-related foreign exchange sales channeled through the interbank market.
- Before moving to full interbank market intervention, Algeria took the intermediate step of holding daily fixing sessions with a limited group of robust commercial banks. It also announced regularly its intervention policy in order to enhance transparency and predictability of its actions.
- However, while the move to direct interbank market sales allowed foreign exchange market unification in Iran, in practice a free float is impeded by the concentration of crude oil receipts with the government and relative dominance of the central bank. This is compounded by the lack of depth of the financial sector and administrative impediments to its further development. The Algerian interbank market suffers from similar market inefficiencies.



<b>Box VI-3. Exchange Arrangements in Selected Oil-Producing Economies</b>				
<b>Country</b>	<b>Oil Exports, 1991-2003</b>		<b>Unified (Yes/No)</b>	<b>Exchange Arrangement</b>
	<b>GDP (percent)</b>	<b>Total Exports (percent)</b>		
Algeria	26.93	96.20	Yes	Managed float, with no pre-announced path for the exchange rate
Azerbaijan	18.25	58.98	Yes	Managed float, with no pre-announced path for the exchange rate
Ecuador	8.54	36.91	Yes	Dollarized (exchange arrangement with no separate legal tender)
Indonesia	4.03	13.86	Yes	Managed float, with no pre-announced path for the exchange rate
Iran, I.R. of	17.12	81.20	Yes	Managed float, with no pre-announced path for the exchange rate
Kuwait	38.46	92.98	Yes	Pegged to the US dollar
Libya	29.19	92.77	Yes	Pegged to the SDR
Nigeria	39.35	94.57	No	Managed float, with no pre-announced path for the exchange rate
Norway	14.66	48.07	Yes	Independently floating
Qatar	29.53	59.19	Yes	Pegged to the US dollar
Russia	8.70	27.73	Yes	Managed float, with no pre-announced path for the exchange rate
Saudi Arabia	32.80	88.99	Yes	Pegged to the SDR
U.A.E.	29.44	40.79	Yes	Pegged to the US dollar
Venezuela	20.05	77.73	Yes	Pegged to the US dollar

Sources: IFS, staff estimates, *Annual Report on Exchange Arrangements and Exchange Restriction* (2003).

### **E. Operational Considerations and Options for Nigeria<sup>72</sup>**

186. The ultimate objective of foreign exchange market reform in Nigeria should be to unify markets and allow the interbank market to become *the* vehicle for allocating foreign exchange in the Nigerian economy. In looking to identify necessary steps and priorities for further reform, past experience provides some fundamental lessons.

- The institutional framework (in this case exchange controls and regulations guiding the operations of various foreign exchange markets) should not be used as the primary means of fostering exchange rate stability (nominal or real). Lack of financial discipline would likely undermine macroeconomic performance irrespective of the exchange rate regime, so prudent macroeconomic policies are an essential pre-condition for a successful exchange market reform, and alleviating the burden currently placed on foreign exchange regulations and administrative controls.

<sup>72</sup> This section draws on earlier technical assistance provided by the Fund in the areas of foreign exchange market intervention (Canales-Kriljenko, 1999), exchange market unification (Geadah and others, 2001), and improving monetary and exchange market operations (Johnson and others, 1999).

#### **Box VI-4. Foreign Exchange Market Operations in Selected Oil-exporting Countries**

Developments in the **Islamic Republic of Iran** represent a useful comparator for Nigeria. Previously the Iranian exchange rate system had been heavily controlled and, like Nigeria, featured multiple exchange markets with associated exchange restrictions and import controls. Earlier reform efforts achieved significant simplification of the exchange system, but failed to achieve unification.

- Prior to March 2002, the exchange rate system consisted of two official rates: (i) a fixed official rate, which applied mainly to imports of essential and government imports, certain priority government projects and public external debt service, and (ii) an effective Tehran Stock Exchange rate applied to non-oil exports and imports maintained by the Ministry of Commerce.
- The two official rates were unified in March 2002 and the value of the rial is determined in an interbank market. Under the new foreign exchange system (i) the central bank intervenes directly in the interbank market, (ii) there are no non-oil export surrender requirements, (iii) the procedure of allocating foreign exchange for authorized imports was eliminated, and (iv) the distinction between internally and externally sourced foreign exchange deposits has largely been eliminated.

However, Iran's financial markets remain relatively underdeveloped and rates of return are administered.<sup>1</sup> Along with the concentration of crude oil receipts with the government and relative dominance of the central bank, these factors have complicated the adoption of a free float.<sup>2</sup> Nevertheless, Celasun (2003) argues that an exchange rate regime that allows for nominal exchange rate movements in response to oil price shocks would be "beneficial in terms of dampening economic fluctuations and promoting growth" in Iran.

**Algeria** presents another interesting example. Prior to October 1994, the exchange rate of the Algerian dinar was pegged against a basket of currencies that was periodically adjusted. Then, as an intermediate step, the Bank of Algeria (BA) introduced a managed float through daily fixing sessions that included six commercial banks. That system was replaced in early 1996 by an interbank foreign exchange market. No margin limits are imposed on the buying and selling rates in the interbank market, although a narrow margin exists between the buying and selling rates of the BA. Surrender requirements are imposed on all crude export proceeds and 50 percent of non-oil export proceeds; the remaining share may be retained in a foreign currency account. As oil export proceeds from the state oil company revert to the BA, the latter remains the largest supplier of foreign exchange and plays a major role in the interbank market. Moreover, the deepening of the interbank market and strengthening of the role of other players in the market is constrained by several other factors, including: extensive capital controls against the build-up of foreign exchange exposure; other limits on foreign exchange use (e.g., ceilings for travel abroad); and extensive procedures for foreign exchange sales for service transactions.

**Indonesia** has had a floating exchange rate, determined by demand and supply in the market, since August 1997. Although the vast majority of the government's foreign currency earnings from production sharing agreements with foreign oil companies are deposited with Bank Indonesia (BI), BI does not dominate in the interbank market. Oil and gas exports, of which less than half accrue to the government, represent less than 25 percent of total merchandise exports and a fraction of market turnover. In any case, BI tends to accumulate reserves through the government's foreign currency earnings and only occasionally sells to (and never buys from) the interbank market.

**Box VI-4 (cont'd). Foreign Exchange Market Operations in Selected Oil-exporting Countries**

The **Azerbaijan** National Bank (ANB) uses the exchange rate as the nominal anchor for monetary policy, which has in effect led to informal exchange rate targeting. Formally, the ANB determines the official exchange rate against the U.S. dollar every day, equal to the weighted average of all foreign exchange markets, including the auction and electronic interbank markets, the retail intra-bank market, and the bank note market in foreign exchange bureaus. The majority of foreign exchange transactions are retail or customer transactions, and the ANB is not the dominant market participant. Noncash exchange rates are determined five times a week in the foreign exchange auctions conducted by the Baku Interbank Currency Exchange, and exchange rates for cash transactions are quoted by licensed commercial banks.

The Central Bank of the **Russian Federation** announces daily an official exchange rate, based on the interbank market exchange rates. The exchange rate of the ruble is determined in a continuous interbank foreign exchange market, which electronically links exchanges across the country. The official rate is set equal to the previous day's weighted average rate in the interbank market. The Bank of Russia operates directly in both the interbank currency exchanges and the over-the-counter interbank market, but is not the dominant player in the market.

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<sup>1/</sup> Jbili and Kranmarenko (2003).

<sup>2/</sup> Celasun (2003).

- Segmented markets are likely to persist where legal or institutional factors prohibit or impede transactions among participants. Therefore, the authorities need to make a firm commitment to unification and allowing the interbank market to play the primary role in allocating and setting the price for foreign exchange.
- As unifying foreign exchange markets could result in some overshooting of the exchange rate, the authorities need a strong commitment not to reverse course in response to the short-term adverse consequences. Unification should be carried out as part of a comprehensive stabilization program, with consistent monetary and fiscal policies to limit the adverse impact of unification on inflation.

187. The nature of macroeconomic policy reforms in Nigeria is the subject of broader discussions between staff and the authorities not covered in this paper. There is, however, significant latitude for institutional reforms to unify foreign exchange markets and allow the CBN to adopt a more market-determined exchange rate regime. In considering reform options, several critical issues need to be addressed. First, how, as the dominant supplier of foreign exchange, should the central bank participate in and facilitate the development of the interbank market in a non-distortionary way. Second, while a functioning interbank market already exists in Nigeria, there is a need to consider how to improve the efficiency of the interbank market to allow it to play a role in allocating foreign exchange on a continuous basis.

### **The role of the CBN in supplying foreign exchange to the interbank market**

188. The role of the central bank in supplying funds to the interbank market can be critical for the market's development: it can both facilitate market making and provide liquidity. However, central banks should avoid becoming the market-maker. In the longer run, direct interbank transactions should be encouraged. However, the issue of market-making takes center stage in countries, such as Nigeria, where the central bank is the foreign exchange agent of the public sector which accounts for the majority of foreign exchange receipts.<sup>73</sup>

189. With the existing interbank market and well defined group of foreign exchange dealers, the CBN could sell and buy foreign exchange directly to the interbank market, as is the case in Algeria and Iran, as well as in most developing countries. Alternatively, an interbank auction could be considered in Nigeria to facilitate efficiency. However, it would be important that such a step be viewed as transitional, with the ultimate aim to move to an interbank arrangement.

#### ***Direct interbank market sales***

190. The concentration of export proceeds with the CBN should not preclude it from directly selling into the interbank market. For instance, the Ugandan authorities decided that, despite the concentration of coffee export proceeds with the government, direct central bank participation in the interbank market would be the more efficient option.<sup>74</sup> Apart from institutional factors—e.g., the depth and expertise of the financial sector—moving to a foreign exchange system centered on direct interbank market sales would be more consistent with a market approach and less prone to administrative interference. It would also provide for a continuous market—enhancing liquidity and reducing transactions costs—and would allow the CBN to distance itself from the political implications of setting or announcing a particular rate.

191. Streamlining restrictions on the use of foreign exchange outside the DAS, and merging the bureau de change and interbank markets would help pool resources across the entire foreign exchange market and ameliorate the CBN's dominance. At the extreme, the authorities could consider decentralizing its supply of foreign exchange by selling directly to commercial banks, which would also support the role of banks as market-makers. However, this would not be ideal in Nigeria, as the dispersion of foreign exchange receipts among the levels of government<sup>75</sup> could result in a coordination problem. Centralizing public sector foreign exchange operations with the CBN avoids lumpy foreign exchange sales that can disrupt the market. The critical issue to ensure that the CBN does not undermine the market-making role of banks will be a transparent and pre-announced intervention policy.

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<sup>73</sup> Quirk (1994).

<sup>74</sup> Quirk (1994).

<sup>75</sup> In addition to the Federal Government of Nigeria and 36 state governments there are over 700 local governments.

192. Moreover, where auction and interbank markets operate in parallel, the competitiveness and efficiency of each market can be undermined by restricting the transferability of resources. In particular, where trading outside the auction is limited or the exchange rate in the interbank market is prevented from fluctuating in response to demand and supply pressures, auctions can undermine interbank market development, foreign exchange market unification and the efficiency of foreign exchange allocation.<sup>76</sup>

### *Foreign exchange auctions*

193. Alternatively, where institutional considerations—such as instability or concentration of foreign exchange flows, balance sheet and governance weaknesses in the banking system or collusive behavior among banks—are of concern, this may call for an alternative arrangement such as an auction system.<sup>77,78</sup> An auction (Box VI-5) may facilitate efficiency and may sometimes provide a useful **transitional** arrangement, provided they are not restrictive and allow for the evolution of a proper interbank arrangement.

- Periodic foreign exchange auctions may allow a central bank to minimize the price impact of intervention and ensure it receives a “fair rate” for its foreign exchange.<sup>79</sup> However, countries that have attempted to do this have often maintained heavy regulations and limits on transferability, which have constrained unification and impeded a deepening of the interbank market.
- Where lack of trust or communications may hinder direct dealings between banks, which is often typical in markets characterized by high segmentation and lack of competition, an interbank fixing arrangement may facilitate interdealer transactions.<sup>80</sup>

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<sup>76</sup> Kovanen (1994).

<sup>77</sup> Galbis (1994), and Quirk and others (1987).

<sup>78</sup> Auctions have provided a market-based method of determining the exchange rate in some countries (including Nigeria) and about half of all countries responding to the Fund’s 2001 Survey on Foreign Exchange Market Organization reported some type of auction market. Canales-Kriljenko (2004).

<sup>79</sup> McDonald and Lum (1994), Canales-Kriljenko and others (2003).

<sup>80</sup> In fixing sessions, both demand and supply of foreign exchange are determined exogenously, and lack of prior surrender distinguishes fixing from an ordinary auction. A fixing arrangement is part of the interbank (retail) market, while the auction comprises the wholesale market. A fixing session can therefore deepen interbank market liquidity by ensuring that smaller banks or other sub-markets will have their demand and supply reflected in the fixing sessions via their trading with participants in the fixing session. Yet, by artificially centralizing transactions around the fixing sessions, the development of a genuine interbank market can be slowed. It is therefore important that participation in fixing sessions be optional and that no limits imposed on dealings taking place outside these fixings. The central bank can rely increasingly on the interbank market while simultaneously using fixing sessions. Johnson and others (1999) and Kovanen (1994).

### Box VI-5. Considerations for Foreign Exchange Auctions

By providing a transparent system of foreign exchange allocation, an auction may improve allocative efficiency. It can also be a viable option where financial markets are underdeveloped or thin. There are, however, two broad factors that can influence the **efficiency and effectiveness of an auction** market, and thus the prospects for exchange market unification:

- **Certainty and transparency of operations:** Auctions are generally more susceptible to official interference or manipulation and, by undermining credibility and transparency, can produce suboptimal results. It is, therefore, important that the organizer commits, in advance, “to a set of rules governing the auction process which are revealed to participants. The organizer should possess the credibility to assure the participants that certain rules would be followed and not changed during the bidding process.”<sup>1</sup> Clarity of rules should extend to the frequency of, and supply of foreign exchange to, each tender session.
- Access to and **competitiveness of the bidding process** is equally important in realizing allocative efficiency. As with interbank markets, this will be influenced by the depth of the financial market, concentration of market power and access to tender sessions. For example, the allocation of foreign exchange may not be efficient where there is a high concentration of demand or supply of foreign exchange or where certain (namely public sector) transactions occur outside the auction system. Limiting the scope of transactions or restricting participation in the auction can substantially reduce the turnover of the auction market, limiting the auction’s ability to achieve a stable exchange rate and sustaining pressures for transacting in the parallel market.

While there is no one “right” type of auction, the **nature of the auction** (and its relationship with the interbank market where one exists) can be instrumental in influencing market conditions.

- In **retail auctions**, where authorized dealers act on behalf of end-users and cannot transact among themselves, there is a formal impediment to integration with the interbank markets. If this results in a divergence between exchange rates in the two markets, it can raise doubts about the auction’s credibility. Participants in a **wholesale auction**, however, may bid on their own account or on behalf of customers, and all retail transactions are confined to the interbank market. Therefore, where there are no restrictions on the price relationship, demand and supply in the two markets can work in a complementary fashion and competition in both markets can be enhanced.
- Under a **discriminative**, rather than **marginal, price auction** (as is the current system in Nigeria), successful participants, in paying the bid price, risk paying significantly more than the market clearing price. Unless there is sufficient transparency in the auction system to allow participants to reasonably gauge demand conditions, a discriminative price auction may inhibit market entry and lead to a continuation of the parallel market. Where an auction gives rise to spreads of more than 2 percent between successful bids, it can result in a multiple currency practice.

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<sup>1/</sup> Kovanen (1994).

194. If an auction were deemed a necessary step in Nigeria, it should be (i) adopted as a transitional step, with a known exit strategy, (ii) conducted transparently and with clearly established rules, and (iii) based on a competitive bidding process. In particular, it should be clear that the main purpose of the auction (if considered necessary) would be to facilitate CBN's interventions in the foreign exchange market and all retail transactions should be clearly conducted outside the auction market in the interbank/bureau market.

- The amount sold to the market should be determined in advance (say a month ahead), relative to projected oil proceeds and likely demand, and consistent with the overall macroeconomic framework and targets on gross international reserves. The CBN could continue to auction dollars twice a week. However, at times the amounts auctioned have been relatively large and this has resulted in market volatility. More frequent (e.g., daily) auctions and smaller but equal amounts could be less disruptive to the market. Recent adjustments to Mexico's rule-based foreign exchange mechanism were designed to smooth the amounts auctioned throughout the year.
- Also, shifting to a wholesale auction may offer several advantages. Restoring the transferability of funds between the official auction and interbank market, and allowing commercial banks to use foreign exchange purchased from the CBN for interbank transactions, will promote integration of the two markets and unification of the exchange rate for legal transactions, as well as help increase the depth and efficiency of the market. However, convergence of the two rates should be achieved through unifying the markets and not through administrative measures. Therefore, the CBN should refrain from administrative limits on the margin between the auction and interbank rates. Moreover, a wholesale auction may involve a larger minimum bid requirement, which acts to encourage intermediation in the interbank market.

### **CBN operational rules and intervention practices**

195. The effectiveness of either direct interbank market sales and an auction will require that the CBN establish (and disclose) the **parameters within which it will conduct activities in the foreign exchange market**. Moreover, the CBN will need to **build credibility in its ability and willingness to adhere to those rules**. As auctions can be subject to manipulation, it is important that the CBN commits to a set of well defined rules governing the auction process.

- **Supply of foreign exchange to the market—be it interbank sales or wholesale auction—should be anchored around a clear and firm reserve target** that allows the exchange rate to respond freely to retail demand in the interbank market. For example, Mexico recently adopted a rule-based mechanism for supply to its daily foreign exchange auction aimed at a particular reserve accumulation path.

- The CBN will need to **develop operational guidelines for official intervention**<sup>81</sup> in the foreign exchange interbank market. That said, the interventions should be treated as exceptional transactions and should be clearly defined with the aim to smooth short-term exchange rate fluctuations or for reserve management purposes.
- The CBN should also establish objective and transparent criteria for choosing counterparties for foreign exchange dealings.<sup>82</sup> **As an interim step, the CBN may only allow primary dealers (market-makers or those deemed to be sufficiently sound) to participate in an auction.** If interbank trading is inhibited by primary dealers' reluctance to deal with smaller or weaker banks, the CBN could consider holding periodic (say, weekly) fixing sessions.<sup>83</sup> Over time, as smaller banks grow or become financially stronger, they could 'graduate' to become primary dealers.
- **The transactions of final end users of foreign exchange should be confined to the retail interbank market** between dealers—commercial banks and bureaux de change—and their customers. And, importantly, **all official transactions should be treated as retail transactions effected in the interbank market.** This will promote market deepening and unification. Exceptions should be kept to an absolute minimum, subject to specific and transparent rules about the circumstances under which transactions can occur outside the interbank market and the relevant exchange rate (for example, the weighted average in a discriminative price auction or the clearing price in a marginal price auction). There needs to be a **clear commitment and signal that these transactions would not occur at a preferential rate.**

### **Strengthening the existing market infrastructure**

196. The existing interbank market in Nigeria functions relatively well. In general terms, the number of participants and their degree of sophistication is sufficient to foster a relatively competitive environment, especially if obstacles to the flow of resources between market segments are removed to allow market deepening (Box VI-6). Irrespective of the choice of market infrastructure foreign exchange reform efforts would be better served if some **aspects of the interbank market and the CBN's role in it were strengthened** (in particular, by establishing a primary dealer network, abolishing regulations that inhibit efficient market operations, and strengthening the supervision of the interbank market).

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<sup>81</sup> Canales-Kriljenko and others (2003). Information on intervention activities need not necessarily be on a real time basis on day-to-day operations, but should at a minimum involve an ex ante statement of policy (Enoch, 1998).

<sup>82</sup> For example, central banks often choose to deal only with financial institutions that are solvent, and provide information and market developments and conditions (Canales-Kriljenko and others, 2003).

<sup>83</sup> The fixing session would act as a clearing house and facilitate trading within the interbank market and help stronger banks feel comfortable selling to smaller dealers.



### Box VI-6. Features of a Well-Functioning Interbank Market

An efficient and well-functioning interbank market will typically be underpinned by the high degree of competition and genuine interdealer transactions, as well as transparency and communication.

A **competitive environment** requires a relatively well-developed financial system with a sufficient number of participants and volume of transactions.<sup>1</sup>

- Appropriately designed **prudential regulation and supervision** that do not unduly restrict or impede effective rate setting can foster interbank market development provided that they focus on safeguarding the soundness of the banking system by (i) preventing monopolistic positions or destabilizing speculation, and (ii) reducing individual foreign exchange risk.
- **Freedom of market entry is central** to facilitating competition and keeping buying/selling spreads to a minimum, so as to support a more stable and competitive market.
- Like other asset markets, exchange markets need sufficient **liquidity** to function efficiently. Legal or institutional structures that impede transactions among participants and perpetuate incentives for transacting outside the official system, can slow the process of market deepening.
- **Surrender requirements** that promote foreign exchange accounts within the domestic banking system—rather than formal surrender to the central bank—can increase the role of that market in the allocation of foreign exchange.<sup>2</sup> However, reforms that reduce incentives for transacting in the parallel market or for retaining foreign exchange to hedge against risks, can promote the flow of funds to the interbank market, without formal surrender requirements.

As information gathering and unfamiliarity in undertaking transactions can be costly for dealers, central banks and clients, the **wide availability of information** can improve the efficiency of interbank market transactions.<sup>3</sup> Regular access to exchange rates (for example, via an electronic exchange) is important for efficient pricing decisions by foreign exchange intermediaries. The clear and transparent communication of policies (including the central bank's intervention policy) is necessary to building market confidence as well as promoting and reducing the cost of skill development and information sharing. Equally, the central bank's ability to provide oversight and participate in the market depends on its own skill base and organizational structure, and access to information gathering and dissemination technologies.

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<sup>1/</sup> Kovanen (1994), Quirk and others (1987).

<sup>2/</sup> McDonald and Lum (1994).

<sup>3/</sup> McDonald and Lum (1994), Quirk and others (1987).

- The CBN needs to **strengthen prudential regulations governing foreign exchange risk**, including limits on foreign exchange working balances, open positions,<sup>84</sup> and reporting requirements. The CBN will need to ensure that it has the requisite skills and institutional framework for prudential oversight. In this regard, plans to introduce the global bank reporting system (Globus) later this year, by providing an electronic interface between banks and supervisors, will allow banks' open positions to be monitored on a daily basis. The CBN needs to continue to enforce sanctions for dealers that violate foreign exchange regulations (including operating in the parallel market and breaches of bureau de change transactions limits).
- Typically, interbank markets are developed around authorized dealers, with some dealers acting as market-makers to maintain liquidity and continuous markets. The CBN should therefore work to **establish a group of reputable primary foreign exchange dealers** that have strong capital bases, and the capacity to manage foreign exchange risk and handle large transactions with ease. Moreover, zero tolerance for violation of prudential regulations should help address the concern that banks will retain foreign exchange and ensure it is channeled to the real economy.
- In addition to dissemination of information by the CBN, there is a need to ensure that **dealers have sufficient capacity and modalities for timely access to information on market developments and transactions** to support informed decision-making. In this regard, access to a two-way quote dealing system is significant and, although not a fundamental obstacle, the replacement of telephones with screen-based dealing would enhance the conduct of foreign exchange deals and their settlement. If necessary, the CBN should work with authorized dealers to strengthen skills.
- Nigeria will have to streamline its foreign exchange regulations and abolish regulations that inhibit efficient market operations (such as limits on foreign exchange spreads). In addition to plans to review the tariff structure, **accompanying measures will be required to liberalize trade and exchange restrictions**—including strengthening the customs administration, and streamlining administrative and documentation requirements—to lessen the incentive to transact outside the official market.
- With foreign oil companies no longer required to surrender foreign exchange to the CBN and the consequent growth of the interbank market, there is **no need to reinstate surrender requirements for foreign oil companies**. With continued sound macroeconomic policies and further deepening of the interbank market, it should also be possible to **unwind the requirements for non-oil export proceeds to be surrendered to commercial banks**. If not immediately possible, this should be done over the medium term once official and interbank market unification has taken hold.

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<sup>84</sup> Fund technical assistance has pointed to the more broadly used method of setting overall open position limits as a percentage, say 20 percent, of bank capital (Canales-Kriljenko and others, 1999).

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## VII. THE PETROLEUM PRODUCTS MARKET<sup>85</sup>

### A. Introduction

197. **The downstream petroleum sector in Nigeria—the industry providing processed petroleum products to Nigerian consumers and businesses—has long been dominated by the government as represented by the Nigerian National Petroleum Company (NNPC) with its refineries, pipelines, and depots.** Notwithstanding, the retail end of the industry—the filling stations and delivery to businesses by road tanker—is almost exclusively in the hands of a number of private companies that buy products from the NNPC’s wholesale depots. The sector has until recently been tightly regulated, with a de facto import monopoly for the NNPC, fixed retail margins, and administered retail prices. At end-September 2003, the government announced that retailers were henceforth free to set prices. Liberalization however, was not complete, as discussed below.

198. **This paper describes the main aspects of the downstream petroleum sector in Nigeria, including the economic effects of price fixing in the recent past, and the policies needed for the sector’s revival under a liberalized regime.** The second part gives an overview of the structure of the industry, starting with the existing infrastructure. The third part analyzes the economic effects of price fixing by the government prior to September 2003. The fourth part calculates implicit subsidies to NNPC and to Nigerian consumers, and presents a downstream balance sheet for the NNPC. The fifth part discusses policy recommendations to move the liberalization of the sector forward.

### B. Industry Structure

199. **The import, distribution, and storage infrastructure is dominated by the Pipelines and Product Marketing Company (PPMC), which is a subsidiary of the NNPC.** Most of the infrastructure investments began late in the 1970s, spurred on by Nigeria’s growing oil production capacity and oil revenue after the oil price hikes in 1973 and 1979.

#### **The import infrastructure**

200. **Nigeria has five jetties for imports, the Agapa and the Atlas Cove terminals near Lagos, Escravos in the Western Delta, Okirika near Port Harcourt, and Calabar near the border with Cameroon.** The two main import terminals are Atlas Cove and Port Harcourt close to the Port Harcourt refinery. These are deep sea ports.

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<sup>85</sup> Prepared by Ulrich Bartsch.

### **The refineries**

201. **Nigeria has four refineries, two in Port Harcourt (Rivers State), one in Warri (Delta State), and one in Kaduna with a total nominal refining capacity of 440 thousand barrels per day (kbd).** The four refineries are characterized as follows:

- the oldest unit in Port Harcourt is decrepit and not producing, although it has a nominal capacity of 60 kbd;
- a new refinery was commissioned in Port Harcourt in 1989 with a processing capacity of 145 kbd of crude oil per day;
- the Warri Refinery was commissioned in 1978 and upgraded to a capacity of 125 kbd in 1987;
- the Kaduna Refinery was commissioned in 1980 and expanded to 110 kbd of processing capacity in 1986; crude oil to the refinery is delivered through a 700 km pipeline from the Escravos Terminal in Delta State.

202. **The refineries have never been operating at their nominal capacities.** In recent years, capacity utilization has been at 30-40 percent. This performance gap is only partly explained by the deterioration of equipment of the old Port Harcourt refinery, supply disruptions at the Kaduna refinery (vandalization of the pipeline), and social unrest in the area around the Warri refinery. More importantly, however, under the pricing regime prevailing before September 2003, there was a clear incentive to export rather than refine crude oil in order to finance NNPC's losses in downstream petroleum distribution (see below).

### **The pipeline network**

203. **Apart from the crude oil pipeline that feeds the Kaduna refinery, Nigeria is criss-crossed by more than 4000 km of petroleum product pipelines, which deliver products to strategic storage depots in the regions.** About 20 pumping and booster stations keep petroleum products flowing through the pipelines. The current configuration dates back to the early 1990s, when the last phase of the Pipelines and Depot Project worth \$600 million was completed. Despite this investment, many pipelines and other pieces of equipment are run down. The functioning of the system is further hampered by vandalization and theft.

### **The wholesale storage depots**

204. **Following the refining process, petroleum products are first deposited in large storage depots at the refineries.** From there, they are shipped through the pipelines to 15 storage depots strategically located in the various regions. A large percentage of the storage depots are old and leaking, which results not only in financial losses, but also in significant groundwater pollution.

### The retail stations

205. **The retail end of the petroleum product market was 100 percent private, until the NNPC opened filling stations in Abuja and Lagos in 2001-02.** Seven major marketers dominate the sector with a combined share of more than 60 percent, led by Total with about 16 percent market share. Other international oil companies (IOCs) include ExxonMobil, ChevronTexaco, and Agip. A large number of small, independent marketers satisfy nearly 40 percent of demand (see Table VII-1).

Table VII-1. Nigeria – Petroleum Product Marketing Companies (2002)

Marketer	Market Share (in percent of total)
TotalFinaElf	15.5
African Petroleum National	11.8
ExxonMobil	8.5
Unipetrol	7.4
ChevronTexaco	6.8
Agip	6.8
Independents	4.7
Total	38.5
	100

Source: Nigerian authorities.

206. **Transportation of products between strategic storage depots and filling stations is provided by a fleet of road tankers owned primarily by the major marketers.**

Due to the low margins that have prevailed over the recent past, the retail sector has suffered from insufficient investment in maintenance and new equipment. Storage tanks, road tankers, and filling stations have deteriorated precipitously. Pumps at filling stations are often out of order, storage tanks are leak, and road tankers are accident-prone and break down often. Petrol queues occur frequently, not only because of shortages in product availability, but also because of the insufficiency and slow operation of petrol pumps.

### C. Economic Effects of Government Involvement in Pricing

207. **The government was involved in the downstream petroleum sector not only through ownership of infrastructure, but also through regulation of wholesale and retail prices.** Liberalization at end-September 2003 ended the retail price regulation, and marketers started setting prices to cover their operating costs. Until September 2003, the government through its Petroleum Product Pricing and Marketing Committee (PPPMC) set wholesale and retail prices for petroleum products, and also fixed the margin for the private retailers. The rationale for price fixing was that Nigerian consumers should have access to cheap fuel at a uniform price across the country.

208. **In recent years, the price set by the government did not cover refining, import, and distribution costs.** The NNPC became therefore the only wholesale supplier of petroleum products, both through refining and imports. The goal of supplying cheap petroleum products to the country was also not achieved: demand was not met, large quantities of subsidized Nigerian products were smuggled to neighboring countries and

outside of Lagos and Abuja, petroleum products were for the most part only available in the informal market at higher prices.

209. **To cover the difference between NNPC's costs of supplying petroleum products and wholesale prices it could charge when selling them, the government allocated to it crude oil below the export parity price.** The domestic allocation crude was in part exported, while the remainder was refined domestically. Exports of crude financed imports of petroleum products. The NNPC made a trading profit by exporting rather than refining, because of the domestic allocation price advantage. The trading profit served to cover losses in refining and wholesale distribution.

210. **The domestic petroleum market regulation led to two distortions,** namely (i) implicit subsidies on domestic retail prices for petroleum products, defined as the difference between market prices and administered prices, and (ii) implicit subsidies to cover NNPC's operating losses in the form of foregone government revenue from the domestic allocation of crude oil.

### **Official and competitive retail prices**

#### ***Pricing regime before June 20, 2003***

211. **Official retail prices were set about once a year between 2000 and mid-2003, increasing from N16 to N26 per liter during this period.** The price the NNPC had to pay for the domestically allocated crude was raised from \$9.50 to \$18 per barrel in 2002, and at the same time the quantity increased from 300 kbd to 450 kbd to partly compensate for the increase in price. NNPC paid for domestic crude in naira, and the applicable naira/dollar exchange rate was fixed at the same time as the U.S. dollar price for the crude.

#### ***Unit Costs in the pre-liberalization period***

212. **To estimate the extent of subsidies prior to the changes in June and September 2003, we use here data contained in the NNPC's audited accounts for 2002 and world oil price data.** As shown in Table VII-2, domestic crude cost, refining, depreciation, distribution and marketing add up to a cost of N22.8 per liter.

213. **Imported petroleum products are estimated to have cost N33.1 per liter.** Using data on consumption of domestic and imported products, the weighted average for domestic and imported fuel is determined as N26.2 per liter, which is a little above the official retail price for 2002, so the official retail price came close to covering NNPC's costs. It was, however, not a market price, as the NNPC was paying less than the market price for crude oil. Removing the cost advantage the NNPC received through the domestic allocation of crude oil would have increased to N30.9 the costs for the average liter of fuel sold in Nigeria.



Table VII-2. Nigeria - Basic Assumptions for Domestic Petroleum Pricing, 2000-04

	2000 1/	2001 1/	2002 1/	2003 2/ Est.	2004 Proj.
	(in naira per liter)				
Domestic crude allocation	5.6	6.0	12.1	15.1	29.0
Refining	2.2	1.6	1.7	1.7	1.9
Depreciation of property, plant and equipment	1.1	0.9	1.2	0.7	1.3
Wholesale marketing and distribution	1.4	1.9	1.8	2.0	2.2
CIF import price	31.3	21.5	24.1	23.5	29.2
Amortisation of TAM costs (N/l)	1.0	1.1	1.3	1.4	1.5
Retailer distribution and tax margin	5.2	5.7	6.0	8.4	8.4
Costs of domestic petroleum products at retail	15.5	16.0	22.8	27.8	42.7
Costs of imported petroleum products at retail	38.8	30.3	33.1	35.3	41.3

Sources: Nigerian authorities and staff estimates.

1/ The 2000-02 columns are based on NNPC audited accounts and NNPC annual reports.

2/ Official retail price for domestic petroleum products and price per barrel for domestic crude is average for prices before and after June 20.

3/ Price actually paid, preferential exchange rate taken into account.

4/ For 2000-03, realized export prices for Nigerian crude.

214. **Note that the audited accounts for 2002 show that domestically refined petroleum products cost about N3.2 per liter less than imported products.**<sup>86</sup> This is a surprising result given that the Nigerian refineries are run down and capacity utilization is far below the optimum. It is unlikely that domestically refined products would be significantly cheaper than imported products, despite the costs of shipping included in the price for imported products.<sup>87</sup> The accounts most likely understate the true costs of operation, for example by not taking full account of equipment replacement costs. The cost differential between domestically refined products and imports is almost three times the depreciation allowance of N1.2 per liter shown in the accounts. To calculate retail subsidies, the import parity price has therefore been used, rather than the average of import and domestic price.

### ***Pricing in 2003***

215. **On June 20, 2003 the government announced an increase in domestic retail prices for petroleum products from N26 to N40 per liter to cover all costs.** The announcement was followed by labor unrest and the new price had to be reduced to N34 per liter. At the end of September 2003, the government announced the end of official retail price fixing, and most retailers increased their prices to at least N40 per liter. For the year as a

<sup>86</sup> At the wholesale level, imported petroleum cost N27.1 per liter, as compared with N23.9 per liter for domestically refined products.

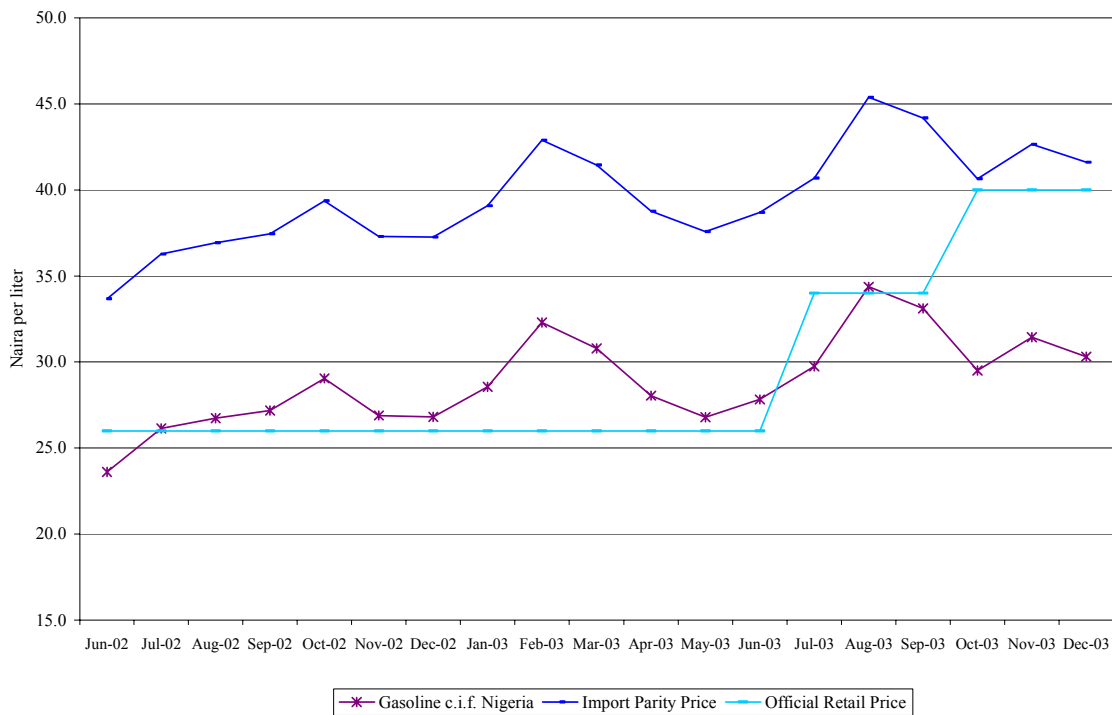
<sup>87</sup> Refining is capital-intensive, and most capital goods are imported. Nigeria's low labor costs would therefore give only a small competitive advantage to domestic refiners.

whole, this meant the average retail price was about N31.5 per liter, compared with an import parity price of N35.3 per liter. Subsidies remained therefore significant during 2003.

216. **With more unrest following the announcement of price liberalization, and under the threat of a general strike, the government held consultations with unions and downstream oil companies.** What emerged was a consultative price fixing of retail prices on a regional basis. Meetings are held weekly to agree on a band of prices that filling stations can charge consumers. The Department of Petroleum Resources (DPR) controls adherence to the agreements and sanctions contravening filling stations with temporary closure. This system is in place in Abuja and Lagos, although in other parts of the country prices are more market-determined.<sup>88</sup>

217. Import parity prices at end-2003 remained somewhat higher than the N40 per liter retail prices observed after the liberalization in September 2003. Figure VII-1 compares c.i.f. prices, import parity prices, and official retail prices for gasoline in Nigeria on a monthly basis between June 2002 and December 2003.

Figure VII-1. Nigeria - Official and Import Parity Gasoline Prices, June 2002-Dec 2003



<sup>88</sup> A court injunction in favor of a complaint by trade unions against the imposition of a fuel tax in January 2004 was interpreted initially as fixing fuel prices until formal proceedings could be heard. In May 2004 however, the authorities reviewed the injunction and came to the conclusion that it only stayed the imposition of the fuel tax. While prices were stable between January and May, they have now increased to more than N50 per liter.

### Implicit subsidies for retail prices

218. **The breakdown of import prices and costs can be used to calculate subsidies on domestic petroleum products.** At about 220 kbd domestic consumption, which is equivalent to 35 million liters, domestic petroleum subsidies as measured by the difference between official prices and import parity costs amounted to N117 billion (US\$1 billion), or 2.1 percent of GDP in 2002 (see Table II-3). Despite the price increases, subsidies are estimated at 1.6 percent of GDP for 2003. Without the price increases, subsidies would have amounted to 2.7 percent of GDP in 2003. Assuming that retail prices are allowed to adjust fully to import parity costs, subsidies would be eliminated in 2004.

Table VII-3. Nigeria - Subsidies for domestic petroleum consumption, 2001-04

	2001	2002	2003	2004
	N16/l; US\$8.5/bbl	N26/l; US\$16.2/bbl	N31.5/l; US\$18.5/bbl	Est. Proj. Market Prices
Retail price; domestic allocation price				
(in billions of Naira; unless otherwise indicated)				
Domestic products (at official prices)	199.8	309.1	303.1	687.1
Domestic products (at import parity cost price)	408.8	426.2	426.5	687.1
Domestic petroleum subsidies	209.0	117.1	123.4	0.0
Domestic subsidies (in percent of GDP)	3.9	2.1	1.6	0.0

Sources: Nigerian authorities and staff estimates.

### Foregone government revenue from the domestic allocation of crude

219. Revenue foregone by the government through NNPC's preferential price for the domestic allocation of crude amounted to 3.2 percent of GDP in 2002.<sup>89</sup> In 2003, the crude subsidy is still estimated at 2.9 percent of GDP, because of a widening gap during the first half of the year between the official price charged, and international prices for crude (see Table VII-4). Assuming that NNPC pays market prices for the domestic allocation in 2004, the domestic allocation advantage would be eliminated.

Table VII-4. Nigeria - Foregone government revenue, 2001-04

	2001	2002	2003	2004
	N16/l; US\$8.5/bbl	N26/l; US\$16.2/bbl	N31.5/l; US\$18.5/bbl	Est. Proj. Market Prices
Retail price; domestic allocation price				
(in billions of Naira; unless otherwise indicated)				
Domestic crude (official prices)	135.2	315.1	377.6	745.7
Domestic crude (export equivalent prices)	376.8	497.6	598.1	745.7
Foregone government revenue	241.5	182.6	220.5	0.0
Foregone revenue (in percent of GDP)	4.5	3.2	2.9	0.0
Excess of crude subsidy over retail subsidy	32.5	65.5	97.1	0.0

Sources: Nigerian authorities and staff estimates.

<sup>89</sup> Based on the official purchase price of \$18, minus the exchange rate advantage of \$1.80, and dated Brent crude price of \$25.

### D. NNPC Cash Flow

220. **Because the NNPC exported part of the domestic crude allocation it acquired at a low price to subsidize petroleum products at the retail level, the NNPC made a profit in the downstream sector.** As shown in Table VII-4, the domestic allocation subsidy exceeded the retail subsidy by a substantial margin. Domestic sales of petroleum products and exports of about half of the domestic allocation provided revenue of N 580 billion (\$4.8 billion) in 2002, while imports of petroleum products, domestic distribution, payments to the government for the domestic crude allocation, and refining costs amounted to about N510 billion (\$4.2 billion; see Table VII-5). The NNPC incurred losses on other business (mainly petrochemicals), resulting in an overall profit of N41 billion (\$330 million). In 2003, the price reforms left the NNPC with a profit estimated at about N60 billion (\$450 million). In 2004, both the retail prices and the domestic crude price are assumed to be market-determined. Nevertheless, from the 2001-02 accounts it can be expected that the company loses money in other activities. The company is therefore expected to incur overall losses in 2004. With market pricing of the domestic allocation, a change in price and/or quantity has no net effect on the government, as opposed to a change in the domestic retail price: higher retail prices mean lower NNPC losses, although there is of course a potentially long time lag between NNPC losses and actual costs accruing in the government budget.

Table VII-5. Nigeria - NNPC Group Summary Statement of Income and Expenditure, 2001-04

	2001	2002	2003	2004
	N16/l; US\$8.5/bbl	N26/l; US\$16.2/bbl	Est. N31.5/l; US\$18.5/bbl	Proj. Market prices
(in billions of naira)				
<b>Revenue</b>				
Petroleum product sales 1/	223.2	329.4	318.5	720.4
Crude exports 2/	154.5	259.6	430.1	372.9
Other	106.2	96.2	111.3	122.4
<b>Total</b>	<b>483.9</b>	<b>685.2</b>	<b>859.9</b>	<b>1215.7</b>
<b>Costs</b>				
Domestic crude allocation	135.2	315.1	377.6	745.7
Wholesale distribution costs 3/	24.4	26.1	24.9	31.5
CIF import costs	142.2	146.2	226.6	287.6
Refining 3/	21.0	19.3	13.4	26.9
Other	141.3	137.9	157.7	173.4
<b>Total</b>	<b>464.2</b>	<b>644.5</b>	<b>800.1</b>	<b>1265.1</b>
<b>Profit before taxes</b>	<b>19.7</b>	<b>40.8</b>	<b>59.7</b>	<b>-49.4</b>

Sources: Nigerian authorities and staff estimates.

1/ Includes exports of surplus refinery output.

2/ Exports of domestic crude in excess of refining capacity.

3/ Includes depreciation.

### E. Future of the Industry

221. **The authorities have formulated an ambitious strategy to privatize the downstream petroleum sector.** This includes the sale of the refineries, pipelines, and storage depots to strategic investors, and the opening of the sector to private investors in pipelines and other infrastructure. In terms of institutional changes, this includes:

- the freeing of crude prices; refineries pay the equivalent of world prices for crude since October 2003; in the future, they will be able to choose which crude to process, including imported crude;

- establishment of an independent regulatory commission for the sector to assure private investors of competition on a level playing field;
- a regulated open access pipeline and storage depot system;

222. **The current market structure is dominated by the NNPC infrastructure. Private marketers depend on NNPC pipelines and storage facilities.** Furthermore, competitive markets will develop only in major cities, where a number of retailers compete for market share. In rural areas, in particular in the North, regional monopolies would eventually erode any gains from privatization. Government regulation of infrastructure and markets will therefore have to continue for the foreseeable time.

223. **In the transitional period, the main challenge is to attract private investors to the refineries, and private importers to the products market.** Investors in refining are unlikely to come forward before the final regulatory regime for the sector has been specified. The authorities are working on an action plan to open transportation and storage installations to the oil marketers on a user fee basis prior to privatization of the infrastructure.

224. **Even after the establishment of a regulatory regime for a private petroleum products market it will be difficult to sell the domestic refineries.** Nigerian refineries may not be attractive to private investors. After years of lack of funds, they probably need substantial upgrading, and recent experience with labor unrest may make workforce downsizing a difficult prospect.<sup>90</sup>

225. **Nigerians have long suffered from shortages of petroleum products.** Businesses have identified the shortages as a major cost element impacting negatively on Nigeria's competitive position. The bold reform measures taken in the last quarter of 2003 have eliminated the considerable drain of the previous pricing regime on the government budget. Further action is needed to bring the benefits of reform to Nigerian consumers. Moving to the next phase will require:

- clearly defining the pricing regulation to be in place over the short- and medium term;
- designating an independent regulatory agency for pipelines and storage depots, that can also act as competition watchdog;
- finalizing infrastructure access regulation and setting transportation tariffs.

226. If private investors cannot be attracted to the refineries, there will undoubtedly be calls for protective measures to subsidize domestic refiners. The government should resist such calls, as protection would only reintroduce the inefficiencies of price distortions that the government wanted to eliminate with the liberalization measures taken in 2003.

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<sup>90</sup> During 2003, substantial amounts were spent to upgrade the refineries, in part through management contracts. These efforts, however, appear to have had little impact on the refineries performance.

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## VIII. NATURAL GAS PROSPECTS<sup>91</sup>

### A. Introduction

227. **Natural gas has seen a rapid rise worldwide as a relatively clean source of energy.**<sup>92</sup> Developments in major energy consuming countries have changed the perception of gas as a low-value commodity, and efforts to find and produce gas have greatly expanded. This paper gives an overview of the natural gas sector in Nigeria with a focus on the impact on government revenue and the balance of payments from existing and planned gas production. It presents the two existing natural gas export projects in detail, following an overview of reserves and production in section B. Section C describes the economics of the Nigeria Liquefied Natural Gas (NLNG) company, and Section D describes the Escravos project. Section E examines the impact of the gas sector on government revenue and the balance of payments. Section F discusses possibilities for expanding the domestic market for natural gas, and the last section gives concluding remarks.

### B. Overview

228. **Nigeria has been producing oil for more than thirty years, and has therefore been producing natural gas for an equally long period.** It is difficult, however, to gauge the availability of natural gas in the Niger Delta Basin because upstream producers have exerted little effort looking for gas. Gas fields have therefore been largely ignored when they were found, and oil companies have left aside prospects without exploratory drilling when the seismic data suggested ‘gassy’ deposits.

229. **Oil and gas reserves worldwide are classified on the basis of marketability.** Starting with the category used for resources that can and will be developed profitably with existing technology and prices, proven gas reserves in Nigeria are booked as only 3.2 billion barrels oil equivalent (bn bl/oe), compared with 24 billion barrels of proven oil reserves in 2002.<sup>93</sup> Proven and probable reserves of gas are estimated at 32bn bl/oe, and yet-to-be-found gas is calculated as 25bn bl/oe based on a probabilistic method, bringing the total natural gas

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<sup>91</sup> Prepared by Ulrich Bartsch.

<sup>92</sup> Natural gas is dissolved in crude oil under the high pressure that exists in hydrocarbon reservoirs, and is freed once the pressure is released. It is therefore not possible to produce oil entirely without having to deal with some associated natural gas. Most crude oil reservoirs also have a gas cap. In some reservoirs there is more gas than oil, although there are no reservoirs without any liquids.

<sup>93</sup> “Proved reserves of natural gas - generally taken to be those quantities that geological and engineering information indicates with reasonable certainty can be recovered in the future from known reservoirs under existing economic and operating conditions” (BP Statistical Review of World Energy June 2003). The Nigerian authorities put current proven oil reserves at 33 bn bl.

reserve base to 57bn bl/oe. Proven and probable crude oil reserves are put at 55bn barrels.<sup>94</sup> The potential for future gas production could therefore be higher than for oil production, although higher transportation costs for gas mean that the value of oil will be higher than that of natural gas (assuming gas prices continue to follow oil prices).

**230. Almost 50 percent of gas produced in 2003 was flared, i.e. burnt at the oil collection point.** The flaring of gas carries potential opportunity costs, and high environmental costs. However, the domestic market for natural gas is still very small, and the conditions for investment in the infrastructure for gas export have only recently been established.

**231. Total gas production is projected to increase from 4.3bn cubic feet per day (cft/d) in 1999 to 6bn cft/d in 2009.** Sales of gas however, are expected to increase from 200 million cft/d to 3.5bn cft/d over the same period (40-760 kb/d oe). Natural gas is now used in three ways, apart from being flared: (i) exported by Nigeria Liquefied Natural Gas (NLNG) from Bonny Island, (ii) gathered and transported to Lagos and beyond in the Escravos project, and (iii) reinjected into oil reservoirs to maintain the pressure needed to lift the oil.

### **C. Nigeria Liquefied Natural Gas Company (NLNG)**

#### **Plant size and investment costs**

**232. After a long period of planning and numerous failed attempts to get the project started, NLNG was created as a joint venture between Shell Nigeria (25.6 percent equity), Elf (15 percent), Agip (10.4 percent), and NNPC (49 percent).** Liquefaction of natural gas started in September 1999, in two production streams (so-called trains) with a capacity of 2.7 million tons (mt) each annually. The construction of the plant cost US\$3 billion spread over more than three years. In 2002, the plant was expanded by another train which increased capacity by 50 percent at a cost of US\$1.3 billion, and currently 9 million tons of LNG are exported mainly to Europe. The plant liquefies 1.2bn cft/d of natural gas, and exports the equivalent of 210 kbd of oil.<sup>95</sup>

**233. Financing arrangements for another expansion by trains four and five have been put in place in December 2002.** Project financing from international banks of US\$1 billion was secured for a total investment of US\$2.1 billion. This was the first time in sub-Saharan Africa that a project of this magnitude was found strong enough by international banks to

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<sup>94</sup> World Bank (2004).

<sup>95</sup> In the liquefaction process, all by-products other than methane are filtered out of the LNG. Heavier hydrocarbon compounds are sold as condensates and LPG.



justify such a financing arrangement.<sup>96</sup> A sixth train is at the planning stage at a projected cost of \$1.8 billion.<sup>97</sup> It is estimated that production will reach a new maximum of 450 kb/d oil equivalent in 2006, equivalent to 17 percent of the oil production projected for that year. Expansion of LNG capacity beyond 2006 is possible at a different location (Bass river). The Bonny island shipping channel is projected to be used to capacity by the six trains' exports.

### **Revenue and cost statement**

**234. To illustrate the importance of the liquefaction plant for government revenue and the balance of payments, we present here the financial details of the project.** As most of the operational financial data were not available, assumptions had to be made for sales prices and operating costs. To illuminate the calculations and assumptions, we take simulated revenues and costs for the year 2003 as an example.

**235. The liquefaction plant produced 9 million tons of LNG in 2003 from three trains of production, which have been built with an investment of US\$4.3 billion provided entirely by the shareholders.** In 2003, the company also invested into trains four and five (and into maintaining production in the existing trains), mostly provided by the project financing from international banks. Capital costs are depreciated over a period of five years. Recurrent costs consist of operating costs and costs for the purchase of natural gas from upstream producers, which are the joint ventures between the NNPC and the private shareholders of NLNG.<sup>98</sup> The LNG is sold in Europe, on the basis of long-term take-or-pay contracts, based on a pricing formula that links the sales price for liquefied gas to international oil prices. Export revenue for the company is estimated as US\$1.9 billion (see

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<sup>96</sup> Project financing means that repayment of the loan will come from project revenue only, and banks cannot have recourse to the project shareholders' capital in case of adverse developments.

<sup>97</sup> The trend in the industry is to build ever larger trains. While the first two trains had a capacity of 2.7mt each annually, the third had 3.4mt, trains four and five will have 3.7mt, and train number six is estimated to reach more than 4mt. Investment figures have been provided by NNPC.

<sup>98</sup> The first two trains of NLNG use gas from designated gas fields. Increasingly, expansions of the plant will use gas associated with oil production and contribute to the reduction of flaring.

Table VIII-1).<sup>99</sup> Despite ongoing investments in expansions, income should have exceeded costs by more than \$400 million in 2003.<sup>100</sup> The projected profit for 2004 reaches \$940 million.

**236. Over the medium term, the company is expected to produce a steady stream of income for both the government and the private partners.** Export revenue is projected to reach US\$5 billion in

2009, and profits are estimated at US\$2.2 billion for the same year, with more than \$1 billion for NNPC.<sup>101</sup> Note that the company is exempt from corporate income tax for ten years.

Table VIII-1. Nigeria - Physical and Financial Data for Nigeria Liquefied Natural Gas (NLNG)

	2002	2003	2004	2005	2006
	(in millions of U.S. dollars, unless otherwise specified)				
Production (mt)	5.7	9.0	10.9	16.0	18.9
Investment					
Capital costs (investment)	452	420	730	950	1,000
<i>of which:</i> debt finance	0	500	500	0	0
<i>of which:</i> retained earnings	300	20	200	650	650
Costs	1,137	1,464	1,744	1,721	2,100
Capital costs (maintenance)	50	100	100	150	150
Capital costs (depreciation over 5 years)	762	852	936	482	697
Debt service (10%, 8 years maturity)	0	0	94	187	187
Operating costs	112	175	212	311	367
Upstream gas purchases	213	337	403	590	698
Production and export revenue	1,056	1,925	2,688	3,590	3,895
Profits	-81	461	944	1,869	1,795
NNPC profits (49% equity share)	-40	226	463	916	880
JV partner profits	-41	235	482	953	916

Source: Nigerian authorities; and staff estimates and projections.

<sup>99</sup> Operating costs are estimated at US\$0.40 per 1000 cft or a total of US\$175 million. The LNG venture purchases 440bn cft (1.2bn cft per day) of natural gas at US\$0.76 per 1000 cft, at a cost of US\$333 million. Operating costs, the upstream gas price, and the LNG sales price in Europe are assumed to be the same as for the OmanLNG project described in Bartsch (1998).

<sup>100</sup> Company results for 2003 are not yet available. One of the joint venture partners indicated however, that a 'small dividend' would be paid by NLNG.

<sup>101</sup> Assumes that two more LNG trains come on stream in 2008-09.

### D. The Escravos Gas Project

237. **Since mid-1997, gas from oil production in the Western delta is collected and processed near the town of Escravos.** Natural gas liquids and condensates are extracted for export and domestic consumption, and gas is transported to domestic customers, mainly in Lagos. The first phase of the project processed 165 million cft/d at an investment of \$550million. The second phase expanded processing capacity to 285 million cft/d (50 kbd oe) at an additional \$82 million and came on stream in late 2000 (Table III-2).

238. **In the third phase, one of the world’s first commercial gas-to-liquids facilities will be constructed.** Still at the planning stage, the third phase would increase processing capacity to nearly 600 million cft/d, to produce 50 kbd of high-quality motor fuel for domestic use and exports. Production is projected to commence in 2005 after an investment of \$2 billion. The next step could be the extension of the Escravos pipeline system to allow exports of 200 million cft/d to countries to the West of Nigeria in the West Africa Gas Pipeline project (WAGP). This project is at the design stage, although purchase and financing arrangements still need to be finalized. Start of production is projected for 2006.

Table VIII-2. Nigeria - Physical and Financial Data for the Escravos Gas Project, Phases I-III, and the West Africa Gas Pipeline

	2002	2003	2004	2005	2006
	(in millions of U.S. dollars, unless otherwise specified)				
Production (million cft/d)	285	285	286	585	785
Investment	151	293	469	700	400
<i>of which</i> : retained earnings	0	200	163	300	300
Costs	88	58	117	238	407
Capital costs (depreciation over 5 years)	46	16	75	152	292
Operating costs	42	42	42	85	115
Revenue	450	479	536	966	1,086
Profits	362	221	256	429	379
NNPC profits (49% equity share)	177	108	126	210	186
JV company profits	185	113	131	219	193

Source: Nigerian authorities; and staff estimates and projections.

239. **With production in the Escravos complex estimated to bring revenue of \$300 million, profits of \$59 million are estimated for 2003.** According to the NNPC, the Escravos project pays upstream gas producers on a net-back basis, which means the gas is not sold at any specified price to the processing plant, but rather, profits are paid as dividends to the producers.

### E. Macroeconomic Impact of the Gas Sector

240. The gas sector generates government revenue, requires public expenditure in the form of NNPC cash calls, and has an impact on the balance of payments through imports of goods and services for operating and investment costs, foreign direct investment by joint venture companies, and profit remittances by the same companies.

#### Government Revenue and Cash Calls

241. **Government revenue related to the gas sector—along with other information—is shown in Table VIII-3.** It increases from \$350 million to \$1.4 billion between 2002 and 2006. In the early years, this depends almost entirely on revenue from the penalty imposed

on oil operators for the flaring of gas. This has been set at naira 10 per thousand cft in 1999, and government revenue from the flaring penalty decreases from \$33 million in 2002 to \$21 million in 2006 as flares are replaced by exports, domestic gas use, and reinjection.

242. Government revenue comes increasingly from the 40-49 percent equity share the NNPC holds in the gas joint ventures. This of course raises the question of the pass-through of profits from the NNPC to government accounts. The NNPC has so far only produced government revenue from the proceeds of the sales of crude oil, and upstream gas sales to NLNG and the Escravos project. The NNPC has to carry investment

costs for gas projects in accordance with its equity share (cash calls). 2003 was a year with heavy investment requirements in the gas sector, for the two-train expansion of NLNG and the onset of investment into Phase III of the Escravos project. Some investment expenditure is financed from retained earnings, as shown in the tables.<sup>102</sup>

### Balance of payments

243. **The gas sector depends to a large extent (we assume 80 percent) on imported goods and services for both operating and investment costs.** Imports follow closely the investment profile, and are projected to peak in 2005 at about \$1.6 billion. The portion of investment that is paid for by the foreign joint venture companies is financed by foreign direct investment, which also peaks in 2005. Foreign operators remit profits from their participation in the Nigerian gas sector, and \$940 million is estimated to have been transferred in 2003.

## F. Outlook for the Domestic Gas Market

244. **As described in the background section to this paper, the reserve base of natural gas in Nigeria is likely to be sufficient to expand gas production significantly beyond the LNG and Escravos projects described here.** Apart from the additional LNG and pipeline

Table VIII-3. Nigeria - Physical and Financial Data for the Gas Sector, and Macroeconomic Impact, 2002-2006

	2002	2003	2004	2005	2006
	(in million cubic feet per day; unless otherwise specified)				
Total production	4,855	4,983	5,571	5,770	5,920
NLNG	765	1,200	1,447	2,128	2,515
Escravos	285	285	285	585	785
Other uses	248	255	286	314	346
Reinjection	749	705	718	744	763
Flaring	1,827	2,368	2,340	1,452	909
Flaring (in percent of production)	38	48	42	25	15
Gas monetization (in million barrels per day oil €)	0.19	0.26	0.31	0.48	0.59
	(in millions of U.S. dollars)				
Production	1,506	2,404	3,224	4,556	4,981
Exports	1,056	1,925	2,688	3,590	4,132
Government revenue	351	531	858	1,469	1,449
NNPC cash calls	295	349	588	809	686
Imports of goods and services	605	744	1,162	1,637	1,505
FDI	370	440	1,011	1,275	1,148
Profit remittances by JV companies	488	944	1,193	1,387	1,310

Source: Nigerian authorities; and staff estimates and projections.

<sup>102</sup> Note that profits are different from cash flow in that they are calculated as gross revenue minus maintenance, capital depreciation, debt service, and operating costs, so they do not depend on the financing of investment activities.

export projects under discussion, the domestic market could in the future provide an outlet for gas that would benefit both producers and the Nigerian economy. This section looks at the potential market, and at institutional and legal changes needed to make the market attractive to investors.

### Domestic Market Potential

245. **Nigeria suffers from a chronic shortage of electricity, mainly because of shortages in generation capacity.** Gas-fired electricity generation alongside major investments in electricity distribution infrastructure could alleviate this shortage, and create the minimum demand necessary to build an extensive gas distribution pipeline system across Nigeria. Currently, the National Electric Power Agency (NEPA) uses gas for 41 percent of its 6,000 Megawatt (MW) power plant capacity. Assuming that electric power consumption grows at 6 percent per year, ExxonMobil estimates that 77,000 MW installed capacity will be needed by 2020. Over the medium-term, the company estimates that new power stations will be based in Kaduna, Enugu, Ibadan, and Lagos with a total capacity of 4,400 MW by 2010.

246. **Gas demand from existing and new power generation would be about 1,000 million cft/d by 2010 from 400 million cft/d today.** Cement, fertilizer, steel, and aluminum

industries could add another 100-200 million cft/d. Residential and small industry demand is more uncertain, and depends critically on the extent of any future gas distribution network. Shell estimates demand to be in the range of 50-500 million cft/d annually (Table VIII-4).

Table VIII-4. Nigeria: Domestic Gas Demand, 2003-10

	2003	2010	
		Proj.	
		low case	high case
	(in million cubic feet per day)		
Power generation	400	1000	1000
Industry (cement, fertilizer, steel, aluminium)	0	100	200
Households	0	50	500
Total	400	1150	1700
Total (in thousand barrels oil equivalent per day)	71	205	303

Source: Nigerian authorities; and staff estimates and projections.

The domestic market for gas over the medium term is therefore likely to be equivalent to the current NLNG gas use. Investment requirements for the domestic gas market are large. Because they are likely to be too large for the public purse, private investment will have to be attracted.

### Regulatory framework for a domestic gas market

247. **The framework for attracting private investment in domestic gas infrastructure is currently not in place.** The government is working on two fronts to change this: first, the revival of the power sector should follow from efforts under way to restructure NEPA, unbundle its activities, and privatize most of its operations. The authorities are hoping to attract private investment, including foreign direct investment, through possibilities for build-operate-transfer schemes. Second, the government is working on a gas sector strategy, with the help of the World Bank.

248. **A technical team and two stakeholder workshops produced a proposal to draft a Gas Act that would create a new and separate legal and regulatory regime for downstream gas.**<sup>103</sup> The proposal also contains suggestions for a combined gas and electricity regulatory agency staffed with relevant personnel from the Department of Petroleum Resources. The Act would define a licensing regime, and distinguish between the roles of a transportation network operator, transporters, and distributors and gas suppliers. A National Gas Transportation Company (NGTC) would be created separate from the NNPC. The Gas Act would allow certain gas users and distributors third party access to the pipeline network to enable them to contract directly with upstream producers.

### **G. Concluding Remarks**

249. **The objective of this chapter was to provide basic information about the natural gas sector in Nigeria.** The chapter has shown a very promising development potential for a sector that is very much in its infancy. Export projects are moving well ahead, although it remains to be seen how the government will share in their expected high profitability. A domestic market does not yet exist, but has a good potential to develop together with an alleviation of the chronic electricity shortages that still plague Nigeria.

250. **Natural gas deserves attention by the government, as it could provide several benefits to Nigeria.** First, the development of profitable outlets for natural gas could reduce the flaring of this resource, with immediate environmental as well as financial benefits. Second, expansion of profitable gas use is not constrained by Nigeria's OPEC quota. This includes the production of natural gas liquids and condensates, which command higher prices than crude oil. Third, natural gas could be used to eliminate electricity shortages, and provide a clean, stable source of energy to industry and households.

251. **A number of concerns follow from our description.** There is a shortage of information on the gas sector in its current form; in particular, (i) the current upstream fiscal regime is not clear, and the pass through of profits from the government's participation in NLNG has yet to occur; (ii) although some private gas-fired power stations are already under construction, the legal and regulatory framework may change considerably; it is not clear what the current agreements are with the sponsors of the projects under construction, and how they would be affected by an eventual Gas Act; the preparation of the Gas Act should therefore proceed without delay.

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<sup>103</sup> IPA Energy Consulting, 2003.

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Table 1. Nigeria: Revised Gross Domestic Product by Sector of Origin at Current Prices, 1999-2003

	1999	2000	2001	2002	2003 Prel.
	(In millions of naira)				
Primary sector	2,156,298	3,384,186	3,813,987	3,795,695	5,237,792
Agricultural activities	1,127,693	1,192,910	1,584,312	1,700,451	1,940,587
Agriculture	948,183	1,000,069	1,328,733	1,411,048	1,628,349
Livestock	111,110	116,393	153,453	175,838	189,247
Forestry	17,684	22,437	27,463	29,111	31,146
Fishing	50,716	54,010	74,664	84,454	91,845
Mining and quarrying	1,028,605	2,191,276	2,229,675	2,095,245	3,297,206
Of which: crude petroleum and gas	1,024,464	2,186,682	2,223,671	2,089,470	3,291,115
Secondary sector	180,584	200,841	244,586	293,612	342,988
Manufacturing	150,947	168,037	201,393	250,187	293,083
Utilities	2,110	2,200	2,438	4,234	5,153
Building and construction	27,528	30,604	40,755	39,191	44,753
Tertiary sector	976,656	952,610	1,119,598	1,364,858	1,779,358
Transport	116,502	129,092	145,661	179,365	239,378
Communication	1,333	1,638	2,114	3,027	3,637
Wholesale and retail trade	485,667	527,485	642,860	772,721	1,041,209
Hotel and restaurants	5,791	6,455	7,252	8,291	9,719
Finance and insurance	39,390	43,775	54,383	79,449	70,113
Real estate	133,185	165,070	171,768	206,626	276,583
Other private services	35,276	44,077	55,385	66,405	87,907
Government services	159,513	35,017	40,176	48,974	50,812
Gross domestic product at factor cost	3,313,538	4,537,637	5,178,171	5,454,165	7,360,139
Oil	1,024,464	2,186,682	2,223,671	2,089,470	3,291,115
Non-oil	2,289,073	2,350,955	2,954,500	3,364,696	4,069,023
Total indirect taxes (net)	128,019	140,663	163,392	180,643	187,625
Subsidies	-1,378	-1,906	-2,500	-2,500	-2,500
Gross domestic product at market prices	3,440,179	4,676,394	5,339,063	5,632,308	7,545,263
Memorandum items:	(In percent of GDP)				
Oil GDP	30.9	48.2	42.9	38.3	44.7
Non-oil GDP	69.1	51.8	57.1	61.7	55.3
Agricultural activities	34.2	26.4	30.7	31.3	26.4
Secondary	5.4	4.4	4.7	5.4	4.7
Tertiary sectors	29.5	21.0	21.6	25.0	24.2

Sources: Federal Office of Statistics; National Planning Commission; and staff estimates.



Table 2. Nigeria: Revised Gross Domestic Product by Sector of Origin at Constant 1990 Prices, 1999-2003

(In millions of naira)

	1999	2000	2001	2002	2003 Prel.
Primary sector	217,288	232,466	239,052	230,615	263,299
Agricultural activities	113,797	117,110	121,605	126,763	131,977
Agriculture	95,682	98,179	101,988	105,189	110,742
Livestock	11,212	11,427	11,778	13,108	12,870
Forestry	1,785	2,203	2,108	2,170	2,118
Fishing	5,118	5,302	5,731	6,296	6,246
Mining and quarrying	103,491	115,356	117,447	103,852	131,322
Of which: crude petroleum and gas	102,663	114,507	116,130	102,627	129,870
Secondary sector	21,201	21,963	23,484	25,791	27,305
Manufacturing	17,721	18,375	19,337	21,977	23,332
Utilities	248	241	234	372	410
Building and construction	3,232	3,347	3,913	3,443	3,563
Tertiary sector	79,616	81,594	84,546	95,567	96,681
Transport	10,859	12,698	12,653	14,870	15,737
Communication	124	161	184	251	239
Wholesale and retail trade	33,852	39,777	43,133	46,478	48,154
Hotel and restaurants	540	635	630	687	639
Finance and insurance	3,671	4,306	4,724	6,586	4,609
Real estate	12,414	16,237	14,921	17,130	18,183
Housing	3,288	4,336	4,811	5,505	5,779
Community and other services	0	0	0	0	0
Government services	14,868	3,444	3,490	4,060	3,341
Gross domestic product at factor cost	318,879	336,858	347,998	352,941	391,300
Oil	102,663	114,507	116,130	102,627	129,870
Non-oil	216,216	222,351	231,868	250,314	261,430
Total indirect taxes (net)	10,089	9,800	9,380	9,994	10,438
Subsidies	109	133	163	186	194
Gross domestic product at market prices	328,859	346,525	357,216	362,749	401,544

Sources: Federal Office of Statistics; National Planning Commission; and staff estimates.

Table 3. Nigeria: Revised Gross Domestic Product by Expenditure Category at Current Prices, 1999-2003

(In millions of naira)

	1999	2000	2001	2002	2003 Prel.
External balance	-85,433	964,618	474,223	-12,859	684,196
Exports of goods and nonfactor services	1,274,680	2,537,758	2,310,724	2,296,286	3,771,043
Goods	1,189,396	2,429,388	2,194,359	2,159,568	3,587,658
Nonfactor services	85,283	108,370	116,365	136,718	183,385
Imports of goods and nonfactor services	1,360,113	1,573,140	1,836,501	2,309,145	3,086,847
Goods	931,195	1,078,946	1,285,645	1,630,367	2,209,615
Nonfactor services	428,918	494,194	550,856	678,778	877,232
Domestic demand	3,525,612	3,711,776	4,864,840	5,645,167	6,861,068
Consumption	2,573,697	2,746,714	3,648,630	4,177,423	5,145,801
Government	620,795	964,433	1,415,537	1,392,649	1,755,272
Private	1,952,901	1,782,281	2,233,093	2,784,775	3,390,529
Gross investment	951,915	965,062	1,216,210	1,467,743	1,715,267
Stock changes	0	0	0	0	0
Gross fixed investment	951,915	965,062	1,216,210	1,467,743	1,715,267
Government fixed investment	260,014	401,413	646,990	572,675	703,900
Private fixed investment	691,902	563,649	569,220	895,069	1,011,367
Gross domestic product at market prices	3,440,179	4,676,394	5,339,063	5,632,308	7,545,263
Net factor income from abroad	-317,041	-644,978	-476,732	-782,179	-1,104,976
Gross national product at market prices	3,123,138	4,031,416	4,862,331	4,850,129	6,440,287
Net transfers from abroad	113,423	160,339	143,074	170,897	216,767
National disposable income	3,236,561	4,191,756	5,005,405	5,021,026	6,657,054
National savings 1/	662,864	1,445,041	1,356,775	843,603	1,511,254
Gross domestic savings 2/	866,482	1,929,680	1,690,433	1,454,885	2,399,463

Sources: Federal Office of Statistics; National Planning Commission; and staff estimates.

1/ National disposable income less aggregate consumption.

2/ Domestic disposable income less aggregate consumption.

Table 4. Nigeria: Revised Gross Domestic Product by Expenditure at Constant 1990 Prices, 1999-2003

(In millions of naira)

	1999	2000	2001	2002	2003 Prel.
External balance	106,673	143,908	115,469	62,031	124,787
Exports of goods and nonfactor services	261,106	303,880	291,955	259,450	343,527
Goods	243,636	290,903	277,253	244,003	326,822
Nonfactor services	17,469	12,977	14,703	15,447	16,706
Imports of goods and nonfactor services	154,433	159,972	176,486	197,419	218,741
Goods	105,732	109,717	123,549	139,388	156,578
Nonfactor services	48,701	50,254	52,937	58,032	62,163
Domestic demand	222,186	202,617	241,747	300,718	276,757
Consumption	173,305	158,041	188,563	222,531	207,568
Government	54,203	78,745	97,920	84,743	93,389
Private	119,102	79,297	90,643	137,789	114,179
Gross investment	48,881	44,576	53,184	78,187	69,189
Stock changes	0	2	0	0	0
Gross fixed investment	48,881	44,576	53,184	78,187	69,189
Government	22,219	20,262	24,175	30,072	27,676
Private	26,662	24,314	29,010	36,086	33,211
Gross domestic product at market prices	328,859	346,525	357,216	362,749	401,544
Net factor income from abroad	-35,998	-65,587	-45,814	-66,872	-78,301
Gross national product at market prices	292,861	280,938	311,402	295,877	323,243
Net transfers from abroad	12,878	16,305	13,749	14,611	15,361
National disposable income	305,739	297,243	325,152	310,487	338,604
National savings 1/	132,434	139,201	136,589	87,956	131,036
Gross domestic savings 2/	155,554	188,484	168,653	140,217	193,976

Sources: Federal Office of Statistics; National Planning Commission; and staff estimates.

1/ National disposable income less aggregate consumption.

2/ Domestic disposable income less aggregate consumption.

Table 5. Nigeria: Selected Petroleum Statistics, 1998–2003

	1998	1999	2000	2001	2002	2003
Production and exports	(In millions of barrels per day)					
Production 1/	2.231	2.110	2.261	2.238	1.960	2.453
Domestic allocation	0.268	0.300	0.302	0.389	0.447	0.431
Exports 2/	1.955	1.844	1.952	1.849	1.513	2.022
	(in U.S. dollars per barrel)					
Average price of Nigerian crude	12.90	17.62	28.00	24.48	25.05	29.02
U.K. Brent, average price 3/	12.72	17.70	28.31	24.41	25.00	28.85
	(in millions of U.S. dollars)					
Export values 2/	9,218	11,943	20,151	16,574	13,834	21,415
	(In naira per liter, unless otherwise indicated)					
Domestic petroleum product prices 4/						
Crude oil (naira per barrel)	374.00	807.50	950.00	950.00	1980.00	2,487.00
Premium motor spirits	11.00	20.00	22.00	22.00	26.00	31.50
Kerosene	6.00	17.00	17.00	17.00	24.00	29.08
Gas oil/diesel	9.00	19.00	21.00	21.00	26.00	31.50
Domestic consumption of petroleum products	(In thousands of metric tons)					
Premium motor spirits	3,530.2	3,153.6	4,799.6	5,397.6	6,928.9	6,294.1
Kerosene	1,266.4	1,217.4	1,217.0	1,744.4	1,281.9	906.3
Gas oil/diesel	1,809.9	2,059.9	2,195.3	2,179.2	1,910.0	1,886.1
Fuel oil (high and low "pour")	1,580.5	2,863.9	...	174.4	220.9	1,287.6
Liquefied petroleum gas	66.1	37.6	...	13.8	...	...
Aviation spirits	26.2	32.4	...	...	...	...

Sources: Central Bank of Nigeria; Nigerian National Petroleum Corporation; and Fund staff estimates.

1/ Includes condensates.

2/ Balance of payments basis, including exports of condensate.

3/ U.K. Brent, light-blend 38 API, f.o.b. United Kingdom.

4/ For 2003, simple averages for the year.

Table 6. Nigeria: Selected Indicators of Agricultural Production and Prices, 1999-2003

	1999	2000	2001	2002	2003
(In thousands of metric tons)					
Food crops					
Millet	6,391	6,765	7,088	7,231	7,377
Sorghum	8,464	8,854	9,408	9,687	9,974
Maize	6,515	6,491	6,592	6,698	6,806
Rice (paddy)	3,522	3,865	3,989	4,085	4,183
Yams	25,950	26,451	27,589	28,979	30,439
Cassava	35,980	36,795	37,949	39,410	40,927
Export crops					
Cocoa	165	170	171	172	173
Groundnuts	2,307	2,390	2,361	2,375	2,389
Palm kernels	600	629	632	645	658
Cotton	351	353	359	379	400
Sheanuts	421	448	455	463	471
Rubber	265	275	279	284	289
(In naira per metric ton)					
Average prices for food crops					
Millet	20,347	21,264	33,528	...	...
Sorghum	18,867	19,284	34,945	...	...
Maize	19,304	20,719	37,351	...	...
Rice	49,226	46,997	51,003	...	...
Yams	15,544	20,975	56,333	...	...
Cassava	9,681	10,969	20,613	...	...
Average prices for export crops					
Cocoa	85,766	90,000	100,744	...	...
Groundnuts	28,589	44,110	44,843	...	...
Palm kernels	19,129	21,260	23,379	...	...
Cotton	40,208	35,000	33,204	...	...
Rubber	57,892	59,400	69,800	...	...

Sources: Federal Office of Statistics; Federal Ministry of Agriculture; and Central Bank of Nigeria.

Table 7. Nigeria: Index of Industrial Production, 1999-2003

	1999	2000	2001	2002	2003
	(1985 = 100)				
Total industrial production	129.7	134.6	145.3	145.2	...
Manufacturing	126.9	136.9	146.3	146.3	...
Sugar confectionary	55.8	56.8	47.5	52.8	...
Soft drinks	147.6	164.8	194.0	208.3	...
Beer and stout	101.9	120.6	125.7	128.3	...
Cotton textiles	87.3	98.5	93.7	95.0	...
Synthetic fabrics	736.8	717.3	665.6	718.1	...
Footwear	44.6	46.1	44.9	46.2	...
Paints	104.7	114.0	114.4	121.0	...
Refined petroleum	117.0	114.0	133.0	133.9	...
Cement	84.5	88.7	93.5	94.5	...
Roofing sheets	27.5	30.9	27.6	30.4	...
Vehicle assembly	12.5	13.7	15.0	17.6	...
Soap and detergent	161.1	189.1	210.1	214.0	...
Radio and televisions	4.9	3.9	3.3	3.8	...
Mineral production	130.9	137.5	144.9	133.7	...
Petroleum	129.7	138.8	146.3	134.9	...
Gas	186.8	191.5	225.0	240.3	...
Cassiterite	20.6	26.1	24.5	25.0	...
Columbite	48.4	98.2	97.7	98.3	...
Coal	11.4	10.8	11.3	11.4	...
Limestone	3.3	5.9	6.4	6.5	...
Electricity production	139.4	136.1	144.6	146.7	...
	(In thousands of megawatts)				
Electricity consumption	8,576	8,689	9,035	8,894	...
Industrial	2,200	2,200	2,200	2,200	...
Commercial and street lighting	2,083	2,083	2,083	2,083	...
Residential	4,293	4,406	4,752	4,611	...

Source: Central Bank of Nigeria.

Table 8. Nigeria: National Consumer Price Indices, 1999-2003

(May 2003 = 100)

	All items	Food	Beverages, tobacco, and kola	Clothing and footwear	Accommodation, fuel, and light	Household goods	Medical care and health	Transport	Recreation and education services	Other services
Weights	1,000.0	637.6	20.6	32.1	181	38.2	13.6	42.4	8.9	3.0
1999										
March	64.8	65.1	48.6	88.7	61.2	85.1	94.3	66.7	59.6	45.5
June	65.5	65.6	47.5	88.3	64.6	83.0	92.7	67.4	56.9	43.7
September	66.9	68.1	47.8	90.3	62.4	84.5	96.1	68.9	59.0	44.6
December	63.3	64.3	48.0	87.3	56.7	85.0	92.2	64.3	61.1	47.2
	63.6	63.5	50.8	89.7	58.8	86.7	98.5	66.0	61.2	49.1
2000										
March	69.3	66.7	53.8	91.6	75.1	89.6	100.2	70.8	66.2	53.1
June	64.6	64.2	52.2	89.6	59.9	88.6	97.9	67.6	65.7	51.0
September	70.9	68.1	53.4	90.6	78.8	92.0	100.3	70.8	65.9	52.9
December	73.1	67.7	54.7	92.8	91.3	89.9	100.8	73.2	66.9	54.9
	72.9	68.5	61.0	94.3	84.2	91.1	102.3	75.1	69.1	56.1
2001										
March	82.3	85.3	74.4	91.4	74.7	92.6	95.4	75.9	75.2	60.8
June	76.3	74.7	64.8	93.0	79.6	93.6	98.7	78.5	71.4	55.2
September	82.2	88.8	79.3	86.8	61.5	95.4	94.8	68.4	75.7	68.3
December	87.1	94.5	77.7	87.5	71.5	90.9	91.5	71.9	82.2	64.4
	84.9	88.3	8.39	100.7	72.0	95.4	84.6	85.0	79.3	65.2
2002										
March	92.9	96.5	92.4	91.5	87.3	95.2	98.5	79.1	82.8	71.9
June	89.6	93.4	92.1	92.9	82.3	89.2	98.2	73.4	76.5	67.2
September	92.3	98.0	95.6	84.1	89.1	90.7	89.3	75.5	70.5	67.8
December	95.8	99.9	96.5	97.6	85.9	96.2	107.1	80.2	96.7	77.4
	95.2	96.4	91.9	100.8	92.1	106.9	119.2	88.8	92.5	91.3
2003										
March	94.8	93.5	101.6	100.3	94.1	100.3	113.3	82.9	92.8	133.6
June	105.2	104.1	100.6	103.1	110.2	103.9	107.6	100.6	105.2	106.0
September	113.4	106.2	105.3	120.1	138.2	108.4	125.3	108.7	111.0	114.4
December	117.9	111.3	106.1	133.5	137.1	113.1	134.9	115.4	148.6	142.4

Sources: Central Bank of Nigeria, and Federal Office of Statistics.

Table 9. Nigeria: Urban Consumer Price Indices, 1999 - 2003  
(May 2003 = 100)

	All items	Food	Beverages, tobacco, and kola	Clothing and footwear	Housing fuel, and light	Household goods	Medical care and health	Transport	Recreation and education services	Other services
Weights	1000	626.5	13.1	36.2	172.8	44.6	8.7	50.3	13.3	2.9
1999 average	63.6	62.6	46.0	79.7	67.8	73.7	78.7	61.1	61.7	73.5
2000 average	72.0	87.2	80.2	83.5	87.6	72.3		68.0		
2001 average	81.6	86.1	72.6	92.8	73.8	88.2	85.7	72.7	72.8	93.9
2002 average	92.0	97.4	91.8	96.6	80.6	96.7	88.5	83.4	80.6	95.6
March	95.1	98.4	79.0	84.6	83.2	78.4	100.5	83.4	86.9	93.3
June	99.4	89.3	82.6	90.7	79.6	81.0	95.5	65.8	61.0	91.8
September	101.2	101.5	81.3	99.7	97.6	85.7	92.1	83.9	101.1	75.0
December	96.8	112.0	87.6	110.0	122.1	89.7	95.5	85.7	107.8	79.3
2003										
March	98.2	96.9	88.0	95.0	122.7	75.9	84.9	87.9	111.4	97.1
June	106.2	107.6	99.9	99.1	113.1	101.8	97.8	100.2	102.5	103.1
September	117.2	106.8	107.5	119.5	143.2	106.3	108.9	106.5	106.1	101.9
December	117.6	110.1	107.1	148.4	139.0	122.1	117.0	117.7	99.9	122.5

Sources: Central Bank of Nigeria, and Federal Office of Statistics.



Table 10. Nigeria: Rural Consumer Price Indices, 1999 -2003  
(May 2003 = 100)

	All items	Food	Beverages, tobacco, and kola	Clothing and footwear	Housing fuel, and light	Household goods	Medical care and health	Transport	Recreation and education services	Other services
Weights	1000	640.1	23.9	30.4	184.5	35.5	15.7	39	7.1	3.0
1999	65.0	65.5	49.1	90.6	59.9	87.2	99.3	70.4	58.3	38.8
2000	69.5	66.9	53.7	92.6	75.3	91.6	103.8	74.4	66.5	45.9
2001	82.4	85.2	74.8	91.1	74.8	93.4	98.5	76.4	76.6	52.9
March	76.0	73.7	66.8	93.3	80.2	95.0	100.9	83.5	73.1	45.7
June	82.3	88.6	80.6	85.8	61.9	95.3	99.5	62.7	75.3	62.9
September	86.8	93.8	77.1	87.8	70.7	92.5	95.5	69.2	84.0	57.4
December	84.8	88.1	83.1	101.3	73.1	94.7	86.8	80.4	80.0	56.4
2002	93.1	96.3	92.5	90.5	88.7	95.0	104.1	70.6	83.9	66.2
March	89.6	93.0	92.8	91.8	83.0	90.1	102.9	54.3	72.7	60.9
June	92.2	97.7	95.3	83.0	90.4	90.7	92.3	66.0	73.1	60.1
September	95.9	99.6	96.4	96.8	86.8	95.6	110.1	70.5	103.7	71.8
December	95.3	96.4	91.3	98.4	93.0	106.3	118.2	84.1	95.1	91.3
2003										
March	95.0	92.6	101.6	101.0	95.3	101.3	110.4	87.7	95.5	137.5
June	104.8	103.5	101.2	107.4	107.2	105.1	115.4	101.3	107.0	108.2
September	111.8	105.9	102.8	120.8	133.1	109.7	138.3	112.7	114.3	123.7
December	118.1	111.7	105.0	117.9	135.1	107.7	149.1	111.2	180.9	157.1

Sources: Central Bank of Nigeria, and Federal Office of Statistics.

Table 11. Nigeria: Consolidated Government Revenue, 1998-2003 1/

(In millions of naira)

	1998	1999	2000	2001	2002	Prel. 2003
Total revenue	496,892	1,010,583	1,986,949	2,247,884	2,037,763	2,752,107
Tax revenue	250,939	320,269	636,082	876,376	711,542	1,029,791
Taxes on net income, profits, and capital gains	113,436	155,588	436,442	560,110	401,532	658,596
Petroleum profits tax	44,050	68,933	332,542	405,941	225,193	437,964
Company income tax 2/	33,500	44,241	51,147	68,726	89,104	114,770
Education tax	2,223	3,622	7,444	16,214	9,570	9,704
Personal income tax 3/	33,663	38,793	45,308	69,230	77,665	96,157
Domestic taxes on goods and services	73,193	70,711	83,937	121,522	108,601	136,402
Value-added tax	38,415	48,232	58,470	91,789	108,601	136,402
Taxes on petroleum products	34,778	22,479	25,467	29,733	0	0
Taxes on international trade and transactions	64,310	93,970	115,703	194,744	201,408	234,793
Import duties, excises, and fees 4/	58,475	85,175	101,521	170,549	181,408	195,462
Customs levies 5/	5,835	8,794	14,182	24,195	20,000	39,331
Nontax revenue	245,953	690,314	1,350,867	1,371,508	1,326,222	1,722,316
Oil crude export proceeds	102,399	518,605	1,001,068	954,816	724,144	966,716
Royalty	0	108,312	192,531	206,593	170,143	245,517
Autonomous foreign exchange market profits	82,158	0	0	0	0	0
Domestic crude 6/	56,585	42,321	96,430	134,037	304,238	386,351
Federal government independent revenue 7/	3,112	14,602	37,828	44,335	68,134	54,164
Upstream gas proceeds/Other oil	1,700	6,474	23,010	31,727	59,562	69,568
Memorandum item:						
Privatization proceeds	0	0	18,104	85,800	19,698	0

Sources: Federal Ministry of Finance; and staff estimates.

1/ Includes the Federal, state and local governments.

2/ Mainly company income tax collected by the Federal Inland Revenue Service Revenue.

3/ Consists of personal income tax, other taxes and fees collected by state governments. The Federal Inland Revenue Service also collects a small amount of personal income tax from armed forces personnel and inhabitants of the Federal Capital Territory.

4/ Consists of import duties, excise duties, and fees that go directly to the Federation account.

5/ Consists mainly of earmarked import levies of a 5 percent port development surcharge, a 1 percent Nigerian Shippers Council surcharge, and a 1 percent Raw Materials Research and Development Council surcharge.

6/ Proceeds from the sale of crude oil to domestic refineries.

7/ Consists of dividends from public enterprises, directors' fees and loan recoveries.

Table 12. Nigeria: Consolidated Government Expenditure, 1998-2003 1/

(In millions of naira)

	1998	1999	2000	2001	2002	Prel. 2003
Total expenditure	723,635	1,118,505	1,706,562	2,509,965	2,334,566	2,853,918
Recurrent expenditure	230,897	492,316	651,615	770,120	868,122	912,239
Goods and services	132,152	206,652	350,078	403,073	477,596	514,371
Federal government personnel costs	56,319	135,066	278,701	285,169	368,484	367,950
Federal government overhead	75,833	71,586	71,377	117,904	109,112	146,422
Customs levies	5,835	8,794	14,182	24,195	20,000	39,331
Education Fund	2,223	3,622	7,444	16,214	9,570	9,704
Interest payments due	90,687	273,248	279,911	326,638	360,956	348,832
Domestic interest	42,770	91,488	104,165	154,796	170,635	169,725
Foreign interest	45,667	181,761	175,747	171,842	190,321	179,108
Other (local contractors)	2,250	0	0	0	0	0
Capital expenditure	220,420	187,158	250,506	440,955	264,002	251,691
Domestically-financed budgetary	212,281	174,588	233,762	433,070	251,078	241,681
Foreign financed	8,139	12,571	16,744	7,885	12,924	10,010
NNPC operations	71,861	207,210	289,856	429,754	352,932	451,683
JVC cash calls	54,991	183,362	267,736	391,680	347,084	451,683
NNPC priority projects	16,870	23,848	22,119	38,074	5,848	0
Extrabudgetary outlays/Other/NDDC	0	0	0	10,000	22,171	54,958
Judiciary	0	0	9,641	15,000	15,415	26,186
Net lending	0	3562.7	0	0	7400	0
State and local governments	200,457	228,257	504,945	844,137	804,524	1,157,161

Sources: Federal Ministry of Finance and staff estimates.

1/ Consists of the Federal, state and local governments.

Table 13. Nigeria: Federation Account Operations, 1998-2003

(In millions of naira)

	1998	1999	2000	2001	2002	Prel. 2003
Total revenue	137,768	454,239	1,007,585	1,096,418	1,176,464	1,449,939
Petroleum revenue	45,793	326,027	855,051	857,201	905,952	1,139,707
Foreign-generated oil and gas revenue (net)	23,988	257,212	740,384	735,656	601,714	753,356
Gross government export proceeds	102,399	498,217	947,163	934,284	783,707	1,036,284
Royalty and petroleum profit tax	44,050	171,411	525,073	639,234	395,336	683,481
First charges / Deductions	-122,461	-412,416	-731,852	-837,862	-577,329	-966,409
Domestically-generated oil revenue (net)	21,806	68,816	114,667	121,545	304,238	386,351
Petroleum naira revenue	56,584	68,816	114,667	121,545	304,238	386,351
Transfer to Petroleum Special Trust Fund	34,778	0	0	0	0	0
Nonpetroleum revenue	91,975	128,212	152,534	239,217	270,512	310,233
Company income tax	33,500	44,985	51,028	68,660	89,104	114,770
Customs and excise	58,475	83,226	101,506	170,557	181,408	195,462
Total expenditure	132,525	436,599	1,020,954	1,212,101	1,168,951	1,471,816
Federation account distribution 1/	132,525	436,599	1,020,954	1,212,101	1,168,951	1,471,816
Federal government	67,157	211,751	514,969	530,658	545,438	616,948
State government	33,232	104,784	256,501	391,327	321,422	419,845
Local government	27,693	87,320	213,751	245,487	269,446	346,866
Special funds	4,443	32,745	35,733	44,629	32,644	88,157
Federal Capital Territory	1,385	4,366	10,210	12,780	5,539	20,170
Ecology / Derivation and Ecology	2,769	8,732	20,419	25,491	8,945	19,433
Statutory stabilization	692	2,183	5,105	6,358	4,471	9,711
Derivation / Development of Natural Resources	-101	8,732	0	0	13,690	38,843
Mineral-producing areas	-303	8,732	0	0	0	0
Overall balance	5,243	17,640	-13,369	-115,683	7,514	-21,877
Financing	-5,243	-17,640	13,369	115,683	-7,514	21,877
Memorandum items:						
First charges / Deductions	122,461	412,416	731,852	837,862	577,329	966,409
JVC cash calls	54,991	183,339	260,000	391,990	347,084	451,683
NNPC priority projects	16,870	23,468	24,750	38,074	5,848	0
External debt service	37,400	177,610	175,034	232,192	143,867	235,807
National priority projects	13,200	0	0	0	0	0
Special reserve/excess proceeds	0	28,000	227,003	97,225	0	141,724
13% natural resource derivation	...	...	45,066	78,381	80,530	137,195

Sources: Federal Ministry of Finance; and staff estimates.

1/ The allocation formula of Federation account revenue as of 2003 was 48.5 percent for the Federal government, 24.9 percent for state governments, 20.6 percent for local governments, and 6 percent for special funds.

Table 14. Nigeria: Summary Federal Government Fiscal Operations, 1998-2003 1/

(In millions of naira, unless otherwise indicated)

	1998	1999	2000	2001	2002	Prel. 2003
Total revenue	285,884	711,449	1,368,233	1,362,701	1,155,688	1,470,637
Distribution from Federation account	67,157	211,751	514,969	530,658	545,438	616,948
Drawdown of Federation stabilization account	0	13,580	0	64	0	0
Federal government share of value-added tax	9,462	7,277	8,770	13,359	15,747	19,778
Independent revenue 2/	3,112	17,000	38,057	44,405	68,134	54,164
Autonomous foreign exchange market profit	39,846	0	0	0	0	0
Education Trust Fund	2,233	3,000	8,302	16,214	9,570	9,704
Customs levies	5,835	8,823	14,182	24,195	20,000	39,331
First charges/deductions	122,461	426,416	783,953	680,070	496,798	730,712
External debt service	37,400	177,610	175,034	232,192	143,867	210,292
National priority projects	13,200	14,000	42,459	18,124	0	0
JVC cash calls and NNPC priority projects	71,861	206,806	284,750	429,754	352,932	451,683
Excess proceeds	...	28,000	227,003	...	...	68,736
Judiciary	...	...	9,641	...	...	...
13 percent derivation grant	...	...	45,066	...	0	0
Transfer for Petroleum Special Trust Fund (PSTF)	34,778	21,000	0	0	0	0
PSTF independent revenue 3/	1,000	0	0	0	0	0
Other	0	2,603	0	53,737	0	0
Total expenditure	513,950	957,960	1,220,744	1,625,255	1,420,406	1,559,726
Recurrent expenditure	221,669	484,494	684,850	762,016	749,712	840,725
Goods and services	132,946	205,931	350,078	403,107	477,596	514,371
Personnel costs	56,319	136,909	278,701	285,118	368,484	367,950
Overhead	75,833	69,023	71,377	117,989	109,112	146,422
PSTF	794	0	0	0	0	0
Interest payments due	88,724	266,740	312,288	358,909	213,247	242,088
Domestic interest	40,520	84,034	104,168	154,796	170,635	169,725
Foreign interest	45,954	182,706	208,121	204,113	42,612	72,364
Local contractors	2,250	0	0	0	0	0
Other	...	11,823	22,484	0	58,869	84,265
Capital expenditure	220,419	166,540	246,098	433,486	317,762	267,317
Domestically financed	212,281	153,940	233,843	425,601	304,838	257,308
Budgetary	132,254	118,940	176,825	403,567	304,838	257,308
National priority projects	13,200	14,000	42,459	18,124	0	0
PSTF	66,827	21,000	14,559	3,910	0	0
Foreign financed	8,139	12,600	12,254	7,885	12,924	10,010
Net lending 4/	0	0	0	0	0	0
JVC cash calls and NNPC priority projects	71,861	206,806	284,750	429,754	352,932	451,683
Other/Extra budgetary expenditure	0	100,119	5,046	0	0	0
Overall balance (commitment basis)	-228,066	-246,511	147,490	-262,554	-264,718	-89,089
Balancing item	-42,100	0	13,300	0	0	0
Overall balance (cash basis)	-185,966	-246,511	134,190	-262,554	-264,718	-89,089
Financing	185,966	246,511	-134,190	262,554	264,718	89,089
Privatization	0	0	18,104	0	0	0
External loans (net)	24,503	-188,265	45,341	-26,290	-106,142	-127,919
Borrowings	8,139	12,600	12,254	7,885	12,924	10,010
Amortization due	-46,720	-200,865	-135,513	-34,174	-101,255	-137,928
Change in arrears (acc. +, red. -)	63,084	n.a.	0	0	0	0
Rescheduling	0	0	168,600	0	-17,812	0
Domestic	161,463	434,776	-179,531	288,843	370,860	217,008
Banking system (net) 5/	151,464	238,000	-99,615	118,724	398,848	178,930
Nonbank	10,000	196,776	-79,916	-30,216	-27,987	38,077
Memorandum items:						
Primary balance 6/	-139,342	20,229	459,778	96,355	-51,471	152,999
Primary balance (in percent of GDP)	-4.9	0.6	9.8	1.8	-0.9	2.0
GDP at market prices	2,836,085	3,440,179	4,676,394	5,339,063	5,632,308	7,545,263

Source: Federal Ministry of Finance; and staff estimates.

1/ Consists of the Federal government and the Petroleum Special Trust Fund (PSTF).

2/ Consists of dividends from public enterprises, directors' fees and loan recoveries from public enterprises.

3/ Miscellaneous revenues.

4/ Consists of interest earned on PSTF balances held as deposits and treasury bills.

5/ To state governments.

6/ Includes adjustment for PSTF deposits held in the commercial and merchant banking system, which are classified as private deposits.

6/ Primary balance is defined as total revenue less total expenditure, excluding interest payments due.

Table 15. Nigeria: Total Expenditure of the Federal Government by Functional Classification, 1998-2003 1/

	1998	1999	2000	2001	2002	2003
	(In millions of naira)					
Administration	89,944	139,871	174,578	230,065	405,313	...
General administration	47,025	82,447	95,882	103,112	183,379	...
National Assembly			6,655	19,813	21,635	...
Defense	25,162	24,477	37,490	63,472	108,148	...
Internal security	17,757	32,948	34,551	43,669	92,152	...
Economic services	180,925	330,347	130,222	307,960	273,628	...
Agriculture and natural services	9,043	12,151	13,609	64,944	44,804	...
Road and construction	2,244	3,895	18,487	28,642	45,126	...
Manufacturing, mining, and quarrying	14,691	9,924	10,514	7,284	39,663	...
Transport and communications	9,965	5,948	9,605	53,176	53,663	...
Housing	4,722	0	0	56,356	44,479	...
National priority projects	14,665	18,920	40,377	18,124	0	...
JVC cash calls/NNPC priority projects	68,210	174,976	0	0	0	...
Petroleum Trust Fund	34,779	20,800	14,559	3,910	0	...
Counterpart funding	17,081	69,628	7,028	0	0	...
Niger Delta Development Commission	0	0	944	10,000	0	...
Others	5,525	14,103	15,098	65,524	45,894	...
Social and community services	50,865	55,002	86,768	189,326	266,378	...
Education	24,614	31,564	49,563	59,745	109,455	...
Health	13,641	16,180	20,445	44,652	63,171	...
Housing	4,722	0	0	56,356	44,479	...
Other	7,888	7,258	16,759	28,574	49,273	...
Transfers	206,591	316,742	469,815	364,318	437,311	...
Outstanding domestic liabilities	4,147	0	0	0	0	...
Interest due	86,474	266,740	279,911	326,638	360,956	...
Domestic	40,520	84,034	104,165	154,796	170,635	...
External	45,954	182,706	175,747	171,842	190,321	...
Other recurrent transfers 2/	52,272	25,190	143,206	30,046	76,355	...
Other capital transfers	63,698	24,812	46697.6	7634	0	...
Total	528,325	841,962	861,383	1,091,670	1,382,631	...
	(In percent of total)					
Administration	17.0	16.6	20.3	21.1	29.3	...
General administration	8.9	9.8	11.1	9.4	13.3	...
National Assembly	0.0	0.0	0.8	1.8	1.6	...
Defense	4.8	2.9	4.4	5.8	7.8	...
Internal security	3.4	3.9	4.0	4.0	6.7	...
Economic services	34.2	39.2	15.1	28.2	19.8	...
Agriculture and water services	1.7	1.4	1.6	5.9	3.2	...
Construction	0.4	0.5	2.1	2.6	3.3	...
Manufacturing, mining, and quarrying	2.8	1.2	1.2	0.7	2.9	...
Transport and communications	1.9	0.7	1.1	4.9	3.9	...
Housing	0.9	0.0	0.0	5.2	3.2	...
National priority projects	2.8	2.2	4.7	1.7	0.0	...
JVC cash calls/NNPC priority projects	12.9	20.8	0.0	0.0	0.0	...
Petroleum Trust Fund	6.6	2.5	1.7	0.4	0.0	...
Counterpart funding	3.2	8.3	0.8	0.0	0.0	...
Niger Delta Development Commission	0.0	0.0	0.1	0.9	0.0	...
Others	1.0	1.7	1.8	6.0	3.3	...
Social and community services	9.6	6.5	10.1	17.3	19.3	...
Education	4.7	3.7	5.8	5.5	7.9	...
Health	2.6	1.9	2.4	4.1	4.6	...
Housing	0.9	0.0	0.0	5.2	3.2	...
Other	1.5	0.9	1.9	2.6	3.6	...
Transfers	39.1	37.6	54.5	33.4	31.6	...
Outstanding domestic liabilities	0.8	0.0	0.0	0.0	0.0	...
Interest due	16.4	31.7	32.5	29.9	26.1	...
Domestic	7.7	10.0	12.1	14.2	12.3	...
External	8.7	21.7	20.4	15.7	13.8	...
Other recurrent transfers 2/	9.9	3.0	16.6	2.8	5.5	...
Other capital transfers	15.2	15.2	15.2	15.2	15.2	...
Total	100.0	100.0	100.0	100.0	100.0	...

Source: Annual reports of the Central Bank of Nigeria and staff estimates of the interest due.

Table 16. Nigeria: Recurrent Expenditure of the Federal Government by Functional Classification, 1998-2003 1/

	1998	1999	2000	2001	2002	2003
	(In millions of naira)					
Administration	54,674	97,224	121,299	180,810	331,736	...
General administration	26,932	48,364	59,332	75,080	146,807	...
National Assembly	0	0	4,766	19,804	20,163	...
Defense	15,460	20,769	31,046	47,072	86,054	...
Internal security	12,281	28,091	26,154	38,855	78,713	...
Economic services	11,862	20,451	29,816	53,011	65,911	...
Agriculture	2,979	5,239	4,806	7,065	12,439	...
Road and construction	2,244	3,895	11,480	7,202	9,276	...
Transport and communications	1,439	2,632	2,428	33,935	36,579	...
Others	5,200	8,686	11,102	4,809	7,616	...
Social and community services	22,778	37,748	58,802	79,634	189,432	...
Education	14,035	23,047	39,034	39,885	100,240	...
Health	5,334	8,793	11,580	24,524	50,563	...
Others	3,409	5,908	8,189	15,226	38,628	...
Transfers	140,709	439,518	423,117	356,684	437,311	...
Interest due	88,437	273,248	279,911	326,638	360,956	...
Domestic	42,770	91,488	104,165	154,796	170,635	...
External	45,667	181,761	175,747	171,842	190,321	...
Others 2/	52,272	166,270	143,206	30,046	76,355	...
Total	230,023	594,942	633,035	670,140	1,024,389	...
	(In percent of total)					
Administration	23.8	16.3	19.2	27.0	32.4	...
General administration	11.7	8.1	9.4	11.2	14.3	...
National Assembly	0.0	0.0	0.8	3.0	2.0	...
Defense	6.7	3.5	4.9	7.0	8.4	...
Internal security	5.3	4.7	4.1	5.8	7.7	...
Economic services	5.2	3.4	4.7	7.9	6.4	...
Agriculture and water	1.3	0.9	0.8	1.1	1.2	...
Construction	1.0	0.7	1.8	1.1	0.9	...
Transport and communications	0.6	0.4	0.4	5.1	3.6	...
Others	2.3	1.5	1.8	0.7	0.7	...
Social and community services	9.9	6.3	9.3	11.9	18.5	...
Education	6.1	3.9	6.2	6.0	9.8	...
Health	2.3	1.5	1.8	3.7	4.9	...
Others	1.5	1.0	1.3	2.3	3.8	...
Transfers	61.2	73.9	66.8	53.2	42.7	...
Interest due	38.4	45.9	44.2	48.7	35.2	...
Domestic	18.6	15.4	16.5	23.1	16.7	...
External	19.9	30.6	27.8	25.6	18.6	...
Others 2/	22.7	27.9	22.6	4.5	7.5	...
Total	100.0	100.0	100.0	100.0	100.0	...

Sources: Annual reports of the Central Bank of Nigeria, except for interest due estimated by the staff.

1/ The figures are based on budgetary data and exclude extrabudgetary expenditures.

2/ Includes pensions, gratuities and contingencies .

Table 17. Nigeria: Capital Expenditure of the Federal Government by Functional Classification, 1998-2003 1/

	1998	1999	2000	2001	2002	2003
	(In millions of naira)					
Administration	35,270	42,737	53,280	49,255	73,577	...
General administration	20,093	34,083	36,550	28,032	36,572	...
National Assembly	0	0	1,889	9	1,472	...
Defense	9,702	3,798	6,444	16,400	22,094	...
Internal security	5,476	4,856	8,397	4,814	13,440	...
Economic services	200,862	323,581	111,508	259,758	215,333	...
Agriculture and natural resources	6,065	6,913	8,803	57,879	32,364	...
Road and construction	26,599	5,000	7,006	21,440	35,850	...
Manufacturing, mining, and quarrying	14,691	9,924	10,514	7,284	39,663	...
Transport and communications	8,526	3,317	7,177	19,241	17,083	...
Housing	4,722	0	0	56,356	44,479	...
National priority projects	14,665	18,920	40,377	18,124	0	...
JVC cash calls/NNPC priority projects	68,210	174,976	0	0	0	...
PTF	34,779	20,800	14,559	3,910	0	...
Counterpart funding	17,081	69,628	7,028	0	0	...
Niger Delta Development Commission	0	0	944	10,000	0	...
Others	5,525	14,103	15,098	65,524	45,894	...
Social and community services	23,366	17,254	27,965	53,336	32,467	...
Education	10,579	8,517	10,529	19,860	9,215	...
Health	8,307	7,387	8,866	20,128	12,608	...
Others	4,479	1,350	8,570	13,348	10,644	...
Transfers	49,518	114,456	46,698	76,348	0	...
Outstanding domestic liabilities	0	0	0	0	0	...
Other	49,518	114,456	46,698	7,634	0	...
Total	309,016	498,028	239,451	438,697	321,378	...
	(In percent of total)					
Administration	11.4	8.6	22.3	11.2	22.9	...
General administration	6.5	6.8	15.3	6.4	11.4	...
National Assembly	0.0	0.0	0.8	0.0	0.5	...
Defense	3.1	0.8	2.7	3.7	6.9	...
Internal security	1.8	1.0	3.5	1.1	4.2	...
Economic services	65.0	65.0	46.6	59.2	67.0	...
Agriculture and water resources	2.0	1.4	3.7	13.2	10.1	...
Road and construction	8.6	1.0	2.9	4.9	11.2	...
Manufacturing, mining, and quarrying	4.8	2.0	4.4	1.7	12.3	...
Transport and communications	2.8	0.7	3.0	4.4	5.3	...
Housing	1.5	0.0	0.0	12.8	13.8	...
National priority projects	4.7	3.8	16.9	4.1	0.0	...
JVC cash calls/NNPC priority projects	22.1	35.1	0.0	0.0	0.0	...
PTF	11.3	4.2	6.1	0.9	0.0	...
Counterpart funding	5.5	14.0	2.9	0.0	0.0	...
Niger Delta Development Commission	0.0	0.0	0.4	2.3	0.0	...
Others	1.8	2.8	6.3	14.9	14.3	...
Social and community services	7.6	3.5	11.7	12.2	10.1	...
Education	3.4	1.7	4.4	4.5	2.9	...
Health	2.7	1.5	3.7	4.6	3.9	...
Others	1.4	0.3	3.6	3.0	3.3	...
Transfers	16.0	23.0	19.5	1.7	0.0	...
Outstanding domestic liabilities	0.0	0.0	0.0	0.0	0.0	...
Other	16.0	23.0	19.5	1.7	0.0	...
Total	100.0	100.0	100.0	84.3	100.0	...

Source: Annual reports of the Central Bank of Nigeria.

1/ The figures are based on budgetary data and exclude extrabudgetary expenditure.



Table 18. Nigeria: Federal Government Outstanding Domestic Debt, 1998-2003

	1998	1999	2000	2001	2002	2003
	(End of period, in millions of naira)					
By Instruments	404,102	794,806	898,253	1,016,974	1,166,000	1,336,370
Treasury bills	221,802	361,758	465,535	584,536	733,762	831,748
Treasury bonds	179,620	430,608	430,608	430,608	430,608	503,152
Development stock	2,680	2,440	2,110	1,830	1,630	1,470
By Holders	404,101	794,807	898,253	1,016,974	1,166,000	1,336,370
Banking sector	355,856	765,123	855,925	937,847	992,683	...
Central bank	301,742	522,820	713,933	738,585	532,453	...
Commercial banks	49,540	226,092	132,682	199,262	460,230	...
Merchant banks	4,574	16,211	9,311	0	0	...
Nonbank sector	48,245	29,684	42,329	79,128	173,318	...
	(In percent of total; unless otherwise indicated)					
Holders	100.0	100.0	100.0	100.0	100.0	...
Banking sector	88.1	96.3	95.3	92.2	85.1	...
Central bank	74.7	65.8	79.5	72.6	45.7	...
Commercial banks	12.3	28.4	14.8	19.6	39.5	...
Merchant banks	1.1	2.0	1.0	0.0	0.0	...
Nonbank sector	11.9	3.7	4.7	7.8	14.9	...
Memorandum items:						
Total domestic debt in percent of GDP	14.2	23.1	19.2	19.0	20.7	17.7
Average rate of interest in percent	9.0	...	...	...	...	...

Sources: Annual reports of the Central Bank of Nigeria; and staff estimates.

Table 19. Nigeria: Summary of Budgetary Operations of State and Local Governments and special funds, 1998-2003 1/

	1998	1999	2000	2001	2002	2003
	(In millions of naira)					
Revenue	224,242	316,820	501,953	727,557	832,072	...
Statutory share of Federation account revenue 2/	132,758	232,221	368,544	523,470	518,864	...
Statutory share of Federation stabilization account revenue	237	922	5,781	7,061	9,570	...
Share of value-added tax	26,378	37,655	44,197	64,233	71,359	...
State allocation	750	719	0	0	0	...
Independent revenue 3/	32,546	38,157	45,308	69,230	100,028	...
Other	31,573	7,146	38,123	63,563	132,252	...
Expenditure 4/	210,122	252,745	355,680	529,930	894,357	...
Recurrent	104,260	139,956	196,784	294,710	565,765	...
Capital	78,514	78,962	158,896	235,220	328,592	...
Net lending						
Expenditure of special funds	27,348	33,827	...	...	...	...
Balance (deficit -)	14,120	64,075	146,273	197,627	-62,286	...
Financing	-14,120	-64,075	-146,273	-197,627	62,286	...
Foreign loans	246	295	156	0	15,879	...
Domestic loans	4,189	4,554	3,835	0	32,452	...
Other (Residual)	-18,555	-68,924	-150,264	-197,627	13,955	...

Source: Central Bank of Nigeria (Annual reports).

1/ These data, obtained through annual surveys undertaken by the Central Bank of Nigeria, are only illustrative.

2/ This revenue is on gross basis (ie. before deductions for payments of various commitments made by the sub national governnr

3/ Mainly personal income tax collected by state governments.

4/ Total spending is underestimated because only a sample of local governments are covered and deductions at source may not have been included.

Table 20. Nigeria: Monetary Survey, 1999–2003 1/

	1999	2000	2001	2002	2003
(In millions of naira; end of period)					
Net foreign assets	649,967	1,164,876	1,322,385	1,282,216	1,388,234
Central Bank of Nigeria (net)	493,688	956,988	1,034,542	902,957	971,656
Foreign assets	510,559	1,091,053	1,156,483	1,013,514	1,065,093
Foreign liabilities	-16,871	-134,065	-121,940	-110,557	-93,437
Commercial and merchant banks (net)	156,280	207,889	287,843	379,259	416,578
Foreign assets	161,754	222,988	305,029	398,210	437,659
Foreign liabilities	-5,474	-15,099	-17,185	-18,951	-21,081
Net domestic assets	66,227	-111,323	19,721	342,690	628,754
Domestic credit	632,010	472,012	829,791	1,329,401	1,764,563
Consolidated government (net)	178,907	-116,425	1,588	390,966	572,804
Claims	736,646	813,542	925,682	1,017,302	951,298
Deposits	-557,740	-929,968	-924,094	-626,336	-378,494
<i>Of which</i> : Federal government (net)	176,805	-123,990	-25,209	373,639	552,569
Non-financial public enterprises	692	951	1,080	164	212
Other financial institutions	4,568	4,881	6,330	5,488	6,878
Claims on private sector	447,843	582,606	820,793	932,783	1,184,669
Other items (net)	-565,783	-583,335	-810,070	-986,712	-1,135,809
Broad money	698,020	1,034,770	1,315,869	1,599,495	1,985,192
Narrow money	400,826	649,684	816,708	946,253	1,225,559
Quasi-money	297,194	385,086	499,162	653,241	759,633
Bonds and money market instruments	18,174	18,784	26,237	25,410	31,796
Capital accounts	481,682	594,207	689,289	598,310	882,906
(Annual percentage change)					
Net domestic assets 2/	-199.3	-268.1	-117.7	1637.7	-26.6
Domestic credit 2/	103.0	-25.3	75.8	60.2	4.4
Claims on private sector 2/	34.8	30.1	40.9	13.6	14.4
Broad money 2/	30.7	48.2	27.2	21.6	0.2
Quasi-money 2/	53.1	29.6	29.6	30.9	5.9
Narrow money 2/	17.9	62.1	25.7	15.9	-3.0
(Contribution to the growth of M2; in percentage points)					
Net foreign assets 3/	24.8	73.8	15.2	-3.1	10.8
Net domestic assets 3/	24.9	-25.4	12.7	24.5	-11.5
Domestic credit 3/	60.0	-22.9	34.6	38.0	3.7
Net credit to the consolidated gover	41.8	-42.3	11.4	29.6	-3.4
<i>Of which</i> : Net credit to the Federal	41.6	-43.1	9.5	30.3	-3.7
Other items (net)	-35.2	-2.5	-21.9	-13.4	-15.3
Velocity (non-oil GDP/broad money)	0.8	0.6	2.2	2.1	2.0

Sources: Central Bank of Nigeria; and Fund staff estimates.

1/ Consolidated accounts of the Central Bank of Nigeria, commercial banks, and merchant banks.

2/ Quarterly data for 2002 reflects growth since the end of 2001.

3/ Quarterly data for 2002 reflects contribution to M2 growth since the end of 2001.

4/ Capital accounts and bonds and money market instruments.

Table 21. Nigeria: Consolidated Accounts of the Central Bank, 1999–2003

(In millions of naira; end of period)

	1999	2000	2001	2002	2003
Net foreign assets	493,688	956,988	1,034,542	902,957	972,630
Foreign assets	510,559	1,091,053	1,156,483	1,013,514	1,065,093
Foreign liabilities	-16,871	-134,065	-121,940	-110,557	-92,463
Domestic credit	43,523	-298,843	-147,881	-28,396	278,494
Consolidated government (net)	15,308	-343,014	-178,998	-41,248	254,128
Claims	532,299	513,010	716,769	532,453	552,859
Deposits	-516,990	-856,024	-895,767	-573,701	-298,730
Non-financial public enterprises (gross)	692	951	1,080	164	212
Private sector (gross)	884	2,163	3,103	1,646	1,705
Claims on banks (gross)	22,070	36,176	20,604	5,554	15,572
Other financial institutions (gross)	4,568	4,881	6,330	5,488	6,878
Liabilities to commercial banks	95,478	130,035	194,830	192,551	260,696
Currency in vault	21,892	34,976	64,835	76,211	90,099
Demand deposits 2/	9,582	21,350	15,294	18,315	30,690
Special deposits	4	4	4	4	4
Required reserves	64,001	73,704	114,698	98,021	139,904
Liabilities to merchant banks	1,488	3,846	8,412	11,942	15,801
Currency in vault	213	1,510	0	0	0
Demand deposits 1/	746	967	1,554	2,316	3,544
Special deposits	9	9	9	9	27
Required reserves	0	1,350	6,847	9,493	12,153
Other deposits of DMBs	520	11	1	124	77
Currency and deposit liabilities	190,904	292,713	368,671	442,382	840,499
Currency outside banks	186,457	274,011	338,671	386,942	369,827
Public sector demand deposits 3/	715	3,702	15,844	51,577	235,281
Private sector demand deposits	3,732	15,000	14,156	3,862	235,391
Other items (net)	-10,931	91,012	-12,027	-157,133	-11,936
Capital accounts	238,409	322,564	302,722	70,553	313,822

Source: Central Bank of Nigeria.

1/ Includes both merchant and commercial bank deposits deposited at the CBN branches.

2/ Data for 2002 Q1 and Q2 are preliminary. Several problems emerged when the CBN shifted commercial bank accounts from its Lagos branch to its Abuja branch.

3/ Non-financial public sector demand deposits.

Table 22 Nigeria: Consolidated Accounts of the Commercial Banks, 1999-2003 1/

(In millions of naira; end of period)

	1999	2000	2001	2002	2003
Net foreign assets					
Foreign assets	130,002	179,719	287,843	379,259	416,578
Foreign liabilities	135,223	194,585	305,029	398,210	437,659
	-5,221	-14,867	-17,185	-18,951	-21,081
Reserves	118,522	167,630	318,986	321,495	362,400
Currency	21,892	34,976	64,835	76,211	90,099
Deposits at central bank	96,630	132,654	254,151	245,284	272,301
Reserve requirements	62,001	77,782	125,258	139,702	152,276
Current accounts	34,624	54,872	94,359	105,320	120,025
Stabilization securities	5	0	0	0	0
CBN Certificates	0	0	34,535	0	0
Domestic credit					
Federal government (net)	540,758	732,251	998,260	1,363,350	1,501,640
Claims	148,155	204,302	153,774	414,886	298,441
Deposits	188,576	278,130	182,116	467,522	378,205
State and local governments (gross)	-40,422	-73,828	-28,342	-52,636	-79,764
Claims on private sector	2,095	7,501	26,796	17,327	20,235
Deposit liabilities 2/	390,508	520,448	817,690	931,138	1,182,964
Demand deposit	476,351	702,105	947,183	1,157,112	1,337,296
Quasi-monetary deposits (time, savings and foreign exchange)	202,152	345,001	448,021	503,870	577,664
State and local government deposits	274,199	357,103	499,162	653,241	759,633
Net of state and local government	20,696	45,932	27,326	47,453	43,936
Other items (net)	455,655	656,172	919,857	1,109,658	1,293,361
Bonds and money market instruments	-119,692	-147,407	-267,411	-380,830	-374,318
Capital accounts	11,337	12,995	26,237	25,410	31,796
	181,903	217,094	364,259	500,751	537,208

Source: Central Bank of Nigeria.

1/ Starting in April 2001, due to regulatory changes merchant banks are being treated as commercial banks.

2/ Includes deposits of state and local governments.

Table 23. Nigeria: Liquidity of Commercial Banks, 1999-2003

	1999	2000	2001	2002	2003
	(In millions of naira)				
Total liquid assets	275,063	398,254	477,317	747,621	655,760
Cash in vault (currency)	21,892	34,976	64,835	76,211	72,983
Reserves with central bank 1/	90,705	127,787	239,605	223,126	214,694
<i>Of which:</i>					
Reserve requirements	62,001	77,782	125,258	139,702	156,248
Stabilization securities	5	0	0	0	0
Current accounts	34,624	54,872	94,359	105,320	108,297
Net interbank positions	-24,176	-39,748	368	-11,232	-32,487
Balances held with other banks (net)	36,029	37,086	54,872	51,377	3,114
Interbank placements (net)	2,540	11,786	3,239	4,933	310
Money at call (net)	1,479	-1,086	-5,305	-10,547	-4,664
Uncleared effects	-64,223	-87,534	-52,438	-56,996	-31,247
Treasury bills	186,143	275,774	173,107	460,229	401,096
Treasury certificates	446	0	0	0	750
Other liquid assets 2/	53	-534	-598	-712	-1,277
Certificate deposits (net)	-63	-572	-627	-877	-1,281
Bills discounted	116	38	30	165	4
Free liquid assets	213,057	320,472	352,059	607,919	499,512
Total deposit liabilities	476,351	702,105	947,183	1,157,112	1,394,977
<i>Of which:</i>					
Demand deposits	202,152	345,001	448,021	503,870	613,175
Time, savings, and foreign currency deposits	274,199	357,103	499,162	653,241	781,802
	(In percent)				
Liquidity reserve ratios 3/					
Actual	44.7	45.6	37.2	52.5	35.8
Required	30.0	30.0	40.0	40.0	42.0
Cash reserves (deposits at the CBN)					
In percent of demand deposits	44.9	37.0	53.5	44.3	35.0
In percent of total deposit liabilities	19.0	18.2	25.3	19.3	15.4
Required 4/	10.0	10.0	12.5	12.5	14.5

Source: Central Bank of Nigeria.

1/ As reported by the commercial banks.

2/ Comprising certificates of deposit, and bills discounted.

3/ Total liquid assets less penalty and cash reserve requirements as a percent of total deposit liabilities.

4/ The base to calculate the reserve requirement comprises banks' total deposit liabilities (i.e., demand, savings, and time deposits) except foreign currency deposits; certificate of deposits; promissory notes held by the non-bank public; bankers' acceptances and since January 2002, VAT and customs duties collected by banks on behalf of the federal government held more than for seven days. Starting in 2002, the CRR's maintenance period was changed from 30 to 15 days. Cash must be held in a separate account with the CBN. Vault cash is not an eligible asset.

Table 24. Nigeria: Balance of Payments, 1999-2003

	1999	2000	2001	2002	2003
	(In millions of U.S. dollars)				
Trade balance	2,802	13,208	8,116	4,331	10,531
Exports	12,907	23,761	19,598	17,672	27,416
<i>Of which</i> : oil and gas	12,178	23,093	18,927	16,935	26,607
Imports	-10,105	-10,553	-11,482	-13,342	-16,885
<i>Of which</i> : non-oil & gas	-7,817	-8,276	-9,084	-8,868	-11,039
Services & Incomes Balance	-7,169	-10,082	-8,138	-10,836	-13,746
Factor services balance	-3,440	-6,308	-4,258	-6,401	-8,444
<i>Of which</i> : interest due on public debt	-1,972	-1,719	-1,535	-1,557	-1,619
Nonfactor services balance	-3,729	-3,774	-3,880	-4,436	-5,302
Private transfers (net)	1,288	1,703	1,303	1,421	1,677
Official transfers (net)	-57	-135	-25	-22	-20
CURRENT ACCOUNT BALANCE	-3,137	4,694	1,255	-5,107	-1,559
Official capital (net)	-2,031	-1,552	-1,642	-1,268	-1,291
Disbursements	136	164	70	106	76
Amortization due	-2,168	-1,715	-1,713	-1,373	-1,368
Other capital flows (net)	1,171	1,236	2,051	2,481	3,246
Direct and portfolio investment	1,171	1,236	2,051	2,481	3,246
Private borrowing (net)	0	0	0	0	0
Short-term capital (net)	-184	-294	-648	-431	-39
CAPITAL ACCOUNT BALANCE	-1,045	-610	-239	782	1,916
Errors and omissions	91	-1,847	-1,114	-177	-1,963
Overall balance	-4,091	2,238	-98	-4,503	-1,606
Financing	4,091	-2,238	98	4,503	1,606
Net reserves (increase -)	1,666	-3,959	-1,023	2,742	213
Exceptional financing	2,425	1,721	1,121	1,761	1,393
Net accumulation of arrears (decrease -)	2,425	-20,381	375	1,900	1,177
Rescheduling 1/	0	22,102	746	0	0
Recovered funds 2/	...	...	...	...	216
Debt buyback (net)	...	...	...	-139	...
	(In percent; unless otherwise indicated)				
<i>Memorandum items:</i>					
Gross official reserves (in US\$ millions)	5,441	9,400	10,423	7,681	7,468
(In months of imports (GNFS))	4.4	7.3	7.6	4.9	3.8
Current account (in percent of GDP)	-8.4	10.3	2.6	-11.1	-2.7
Non-oil current account (in percent of non-oil GDP)	-39.9	-42.4	-41.3	-39.6	-42.6
Primary balance/GDP	-13.7	6.5	-0.6	-14.5	-5.5
Trade balance/GDP	7.5	28.9	17.0	9.4	18.3
Non-oil trade balance/Non-oil GDP	-28.5	-33.1	-31.9	-29.5	-32.9
Total external debt/GDP	76.9	66.1	62.3	67.2	56.9
Total external debt/Exports (GNFS) 3/	207.4	182.9	150.2	144.7	144.3
Total external debt/Consolidated revenue	268.1	155.6	147.9	185.9	156.0
Debt service due/GDP	11.1	3.7	5.2	6.4	5.2
Oil export price (U.S. dollars per barrel)	18.0	28.2	24.3	25.0	29.0
Oil exports (million barrels per day)	...	2.15	2.03	1.74	2.33

Sources: Nigerian authorities; and staff estimates and projections.

1/ In 2000-01, reflects the Paris Club rescheduling agreement of December 13, 2000.

2/ For 2003, actual recovered funds received by CBN.

3/ Three-year moving average of exports.

Table 25. Nigeria: Selected Interest Rates, 1999–2003

(In percent; end of period)

	1999	2000	2001	2002	2003			
					Q1	Q2	Q3	Q4
Minimum rediscount rate	20.0	14.0	20.5	16.5	16.5	16.5	15.0	15.0
Treasury bill rate (stop rate)	14.0	13.0	20.3	13.8	15.2	16.4	13.8	14.9
Seven-day Nibor	17.2	15.9	25.3	15.1	15.1	18.3	14.0	20.8
Savings deposit rate 1/	5.2	4.9	5.0	3.7	5.0	3.6	4.8	3.2
Prime lending rate 1/	22.5	19.5	26.0	20.6	21.2	21.2	20.0	19.6

Source: Central Bank of Nigeria.



Table 26. Nigeria: Imports, 1999–2003 1/

	1999	2000	2001	2002	2003
(In millions of U.S. dollars)					
Imports from the wo	7,696	8,971	11,675	12,442	14,452
Industrial countries	4,653	5,167	6,784	7,074	7,997
<i>Of which</i>					
United States	709	789	1,053	1,163	1,132
Japan	271	318	487	286	328
France	631	746	832	1,076	1,157
Germany	740	635	971	811	854
Italy	366	458	546	578	817
Netherlands	383	448	610	640	936
United Kingdom	821	881	1,082	1,185	1,351
Africa	330	438	424	425	471
<i>Of which</i>					
Côte d'Ivoire	41	75	56	58	64
Ghana	69	86	86	89	98
Niger	56	86	68	57	63
South Africa	91	112	142	147	163
Asia (excluding Japan)	2,092	2,517	3,298	3,712	4,645
<i>Of which</i>					
China, P.R.: Mainland	436	630	1,011	1,152	1,966
China, P.R.: Hong Kong	195	184	198	166	164
India	311	398	396	410	456
Indonesia	226	260	311	323	360
Korea	185	273	456	756	840
Singapore	213	257	269	263	258
Thailand	259	247	384	321	246
Other	621	848	1,168	1,231	1,338
<i>Of which</i>					
Russia	28	90	70	71	77
Turkey	41	50	76	69	66
Ukraine	108	84	147	99	110
Brazil	249	271	489	586	652
(In percent of total)					
Industrial Countries	60.5	57.6	58.1	56.9	55.3
Africa	4.3	4.9	3.6	3.4	3.3
Asia	27.2	28.1	28.2	29.8	32.1
Other	8.1	9.5	10.0	9.9	9.3
(In millions of U.S. dollars)					
<i>Memorandum items:</i>					
Total merchandise imports in BoP	10,105	10,553	11,482	13,342	16,885

Source: IMF, *Direction of Trade statistics*, and staff estimates.

1/ c.i.f. basis, based on partner-country data.

Table 27. Nigeria: Exports, 1999–2003 1/

	1999	2000	2001	2002	2003
	(In millions of U.S. dollars)				
World	13,227	21,174	20,072	17,012	24,746
Industrial countries	7,636	15,660	14,278	11,060	17,882
<i>Of which:</i>					
United States	4,220	9,409	8,345	5,654	9,953
Canada	261	311	138	130	296
Japan	189	195	251	681	1,026
Austria	83	189	240	260	245
France	684	1,055	1,073	974	1,246
Germany	189	463	627	488	615
Netherlands	130	217	378	214	702
Portugal	292	727	657	482	677
Spain	876	2,189	1,747	1,258	2,063
Switzerland	211	325	270	249	278
United Kingdom	190	130	90	131	132
Africa	1,466	2,108	1,894	2,001	2,426
<i>Of which:</i>					
Cameroon	141	260	235	250	303
Côte d'Ivoire	359	601	435	462	561
Ghana	439	545	588	625	758
Senegal	103	185	154	155	188
South Africa	202	250	270	287	348
Asia	3,123	1,802	1,766	2,372	2,642
<i>Of which:</i>					
China,P.R.: Mainland	166	267	207	122	65
India	2,264	709	765	814	986
Indonesia	171	401	405	1,029	1,145
Korea	216	79	69	66	80
Other	1,002	1,605	2,133	1,579	1,796
<i>Of which:</i>					
Turkey	4	120	207	165	175
Brazil	738	738	1,372	1,091	1,323
Chile	119	285	111	171	97
	(In percent of total)				
Industrial Countries	58	74	71	65	72
Africa	11	10	9	12	10
Asia	24	9	9	14	11
Other	8	8	11	9	7
	(In millions of U.S. dollars)				
<i>Memorandum items:</i>					
Total merchandise exports in BoP	12,907	23,761	19,598	17,672	27,416
<i>of which</i> : oil exports	12,129	22,250	18,031	15,878	24,683

Source: IMF, *Direction of Trade statistics*, and staff estimates.

1/ f.o.b. basis, based on partner country data.

Table 28. Nigeria: External Public Debt Stock, 1999–2003 1/

	1999	2000	2001	2002	2003
(In millions of U.S. dollars)					
Multilateral	3,665	3,342	3,037	2,961	3,042
World Bank	2,340	2,149	1,958	1,951	1,988
African Development Bank	1,119	990	909	838	873
Other	206	203	170	172	181
Bilateral	21,243	23,296	23,211	25,384	27,373
Paris Club 2/	21,219	23,272	23,199	25,381	27,371
Medium- and long-term debt	...	23,272	22,831	22,966	23,897
Pre-cutoff	...	21,731	21,058	...	...
Post cutoff	...	1,541	1,774	...	...
Arrears	...	0	368	2,415	3,474
Other bilateral	24	24	11	3	2
Commercial	3,809	3,596	3,438	2,649	2,403
Par bonds (London Club debt)	2,043	2,043	2,043	1,442	1,442
Promissory notes	1,667	1,446	1,292	1,153	911
Other (including arrears)	99	107	103	54	50
Total	28,717	30,234	29,686	30,993	32,818
(In percent of total)					
Multilateral	12.8	11.1	10.2	9.6	9.3
World Bank	8.1	7.1	6.6	6.3	6.1
African Development Bank	3.9	3.3	3.1	2.7	2.7
Other	0.7	0.7	0.6	0.6	0.6
Bilateral	74.0	77.1	78.2	81.9	83.4
Paris Club 2/	73.9	77.0	78.1	81.9	83.4
Other bilateral	0.1	0.1	0.0	0.0	0.0
Commercial	13.3	11.9	11.6	8.5	7.3
Par bonds	7.1	6.8	6.9	4.7	4.4
Promissory notes	5.8	4.8	4.4	3.7	2.8

Sources: Nigerian authorities; Paris Club; and Fund staff estimates.

1/ As reported by creditors. These figures are tentative pending the reconciliation of Nigeria's obligations with

2/ Excluding late interest in 1999. In 2000, including late interest as reported by the Paris Club and capitalized moratorium interest as estimated by Fund staff.

Table 29. Nigeria: External Debt Service 1999–2003

	1999	2000	2001	2002	2003
	(In millions of U.S. dollars)				
Total debt service due	4,140	3,434	3,248	2,931	2,987
Interest payments due before rescheduling	1,972	1,719	1,535	1,557	1,619
Multilateral	283	187	132	143	142
Bilateral	1,459	1,345	1,204	1,224	1,335
Commercial	230	187	199	191	142
Amortization payments before rescheduling	2,168	1,715	1,713	1,373	1,368
Multilateral	443	423	364	331	367
Bilateral	1,568	1,166	1,225	914	876
Commercial	158	126	124	129	124
Rescheduling (principal, interest)	...	22,102	746	...	...
current maturities	...	247	149	...	...
arrears	...	21,362	0	...	...
capitalized moratorium interest	...	493	597	...	...
Flow accumulation of arrears	2,425	-20,381	375	1,900	1,177
Cash Debt Service Payments:	1,715	1,714	2,127	1,031	1,809
Multilaterals	751	610	497	474	509
Bilaterals	576	790	1,308	237	1,034
Paris Club	463	725	1,274	162	1,021
Other bilaterals	113	66	35	76	13
Commercial banks	388	313	322	320	267
Brady bonds	129	129	134	128	90
Promisory notes	259	185	188	192	176
Debt conversion program	49	58	27	22	18
Cash interest paid	...	815	1,823	350	548
Cash principal paid	...	898	304	680	1,262

Source: Central Bank of Nigeria; Debt Management Office; Creditors; and Fund staff estimates.

**Nigeria: Tax Summary**  
(As of February 2004)

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
<b>1. Tax on net income and profits</b>			
1.1 Company income tax ( <i>Companies Income Tax Act of 1979, as amended to date</i> ); ( <i>Industrial Development Income Tax Relief Act</i> )	<p><b>Taxable persons</b></p> <p>Annual tax on profits of companies, except those engaged in exploration, drilling, and extraction of petroleum. Gas operations are subject to companies income tax, though upstream gas investment can be deducted against oil income.</p> <p>Total profits are defined as assessable profits from all sources after adjusting for balancing charges, losses, investment, and capital allowances. Losses may be carried forward against future profits for four years.</p> <p>Profits of a non-resident corporation are taxable if attributable to operations carried out in Nigeria. This includes contracts awarded in Nigeria on surveys, deliveries, installation or construction (whether or not executed in Nigeria).</p>	<p><b>Exemptions</b></p> <ul style="list-style-type: none"> <li>• nonprofit organizations, including religious and educational institutions where the profit is not derived from trade or business;</li> <li>• companies with pioneer status, which have a tax holiday of between three to five years;</li> <li>• statutory corporations established by states or local governments;</li> <li>• state purchasing authorities established to acquire any commodity for exports;</li> <li>• enterprises operating in an export processing zone will have a tax holiday of three years;</li> <li>• profits from export activities that are used for the purchase of raw materials, plant, equipment and spare parts;</li> <li>• three-year tax holiday for enterprises whose supplies are exclusively inputs to the manufacturing of products for exports;</li> <li>• three-year tax holiday for enterprises engaged in mining of solid minerals; interest on public loans; and</li> <li>• dividends paid by unit trusts, between related companies and by companies with pioneer status.</li> </ul>	<p><b>General tax rates</b></p> <p>30 percent of taxable income; 20 percent if engaged in manufacturing, mining, exports or agricultural production, and the turnover is N1 million or less for the first 3-5 years of operation.</p> <p>Tax must be deducted at source from construction-related activities at the rate of 5 percent from payments. The tax is credited against the final tax assessment</p> <p>The profit of an export-oriented undertaking within or outside an Export Free Zone benefits from a 3 year tax holiday, provided that exports are not less than 75 percent of the turnover.</p> <p><b>Minimum tax</b></p> <p>There is a minimum tax base, for turnover of N500,000 or less, of</p> <ul style="list-style-type: none"> <li>• 0.5 percent of gross profits, or</li> <li>• 0.5 percent of net assets, or</li> <li>• 0.25 percent of paid-up capital, or</li> <li>• 0.25 percent of turnover, whichever is the highest.</li> </ul> <p>For turnover of more than N500,000, the minimum tax on turnover up to N500,000 plus 0.125 percent of the</p>

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
		<p>Dividends received from investments in export-oriented companies, from small companies in the manufacturing sectors in the first five years of operation, and from unit trusts are exempt. Dividends received by resident companies are recorded as franked income and are excluded from taxable income.</p>	<p>turnover in excess of N500,000 is applied.</p>
		<p><b>Deductible expenses</b></p>	
		<p>Deductions include expenditure incurred in the earning of income. Apart from the usual expenses, those include contributions to pension funds, Industrial Training Fund contributions, donations out of profits to a maximum of 10 percent of total profits, and reserves made out of profits for research and development, up to a maximum of 10 percent of total profits.</p>	
		<p><b>Depreciation allowances</b></p>	
		<p>Instead of a depreciation provision, there is a system of capital allowances for prescribed assets (effectively amounting to depreciation allowances). These allowances are calculated on a straight-line basis by spreading annual allowances over the specified period of write-off. The annual claim for capital allowances by companies (except manufacturing, agro-allied and agricultural trade or business) may not exceed 66 2/3 percent of profits in any year.</p>	

The following rates apply for capital

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
		allowances:	
	(i) buildings		10%
	(ii) plant and machinery in agricultural production		nil
	(iii) other plant and machinery		25%
	(iv) ranching and plantation expenditure		50%
	(v) motor vehicles		25%
	(vi) housing estate		25%
	(vii) furniture and fittings		20%
	<b>Other allowances</b>		
	(a) <i>Initial allowance</i>	An additional initial allowance is granted for certain expenditure items at the following rates:	
	(i) buildings		15%
	(ii) plant and machinery in agricultural production		95%
	(iii) plant and machinery replacing oil manufacturing plant and machinery		95%
	(iv) other plant and machinery		50%
	(v) ranching and plantation expenditure		30%
	(vi) motor vehicle expenditure		50%
	(vii) motor vehicles for public transportation		95%
	(viii) housing estate expenditure		50%
	(ix) furniture and fittings		25%
	(x) research and development		95%
	(xi) plantation equipment		95%
	Export-processing companies in an Export Processing Zone will be entitled		

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
		to 100 percent first-year capital allowance on their qualifying expenditure.	
		Agro-allied companies receive in addition an investment allowance of 10 percent.	
		<i>(b) Investment allowance</i>	
		An investment allowance at the rate of 10 percent will be given in addition to the annual and initial allowances where a company incurs expenditure on plant and machinery.	
		<i>(c) Rural investment allowance</i>	
		Graduated allowances at a rate of 5-100 percent for infrastructure expenditure in remote areas.	
		<i>(d) Investment tax credit</i>	
		There is an investment tax credit for research and development (20 percent), capital expenditure for the acquisition of tools (25 percent), locally manufactured machinery and equipment (15 percent), and for replacement of obsolete plant and machinery (15 percent).	
		<b>Incentives to gas development</b>	
		Any company engaged in gas utilization will benefit from a three-year tax holiday (renewable for an additional 2 years) or an additional investment allowance of 35 percent.	
		In addition, there are accelerated capital allowances following the tax holiday period (an annual allowance of 90 percent for plant and machinery), and an additional investment allowance of 15	



Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
<p><b>1.2</b> Petroleum profit tax and royalties (<i>Petroleum Profit Tax Act</i> of 1959, as amended in 1979 and 1990)</p>	<p>Annual tax on profits of companies engaged in exploration, drilling, and extraction of petroleum and natural gas. Income generated by a petroleum company not related to its petroleum operations is subject to the company income tax. Tax payments are spread over 12 monthly installments. In determining profits, exports of crude oil are valued at a posted price, which is determined by the government, while domestic sales are valued at the actual price.</p> <p>Projects operating under a Memorandum of Understanding (MOU) fiscal regime are subject to the fiscal terms specified in these. Currently, between 96 and 98 percent of total crude is produced under the MOU fiscal terms.</p> <p>Projects operating under a Production Sharing Contract (PSC) regime are subject to the fiscal terms specified in these contracts and the Deep Offshore and Inland Basin Production Sharing Contract Decree, 1999. The share of projects producing under PSCs is expected to increase over the medium term.</p>	<p>percent.</p> <p><b>Deductible expenses</b></p> <p>Deductions include any current expenditure (incl. interest) incurred in the earning of income, and royalties and duties to the federal government or local authorities.</p> <p>Profits in the form of dividends derived from manufacturing companies in petrochemical and liquefied natural gas are tax exempt for the first 3-5 years.</p>	<p>In general, a tax rate of 85 percent applies. However, for new operations which have not yet commenced sales, a reduced rate of 65.75 percent applies until pre-production costs are fully amortized.</p> <p>Under the <b>2000 MOU</b>, producers are guaranteed a profit margin of US\$2.5 or US\$2.7 per barrel (depending on capital costs) when oil prices are between US\$15-19 per barrel.</p>
		<p><b>Depreciation allowances</b></p>	<p>The royalty rate is graduated as follows:</p> <ul style="list-style-type: none"> <li>• onshore operations, 20 percent;</li> <li>• offshore operations between 0-19 percent depending on water depth (the rate is gradually reduced by water depth)</li> </ul>
		<p>Qualifying expenditure in respect of petroleum operations benefit from the following petroleum investment allowances:</p> <ul style="list-style-type: none"> <li>• operations onshore, 5 percent;</li> <li>• operations in offshore areas of water depth up to 100 meters, 10 percent;</li> <li>• operations in offshore areas of water depth between 100 and 200 meters, 15 percent; and</li> <li>• operations on offshore areas of water depth beyond 200 meters, 20 percent.</li> </ul>	<p>Under the <b>PSC fiscal terms</b>, the profit oil after deduction of cost oil is split between the NNPC and the Contractor at a progressive split depending on cumulative production in the contract area. Under the 1993 Deep Water model the profit oil is split between the NNPC and the Contractor at progressive rates reaching a maximum of 60:40 percent whereas more recent PSC terms have split profit oil at the progressive rates reaching 70:30 percent.</p>
		<p>In addition, the following annual capital allowances are granted for five years:</p> <p>1<sup>st</sup> year—20 percent                  2<sup>nd</sup> year—20 percent                  3<sup>rd</sup> year—20 percent                  4<sup>th</sup> year—20 percent                  5<sup>th</sup> year—19 percent</p>	

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
		<p>The capital allowances are restricted so that tax payable is not less than 15 percent of the tax that would have been payable without any allowances.</p>	<p>Royalty oil is a first call on production at variable rates between 0-12 percent depending on location (deep water blocks in excess of 1000 meters water depth face a zero percent royalty rate).</p>
		<p><b>Other allowances</b></p>	
		<p>Qualifying capital expenditure incurred for the purpose of petroleum operations carried out under the terms of a PSC benefit from a 50 percent investment tax credit for all PSCs executed before July 1998, and a 50 percent investment tax allowance for PSCs executed after July 1998).</p>	<p>Petroleum profit tax is applied at a rate of 50 percent for projects operating under PSC terms.</p>
		<p>The following incentives are provided to the <i>gas industry</i>:</p>	
		<ul style="list-style-type: none"><li>• All development gas projects, including those engaged in power generation, liquid plants, fertilizer plants, gas transmission, and distribution pipelines, are to be taxed under the company income tax instead of the petroleum profit tax;</li><li>• Capital investment for associated and non-associated gas may be treated as part of the capital investment for oil development (and therefore be deductible at the 85 percent PPT rate).</li></ul>	

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
<b>1.3. Personal Income Tax (Decree no. 104 of 1993)</b>			
	<b>Taxable persons</b>	<b>Deductible expenses</b>	<b>General tax rates</b>
	For resident individuals, taxable income includes both domestically and foreign sourced income. Individuals pay tax to the state of residence. However, persons employed in the armed forces, the foreign service, residents of the Federal Capital Territory, and residents outside Nigeria who derive income in Nigeria pay taxes to the Federal Board of Inland Revenue (FBIR).	The following deductions and allowances are provided: <ul style="list-style-type: none"> <li>personal allowance of N 5,000, plus 20 percent of earned income;</li> <li>N 2,500 per annum per unmarried child (maximum of 4 children);</li> <li>N 2,000 each for two dependent relatives;</li> <li>for disabled persons, N 3,000 or 20 percent of his/her earned income, whichever is higher; and</li> <li>alimony deductions, not exceeding N 1,000.</li> </ul>	Annual income 0 – 30,000                    5 30,000 – 60,000        10 60,000 – 110,000     15 110,000 – 160,000    20 Over 160,000            25  A minimum tax of 0.5 percent of total income applies.
	Non-residents are liable to tax on income from sources in Nigeria. Only the personal allowance is available to non-residents.		
	For employment-sourced income, tax is deducted at source and is paid under the PAYE system each month.		
	<b>Concept of income</b>		
	Progressive tax on income arrived at after deducting personal allowances and exempted categories of income. Taxes on rents, dividends, royalties, and interest are withheld at source at a rate of 2.5-10 percent depending on the activity. For nonresidents, the withholding constitutes the final tax.		
	<i>Income</i> includes:		
	(i) gains from trade, profession or vocation,		
	(ii) salary, wages and other benefits		
		<ul style="list-style-type: none"> <li>official emoluments of the President and Vice President, and State Governors and Deputy Governors;</li> <li>investment income of any pension fund;</li> <li>death gratuity and compensation for death, or injuries;</li> <li>retirement gratuities;</li> <li>gratuities paid to public officers;</li> <li>compensation for loss of office;</li> <li>proceeds of foreign earnings that are repatriated into Nigeria in convertible currencies, to which concessional tax rates apply;</li> <li>all salaries, dividends, interest, rent, royalties, fees, commissions, etc., earned from abroad and brought into</li> </ul>	

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
	<p>(iii) property gains and profits                      (iv) dividends and interest                      (v) pension or annuity                      (vi) any other personal gain or profit</p>	<p>Nigeria by Nigerian residents, provided the income is received in convertible currency that is paid into a domiciliary account in a bank approved by the government;</p>	
	<p><i>Benefits in kind</i> are included in taxable income, with the exception of reimbursement of expenses, medical costs, and cost of passage to or from Nigeria.</p>	<ul style="list-style-type: none"> <li>• interest paid by the Nigerian Post Office Savings Bank or in respect of Nigerian Savings Certificates and on specific government bonds; and</li> <li>• income earned by non-residents under a technical assistance agreement.</li> </ul>	
	<p><i>Exempted salary income</i> include:</p>		
	<p>(a) housing allowance paid by the employer not exceeding N 150,000 per year;</p>	<ul style="list-style-type: none"> <li>• all life assurance premiums subject to N5,000 limit;</li> </ul>	
	<p>(b) transport allowance not exceeding N 20,000 per year;</p>	<ul style="list-style-type: none"> <li>• interest on loans for owner-occupied house;</li> </ul>	
	<p>(c) meal subsidy not exceeding N 5,000 per year;</p>	<ul style="list-style-type: none"> <li>• contributions to pension, provident, or other retirement benefit funds;</li> </ul>	
	<p>(d) utility allowance of N 10,000 per year;</p>	<ul style="list-style-type: none"> <li>• losses incurred in trade or business, profession, or vocations;</li> </ul>	
	<p>(e) entertainment allowance of N 6,000 per year; and</p>	<ul style="list-style-type: none"> <li>• equity shareholding in company floated exclusively for research and development on 25 percent of chargeable income in year of assessment; and</li> </ul>	
	<p>(f) leave grant not exceeding 10 percent of basic salary.</p>	<ul style="list-style-type: none"> <li>• dividends for three years if</li> </ul>	
		<ul style="list-style-type: none"> <li>• (a) company is incorporated in Nigeria, (b) equity participation was imported into the country between January 1, 1987 and December 31, 1992, and (c) the recipient's equity in company constitutes at least 10 percent of the company's share capital.</li> </ul>	

Dividend income for resident individuals is grossed up by the withholding tax and the grossed-up amount is subject to tax as

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
		<p>other income. The withholding tax is credited against the personal income tax.</p>	
		<p><b>Capital allowances</b></p> <p>Personal income taxpayers can also benefit from capital allowances, albeit at different rates than corporate taxpayers:</p>	

**1.3 Taxation of capital gains**  
*(Capital Gains Tax Act of 1967)*

A tax levied on capital gains by individuals or companies accruing and derived from the sale, lease, or transfer of property rights in chargeable assets in or outside of Nigeria. Capital losses cannot be offset against capital gains. However, where two or more assets are disposed on in a single transaction, they are treated as a single disposal. Chargeable assets consist of loans, buildings, and movable assets (such as motor vehicles).

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates
<p><b>3. Taxes on goods and services</b>  <b>3.1 Value added tax</b>  <i>(VAT) Decree no. 102 of 1993</i></p>	<p><b>Taxable transactions</b></p> <p>VAT is payable on the supply of goods and services provided in Nigeria by a taxable person and on the importation of goods by any person, irrespective of whether they are taxable persons, unless explicitly exempted.</p> <p>The deduction of input tax against output tax charged on sales is limited to the tax on goods purchased or imported directly for resale or as an input for production. However, input tax on (i) any overhead, service and general administration; and (ii) any capital item and asset is not allowed as a deduction from output tax.</p> <p>The legislation does not specify a turnover threshold.</p>	<p><b>Exemptions</b></p> <p>Exempted items (with no credit for VAT paid) include the following goods:</p> <ul style="list-style-type: none"> <li>• exported goods;</li> <li>• medical and pharmaceutical products;</li> <li>• basic food items—beans, yam tubers, cassava, maize, millet, rice, milk, meat, fish, and infant food;</li> <li>• books and educational materials, including exercise books, laboratory equipment, school fees, PTA levies, etc.;</li> <li>• baby products, including feeding bottles, carriages, clothes, napkins, baby cream and powder, soap, toys, and baby dresses;</li> <li>• plant and machinery imported for use in an EPZ;</li> <li>• plant and machinery for gas utilization in downstream petroleum operations;</li> <li>• locally produced fertilizer; and</li> <li>• agricultural equipment and products, fertilizer, and veterinary medicine.</li> </ul> <p>The following services are exempt:</p> <ul style="list-style-type: none"> <li>• medical services;</li> <li>• services by community banks, peoples' banks, and mortgage institutions;</li> </ul>	<p><b>Tax rates</b></p> <p>There is only one statutory rate of 5 percent.</p>

Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates								
		<ul style="list-style-type: none"> <li>• exported services; and</li> <li>• plays and performances conducted by educational institutions as part of learning.</li> </ul>									
		<p>Educational goods and services incidental to education for an educational institution are also exempt.</p>									
		<p>Input tax on the following is not allowed as a deduction from output tax:</p> <ul style="list-style-type: none"> <li>(a) on overhead, service, and general administration of any business which otherwise can be expended through the income tax; and</li> <li>(b) on any item and asset which is to be capitalized along with cost of the capital asset.</li> </ul>									
<b>3.2 Excise duties</b>	<p><b>Tax base</b> Excise duties are levied at ad valorem rates on selected goods manufactured or produced in Nigeria.</p>		<p><b>Tax rate</b></p> <table border="0"> <tr> <td>Excisable goods</td> <td>In percent</td> </tr> <tr> <td>Beer</td> <td>20</td> </tr> <tr> <td>Other alcoholic beverages</td> <td>40</td> </tr> <tr> <td>Cigarettes and other tobacco products</td> <td>40</td> </tr> </table>	Excisable goods	In percent	Beer	20	Other alcoholic beverages	40	Cigarettes and other tobacco products	40
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Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates																								
<p><b>4. Taxes on international transactions</b>  <b>4.1 Customs duties</b>  <i>Customs Tariff</i>  <i>Consolidation Decree, 1995 as amended 1996-2002.</i></p>	<p>Customs duties are levied on goods imported into Nigeria calculated on the c.i.f. value. Nigeria uses the Harmonized Tariff System.</p> <p>Other levies on imports are:</p> <p>Port development levy – 7 percent of duty payable;</p> <p>National automotive council levy – 2 percent tax on vehicles and parts;</p> <p>Sugar levy of 10 percent of sugar imports;</p> <p>Rice development levy of 10 percent of rice imports;</p> <p>ECOWAS community levy of 0.5 percent of c.i.f. value of imports; and</p> <p>Comprehensive Import Supervision Scheme (CISS) charge of 1 percent on f.o.b. value of imports for pre-shipment inspection.</p>	<p>Exemptions include the following:</p> <ul style="list-style-type: none"> <li>• aircraft equipment used by foreign airlines;</li> <li>• films of educational, scientific, or cultural character imported by the United Nations or its agencies or an approved educational or scientific organization;</li> <li>• fuel, lubricants, etc., used exclusively for operation of military equipment or aircraft;</li> <li>• government imports by internationally recognized nonprofit organizations or by the Head of State, consular offices, or under diplomatic privilege, or for other technical assistance purposes; and</li> <li>• life-saving appliances.</li> </ul> <p>There are various incentive schemes in place. The so-called Export Expansion Grant provides tax vouchers for either 5 percent or 40 percent of non-traditional exports (depending on the sector) that can be used to offset other duty or tax payments, and is administered by the Ministry of Commerce. A 40 percent</p>	<p>The tariff structure in effect in 2003 and early 2004 is based on the 1995 Customs and Excise Tariff Book (which was extended for two years beyond its initial expiration date of end-2001). The number of bands (six) and rates (20 rates, ranging from 2.5 percent to 150 percent) is unchanged from 2002. The trade weighted statutory average tariff was 17.4 percent in 2002 (weighted by 2002 imports), and has not been recalculated for 2003 due to lack of data on the weighted distribution of trade and lack of specificity on information on changes in the application of tariffs to certain items in the 2003 budget.</p>																								
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Taxes	Tax Base	Exemptions, Allowances, and Deductions	Tax Rates						
		<p>EEG applies to all textile products (e.g., yarn, cloth, polyester, etc.) and a 5 percent EEG applies to all agricultural cash crops (e.g., cocoa, groundnuts, rubber, ginger, etc.).</p> <p>Importation under the ECOWAS Trade Liberalization Scheme (ETLS) attract zero duty for specific products (e.g., pharmaceuticals) and companies (e.g., tobacco companies).</p> <p>The Duty Draw Back scheme ceased to exist in 2003.</p>	<table border="1"> <tr> <td data-bbox="298 621 321 690">Food</td> <td data-bbox="298 506 321 575">5-100</td> </tr> <tr> <td data-bbox="331 621 354 690">Cigarettes and tobacco</td> <td data-bbox="331 506 354 575">150</td> </tr> <tr> <td data-bbox="363 621 386 690">Alcoholic beverages</td> <td data-bbox="363 506 386 575">100</td> </tr> </table>	Food	5-100	Cigarettes and tobacco	150	Alcoholic beverages	100
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		<p>There are numerous restrictions and/or bans on importation and exports. The import prohibition list in effect in early 2004 includes 28 items or categories banned for commercial or retail purposes (e.g., vehicles older than 8 years, poultry, cassava, toothpicks, fruit juice, textile fabrics, used refrigerators and air conditioners, mosquito repellent and cement) and 19 items or categories banned for import for both commercial or personal use (e.g., air pistols, cowries, second-hand clothing).</p>							
		<p>The current export prohibition list includes maize, timber, raw hides, scrap metals, unprocessed rubber, artifacts and wild animals.</p>							
<b>5. Other taxes</b>									
<b>3.1 Stamp duty</b>									
<i>Stamp Duty Act</i>	Stamp duty is levied on a number of instruments, including agreements, bills of exchange, leases and licenses, mortgages, and insurance policies.	No stamp duty is payable on instruments executed by the government and on all forms of securities.	Rates of stamp duty vary depending on the nature of the instrument and the value thereof.						

Sources: Ministry of Finance, various tax legislation; Nigerian Tax Companion, 2001; and International Bureau of Fiscal Documentation.