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Nigeria: 2002 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the Article IV consultation with **Nigeria,** the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **October 18, 2002,** with the officials of Nigeria on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on November 25, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **December 18, 2002** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its December 18, 2002 discussion** of the staff report that concluded the Article IV consultation.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

NIGERIA

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the
2002 Consultation with Nigeria

Approved by Donal Donovan and Mark Allen

November 25, 2002

- The 2002 Article IV consultation discussions with Nigeria were held in Abuja and Lagos during June 12-25, 2002 and October 9-18, 2002. The Nigerian representatives included the Minister of Finance, the Chief Economic Advisor to the President, the Governor of the Central Bank of Nigeria (CBN), the Minister of Industry, and other senior officials. The mission also met with representatives of the oil sector, and members of the National Assembly, business community, and civil society, as well as with representatives of the international community in Nigeria.

- The staff representatives were Mr. Katz (Head), Mr. McDonald, Ms. Gobat, and Mr. Blavy (all AFR), Mr. Lane (PDR), Mr. Leruth and Mr. Baunsgaard (both FAD, June and October, respectively). The mission was assisted by Mr. Moser, Senior Resident Representative, and Mr. Kuoh, former Resident Representative. The mission collaborated with the World Bank Resident Country Director and with the Country Economist for Nigeria. An FSSA team overlapped with the staff in June. Mr. Usman, Alternate Executive Director for Nigeria, and Mr. Atoloye from the Executive Director's office participated in the discussions.

- Although Nigeria has not yet accepted the obligations of Article VIII, Sections 2, 3, and 4, it no longer maintains any restrictions under Article XIV. However, Nigeria maintains a multiple currency practice. Nigeria has no outstanding use of Fund credit.

- A summary of Nigeria's relations with the Fund and the World Bank Group is contained in Appendices I and II, respectively. Nigeria's statistics continue to suffer from serious deficiencies that hamper surveillance. These issues are discussed in Appendix III, while a table on social and demographic indicators is to be found in Appendix IV. Fund technical assistance since 2000 is described in Appendix V, a tentative work program is contained in Appendix VI, and a draft public information notice is presented in Appendix VII.

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Executive Summary

Overall economic performance in 2001 and early 2002 was marked by macroeconomic imbalances. The fiscal deficit widened, the external current account deteriorated, inflation accelerated, and the parallel exchange rate premium increased. The authorities have taken some actions to address the challenges raised in the last Article IV consultation discussions. While fiscal policy remains expansionary, the executive has been implementing a budget in 2002 that is less destabilizing than that originally approved by the National Assembly. Monetary policy was tightened in late 2001 and early 2002, contributing to a fall in inflation during 2002. The exchange rate has become more market determined with the introduction of a retail Dutch auction for foreign exchange, resulting in a fall in the parallel exchange rate premium.

Nonetheless, macroeconomic imbalances persist. The current expansionary fiscal stance is particularly troublesome in the context of historically high oil prices. An expansionary fiscal policy, lower reserves, rising domestic short-term debt, and a weak banking system raise Nigeria's vulnerability. Although non-oil GDP is expected to grow significantly in 2002, overall growth is projected to be negative, reflecting lower oil production aimed at meeting the reduced OPEC quota.

The immediate challenge is to arrest the growing macroeconomic instability. This implies containing expenditure in the remainder of 2002 and preparing a 2003 budget that is consistent with macroeconomic stability. These actions will have to be accompanied by monetary tightening and a prudent exchange rate policy that safeguards external reserves. For 2003 and in the medium term, a strengthening of the fiscal policy framework is critical. A key aspect of this is the introduction of a fiscal rule based on a benchmark price of oil, so as to stabilize public expenditure in the face of volatile oil prices. Implementing this rule will require the cooperation of subnational governments. To buttress the rule, Nigeria needs to strengthen transparency and accountability in all its fiscal operations. Expenditure policies and the budget process also need to be reformed. The PRSP process and the authorities homegrown program provide opportunities to address these issues.

Monetary and exchange rate policies should be aligned more closely with fiscal developments. The central bank should be prepared to adopt tighter monetary policies when needed and should seek to improve its monetary operations. Ultimately, the effectiveness of monetary policy will also depend on a strengthening of the banking system. Follow-up on the recommendations of the FSSA to improve the soundness and stability of the banking system will be critical. Further steps are also needed to unify the foreign exchange market.

Nigeria is encouraged to meet its external debt-service obligations to the fullest extent possible. In order to bring debt service down to manageable levels, the authorities will need to present a credible medium-term program, that also addresses poverty issues.

Medium-term growth prospects can be further enhanced through a reform of trade policies and an acceleration of the privatization program, with no political interference. Finally, the conduct of economic policy will require the strengthening of institutional and statistical capacity.

I. INTRODUCTION

1. **The most recent Article IV consultation was concluded on June 29, 2001.** At that time, Directors noted that major macroeconomic imbalances had emerged as a result of sharp increases in government spending and expressed concern at the risks of a further acceleration of inflation and continuing instability in the exchange market. They cautioned that the erosion of living standards from higher inflation could outweigh any gains from increased public spending, and stressed the need for the implementation of prudent fiscal and monetary policies to restore macroeconomic stability. On exchange rate policy, Directors expressed concern at recent administrative measures by the central bank aimed at stemming speculative pressures on the exchange rate, underscored the need for exchange rates to reflect market forces, and urged the Central Bank of Nigeria (CBN) to reverse the measures taken and to move quickly to unify the exchange markets. Directors viewed savings of the excess oil proceeds as part of the stabilization process and expressed disappointment that the objective of saving those proceeds had not been realized. They stressed that it was imperative that state and local governments, along with the federal government, contribute to reestablishing macroeconomic stability.

2. **Over the past year, the authorities have taken actions that attempt to address some of these challenges.** While the overall fiscal stance remains highly expansionary, the executive has been implementing a budget that is less destabilizing than that approved by the National Assembly. Also, monetary policies were tightened in the latter part of 2001 and early 2002. Nonetheless, there is need for further tightening, as discussed below. The authorities have introduced a Dutch auction system for foreign exchange, and the parallel market premium has been lowered considerably. Less progress has been made in saving excess oil proceeds in order to contribute to the stabilization effort, an issue at the core of the discussions. While the authorities have not yet addressed the issue head-on, some progress has been made during the year with the drafting of the Fiscal Responsibility Bill. These and other issues are discussed below.

Fund Relations

A 12-month Stand-By Arrangement for the period July 2000-June 2001 was approved on August 4, 2000. The first review was initially postponed as the program went off track. Directors agreed to a three-month extension of the program until end-October 2001. However, key program objectives for end-June 2001 had been missed, and the Stand-by Arrangement lapsed at end-October 2001.

The staff proposed informal monitoring of policies through March 2002. However, as key end-December targets had not been observed and given the risk that appropriate macroeconomic policies might not be implemented in 2002, the staff came to the view that there would be insufficient basis for continuing the informal monitoring of economic policies. The authorities likewise considered it imprudent to commit themselves to policies that could prove difficult to implement, particularly in light of the upcoming presidential elections. The Board was notified of these developments in April (EBS/02/66; 4/11/02).

II. BACKGROUND

3. The present administration took office in May 1999 following almost three decades of military rule, gross mismanagement and a virtual destruction of the civil service and public institutions. This legacy has been exacerbated by the dominance of oil[1] and constitutional structures that make the formulation of policies that foster a stable macroeconomic environment very difficult. Against this backdrop, the government has attempted to balance the need to remotivate the civil service and to begin rebuilding the country's infrastructure and provide public goods and services against the need to establish a stable macroeconomic environment. **While there have been some modest achievements, the high expectations from the return to democratic rule for growth and poverty reduction have not been fulfilled owing to institutional weaknesses and growing macroeconomic imbalances, particularly in the past two years.**

4. **The overall fiscal balance deteriorated sharply in 2001, the external accounts worsened, and inflation accelerated.** As fiscal policies became expansionary, the authorities were faced with several policy options. These included pursuing offsetting monetary policies, allowing the exchange rate to depreciate, or accepting a loss in international reserves. In the event, the authorities continued to implement an inflexible exchange rate policy, leading to a sharp widening in the differential between the official and parallel rates. Real GDP grew by 2.9 percent in 2001, driven largely by the non-oil sector, which expanded by 4.1 percent as a result of an above-average harvest and a rapid increase in public spending (Table 1 and Figure 1).

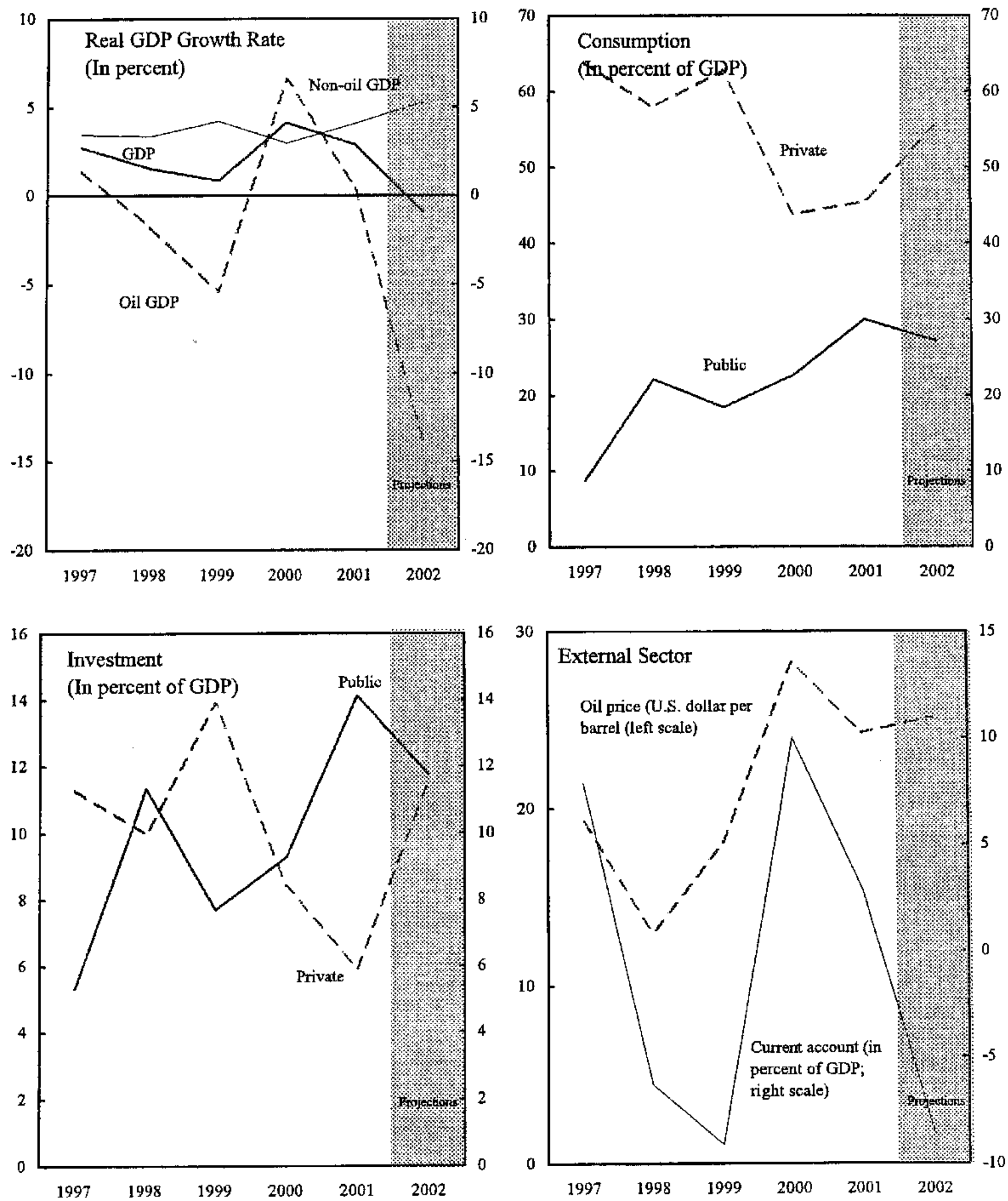
Nigeria: Core Indicators, 1999 - 2002
(Annual percent changes, unless otherwise specified)

	1999	2000	2001	2002
Real GDP (at factor cost)	0.9	4.2	2.9	-0.9
Non oil sector	4.2	3.0	4.1	5.3
Oil sector (incl. gas)	-5.4	6.6	0.5	-14.0
Consumer prices (avg)	6.6	6.9	18.9	13.4
Overall fiscal deficit (in percent of GDP)	-5.1	6.4	-3.3	-5.8
Domestic public debt (in percent of GDP)	23.6	21.0	21.4	25.0
Current account (in percent of GDP)	-9.1	10.0	2.8	-8.6
Gross int. reserves (US$ billions)	5.4	9.4	10.4	7.2

5. In 2002, the staff projects non-oil GDP to grow by 5.3 percent, in large part reflecting strong agricultural output, boosted by good rains. Also, some subsectors within manufacturing and services are experiencing high growth rates, particularly telecommunications and selected consumer goods. Overall GDP growth for 2002 is projected to be -0.9 percent, primarily as a result of the lower oil production occasioned by the smaller Organization of Petroleum Exporting Countries (OPEC) quota. Inflation declined in the first eight months of the year, benefiting from the tightening in monetary policy in late 2001 and falling food prices. End-period inflation is now projected to reach 13.8 percent in 2002.

[1] Oil revenue accounted for 96 percent of export receipts in 2001—hence, the bulk of foreign exchange—and for about 77 percent of government revenue.

Figure 1. Nigeria: Real Sector Developments, 1997–2002



Sources: Nigerian authorities; and Fund staff estimates and projections.

6. **In late March, the National Assembly ratified the federal government budget for 2002; the budget contained significantly larger capital spending than the outturn for 2001 and was markedly higher than what had been proposed by the executive.** The National Assembly increased the wage bill and capital expenditure, which, in turn, increased the deficit to almost 9 percent of GDP. The President signed into law the budget for 2002 in early April, while stating it would be difficult to fully implement the higher spending level. [2]

7. **The overall stance of fiscal policy remains highly expansionary in 2002, notwithstanding efforts by the executive to contain capital spending.** The consolidated cash deficit of the three tiers of government is projected to reach 4.9 percent of GDP in 2002 (5.8 percent on a commitment basis), which is 4.5 percentage points of GDP wider than in 2001 (Tables 3 and 4 and Figure 2). The deficit is projected to be financed by a drawdown of government deposits in the banking system and the issuance of short-term debt. [3] Despite the cut in oil production, oil revenue in 2002 is projected to be higher than budgeted by about 5 percent of GDP, thanks to greater-than-projected oil prices and a more devalued exchange rate. However, oil revenues are still expected to be about 18 percent below 2001 levels in U.S. dollar terms. Expenditure pressures stem primarily from the recurrent budget, which in turn, largely reflect an oversized civil service and related pension costs. Although below the budget passed by the National Assembly, capital spending is projected to reach

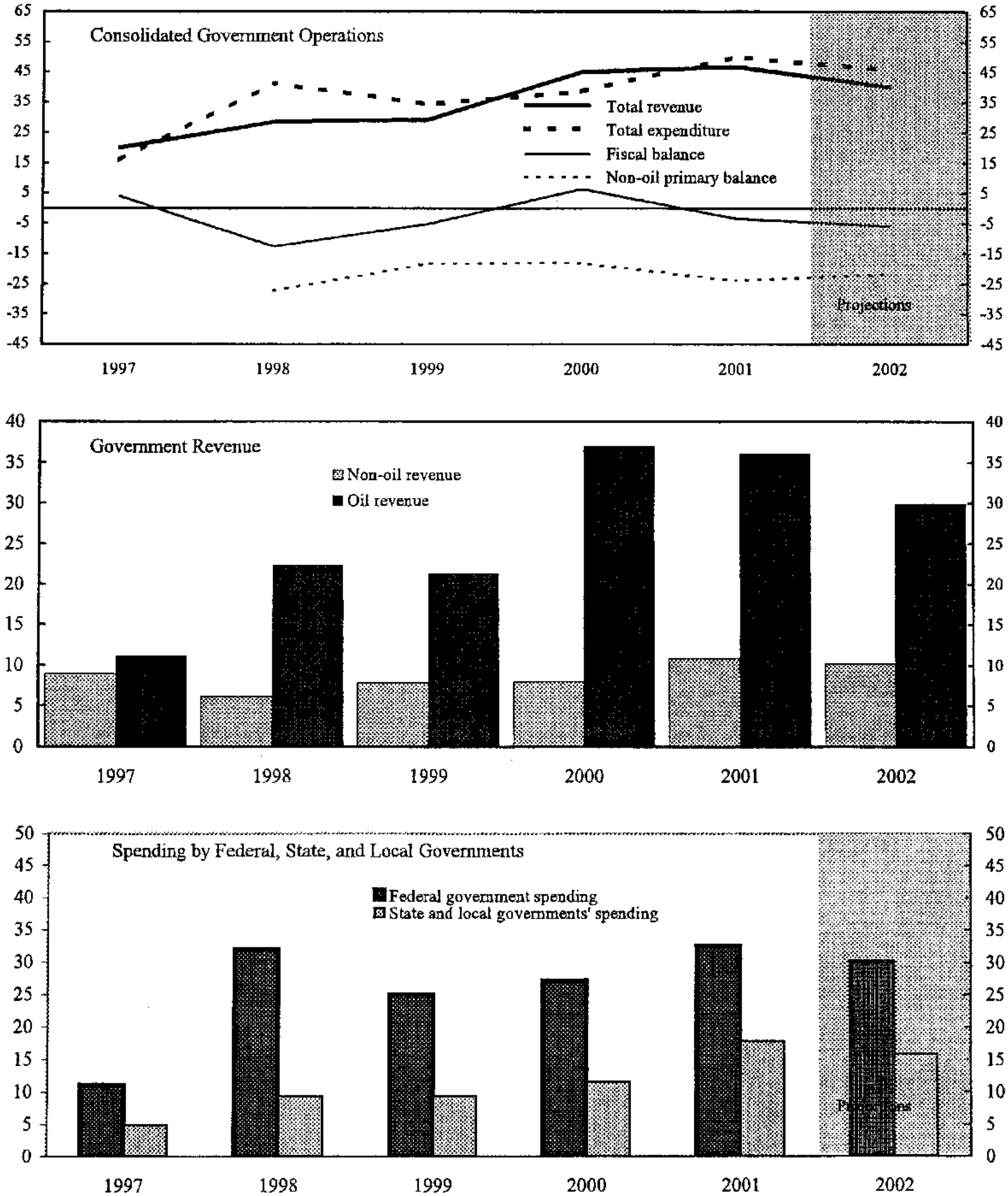
Nigeria: Consolidated Government Operations (Cash Basis), 2001-02
(In percent of GDP, unless otherwise indicated)

	2001	2002		
	Est.	Executive	National Assembly	Staff proj.
Consolidated revenue	46.9	34.6	35.1	40.2
Of which: petroleum revenue	36.1	24.7	25.0	30.0
Consolidated expenditure	47.3	39.6	43.8	45.1
Federal government expenditure	29.6	26.9	30.1	29.3
Recurrent expenditure	22.9	18.8	20.7	22.1
Capital expenditure and net lending	6.7	8.1	9.4	7.2
State and local governments' expenditure	17.8	12.7	13.7	15.8
Consolidated balance, cash	-0.4	-4.9	-8.7	-4.9
Consolidated balance, commitment	-3.3	...	...	-5.8
Memorandum items:				
Non-oil primary balance (in percent of non-oil GDP)	-35.6	-27.2	-31.5	-31.8
Oil price (US$ per barrel)	24.3	18.0	18.0	25.2
Deviation from fiscal rule (commitment basis)	-8.8	...	...	-11.5

[2] Since the mission's departure, the government has submitted a supplementary budget to the National Assembly totaling N 124 billion (2.4 percent of GDP). An earlier supplementary budget of N 236 billion (4.5 percent of GDP) was rejected by the National Assembly in September. Indications are that this bill may suffer the same fate, except for the proposed allocations to the election commission—N21 billion (0.4 percent of GDP).

[3] In the first eight months of the year, the federal government's deposits with the CBN fell by N 373 billion (58.4 percent of end-2001 reserve money), implying substantial injection of liquidity into the banking system. The federal government's overdraft (Ways and Means account) stood at N 50 billion (about 7 percent of reserve money) at end-September, another source of liquidity injection.

Figure 2. Nigeria: Consolidated Government Operations, 1997–2002
(In percent of GDP)



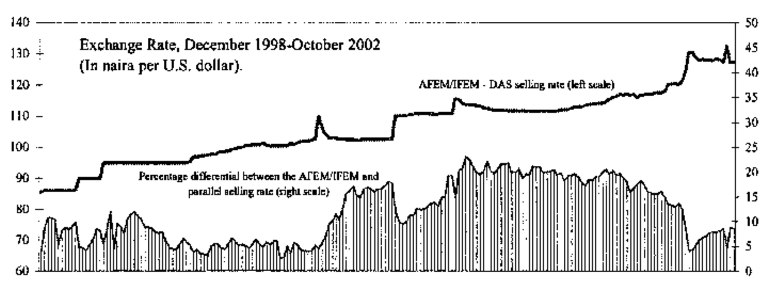
Sources: Nigerian authorities; and staff estimates and projections.

7.2 percent of GDP.[4] The non-oil primary deficit is expected to narrow by 3.8 percentage points of non-oil GDP (cash basis) in 2002.

8. **Monetary policy has accommodated the fiscal policy stance.** Provisional monetary data for September 2002 indicate that broad money rose by 17.5 per cent during the first nine months of the year, compared with a targeted growth of 11.5 per cent. Aggregate bank credit to the federal government rose tenfold during the same period in part reflecting the banking sector' s sharp increase in holdings of Treasury-bills as the CBN sold most of its T-bill holdings (Naira 325 billion at end-2001) to the market in an attempt to mop up excess liquidity. During the first eight months of the year, credit to the private sector was very sluggish, increasing by only 7.3 per cent. The current trend in monetary aggregates suggests that broad money growth in 2002 is likely to exceed the CBN's target rate of 15.3 percent (Table 6). The 91-day treasury bill rate has continued its downward trend since May 2002 and stood at 14.5 percent at end-October. The average interbank call rate has also been falling in response to the decline in the treasury bill rate (Figure 3). As interest rates have declined faster than inflation, real interest rates have fallen significantly.

9. **Lax financial policies have led to a sharp fall in international reserves.** Gross international reserves declined from $10.4 billion at end-2001 to $7.4 billion at end-September 2002, and are projected to fall further to about US$7.2 billion at year's end (Table 5 and Figure 4).[5] In view of the rapid loss in reserves, the CBN undertook a series of small devaluations during June and July. This, however, did not sufficiently dampen market demand, and, as a result, the CBN introduced on July 22 a biweekly Dutch auction system (Box 1). In a somewhat contradictory move, the CBN at the same time also eased monetary policy by lowering the minimum rediscount rate (MRR) by 200 basis points (bp) to 18.5 percent, and the cash reserve ratio by 300 bp to 9.5 percent for banks that increase their credit to the real sector by a minimum of 20 percent over the level at end-June.

10. **The step devaluation of the naira combined with the introduction of the Dutch auction has contributed to slowing the reserve loss while allowing the exchange rate to be more market determined.** The naira stood at 127.6 against the U.S. dollar on October 31, 12.5 percent lower than at end-December 2001.



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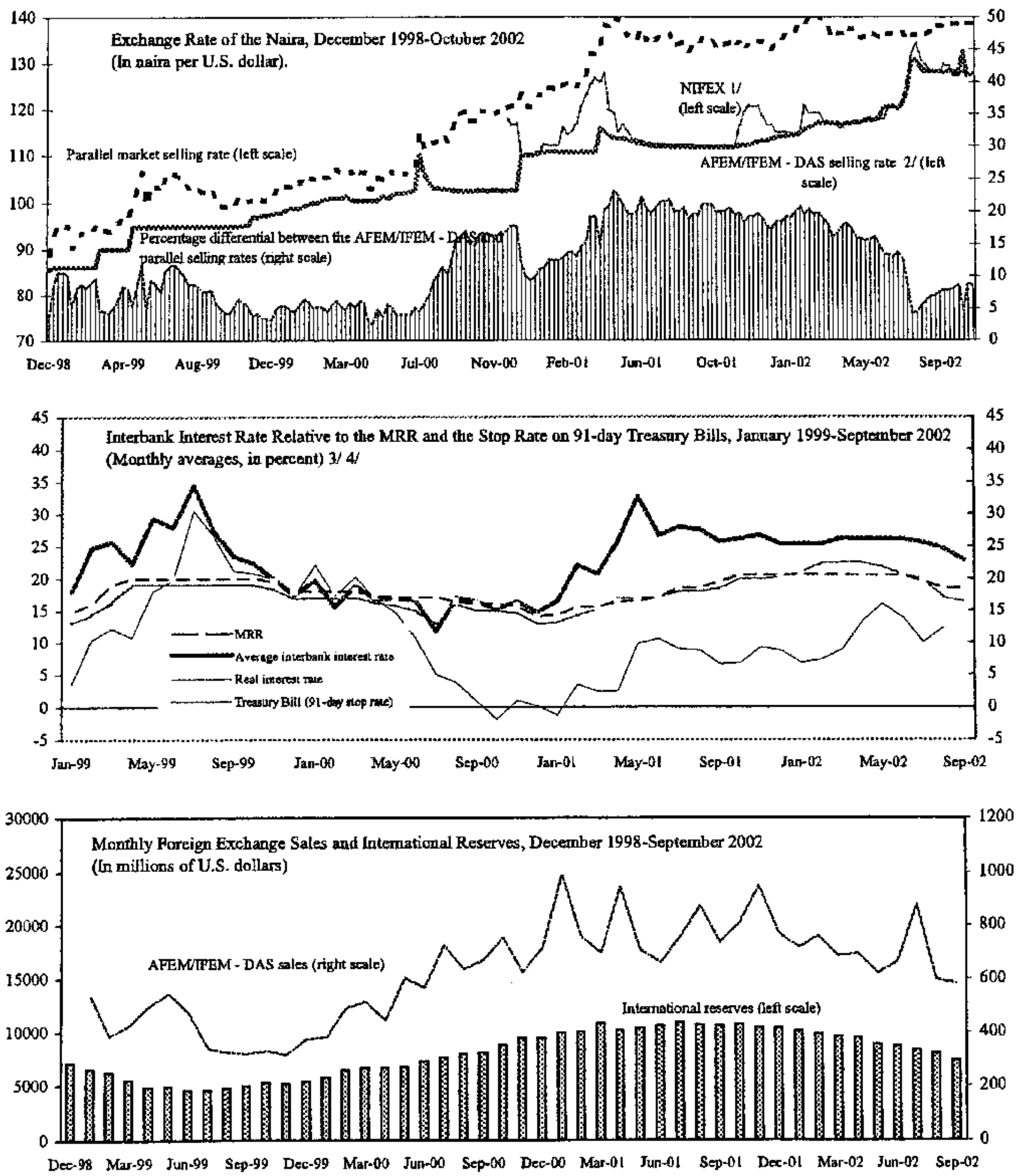
[4] This included 1.5 percent of GDP carry-over from 2001.

[5] The agreement reached to repatriate about US$1 billion in funds alleged to have been looted by the Abacha family appears to have fallen through.

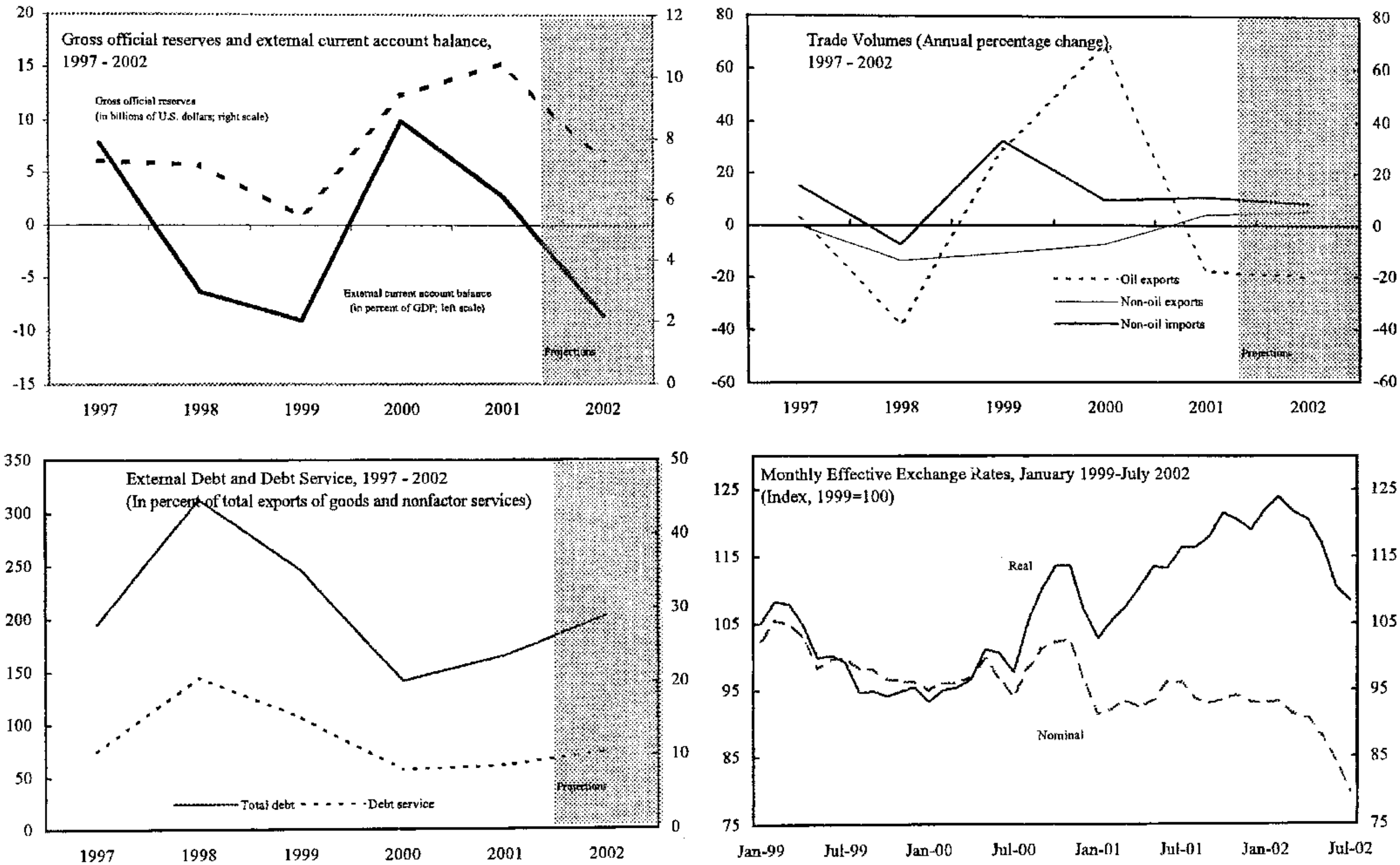
Figure 3. Nigeria: Monetary and Financial Indicators



Source: Nigerian authorities, and staff estimates.

1/ The Nigeria interbank foreign exchange index (NIFEX) reflects exchange rate on the open interbank market.
2/ The autonomous foreign exchange market (AFEM); its successor, the interbank foreign exchange market (IFEM); and beginning July 23, 2002 the dutch auction system (DAS) represent the official interbank market (the exchange rate reported is the average of the highest and the lowest bids).
3/ The interbank interest rate is a weighted average of the 7-day call rate (40 percent weight) and the 30, 60, and 90 day rates (20 percent weight each). MRR is the minimum rediscount rate.
4/ The real interest rate is the average interbank interest rate minus the 12-month inflation rate.

Figure 4. Nigeria: External Sector, 1997–2002



Sources: Nigerian authorities; IMF Information Notice System; and staff estimates and projections.

Box 1. Foreign Exchange Developments and the New Dutch Auction System

Faced with a rapid decline in international reserves, the authorities adopted the Dutch auction system (DAS) for foreign exchange in late July 2002. After a rough start, the system has proven effective in tempering the decline in reserves and achieving market stability. This box summarizes events that led to the adoption of the DAS and issues that still need to be addressed to achieve a unified foreign exchange market.

Faced with consistently high demand for foreign exchange in the first half of the year— resulting from the expansionary fiscal stance and a deterioration in the current account—the CBN was forced to carry out a series of mini-devaluations in June and July and to draw on its reserves to meet demand. In spite of these efforts, demand at the interbank foreign exchange market (IFEM) remained high, with daily average foreign exchange sales averaging US$56 million at mid-June, compared with US$31 in the first five months. The authorities attributed part of the surge to growing public concerns over the rapid loss of gross international reserves, which had fallen from US$10.4 billion at end-2001 to US$8.3 billion at end-May, the lowest level in over 1½ years. The reserve buildup since 1999 was viewed as an economic achievement.

Unsuccessful in arresting the reserve decline, the CBN adopted on July 22 a DAS for foreign exchange. The objectives of the new system are to safeguard international reserves by setting an implicit floor on net international reserve, while allowing the exchange rate to adjust to market pressures. The DAS is a sealed-bid multiple price auction system. Auctions take place twice a week. The CBN announces the amount on offer the day before the auction, successful bids are satisfied at the bid price, and the marginal rate is the bid that clears the market. The results are posted the day after the auction. The CBN left the criteria for eligibility of the bids for foreign exchange and the list of required documents unchanged, and banks are still not allowed to transfer funds obtained in the auction to the wholesale interbank market. Currently, the DAS is limited to supplying foreign exchange to the retail end of the market.

While the naira overshot initially with the introduction of the DAS, the system has proved to be effective in safeguarding reserves and achieving market stability. The CBN undersupplied the market in the first auction on July 22, with daily foreign exchange sales almost half what they had been in the previous months. The CBN offered US$40 million, equivalent to US$17 million in daily foreign exchange sales. This led to frantic buying. In an effort to calm the market, the CBN responded quickly by more than doubling the amount offered in the following seven auctions. By August 7, the amount offered had markedly exceeded the amount demanded (US$100 million versus US$89 million), which helped to calm the market. The weighted-average exchange rate (of the successful bids) peaked at N 132.6 per dollar on July 31 and has fallen since. Also, the average bid is now close to the lowest bid, indicating the system is maturing. Furthermore, the quantity of foreign exchange supplied has dropped. IFEM/DAS sales fell to US$598 million in August and US$581 million in September, compared with US$728 in July and a monthly average of US$671 for January-June.

The devaluation in the exchange rate has helped narrow the differential between the official and parallel rates, with the spread now below 10 percent, compared with 20 percent at the beginning of the year. Along with the crackdown on illegal round-tripping activities by financial institutions, the devaluation has substantially reduced the profit opportunity offered by the foreign exchange rate distortions which had led banks to arbitrage between the two markets.

Additional reforms are warranted to unify the foreign exchange market, as the market still remains segmented and administrative procedures and documentations highly burdensome. The ultimate aim should be to allow the interbank foreign exchange market to play the role of allocating foreign exchange in the system on a continuous-time basis. To this end, tariff levels would have to be lowered and the structure simplified to reduce the incentives for resorting to the parallel market; also, the restrictions on transferability of funds between the DAS and the foreign exchange interbank market would have to be lifted. This would help reduce banks' incentives to misreport and circumvent rules. Finally, the CBN would have to adopt stronger prudential standards and a risk-based supervision framework, so that banks can eventually trade foreign exchange obtained on the DAS for their own trading purposes. Effective prudential rules, such as net foreign exposure rules, would reduce the banking system's vulnerability to foreign exchange risk.

As a result, the spread between the official and the parallel exchange rates has narrowed to below 10 percent from over 20 percent prevailing in much of 2001 (see chart). Taking into account the relative movement of other trading partner currencies, the real effective exchange rate is estimated to have depreciated by about 9 percent through the first seven months of 2002. The external current account balance is projected to deteriorate considerably in 2002, falling to a deficit of 8.6 percent of GDP, reflecting the decline in oil revenue and strong demand pressures caused by the budget, while the overall balance is projected to record a deficit of US$4.9 billion.

11. **Domestic public debt could rise sharply and external arrears are accumulating.** Domestic debt—of which the lion's share is short-term debt (91-day treasury bills)—could reach about 25 percent of GDP at end-2002—depending on how the budget deficit is financed. In view of the difficult budgetary position, the authorities have decided to reduce total budgeted external debt service in 2002 by some US$500 million to US$1 billion, which would cover all debt service falling due to multilateral and commercial creditors (totaling US$900 million), and allow some payments to official creditors.[6] Nigeria has signed bilateral agreements with three Paris Club creditors and is close to finalizing agreements with several other creditors.

12. **In early April 2002, the Supreme Court ruled on the sharing of natural resources (oil and gas) revenue among the three tiers of government hampering the conduct of fiscal policy**. First, the court determined that the rule whereby the oil-producing states receive up-front 13 percent of the revenue generated from oil and gas only applies to oil and gas produced onshore, while revenue from offshore oil and gas accrues to the federation.[7] Second, the court ruled that it is unconstitutional for the federal government to finance certain expenditures (so-called first charges) from oil revenue before distribution to the three tiers of government. First charges include primarily the government's share of investments and operational expenses of its joint-venture holdings in the oil sector, and external debt service.[8] These rulings have required substantial changes in the delicately balanced revenue-sharing formulas between the federal and subnational governments, and

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[6] Arrears accumulation in 2002 is projected to total US$1.93 billion, bringing the end-2002 stock of arrears to US$2.36 billion.

[7] The 13 percent derivation rule is a special allocation to the nine oil-producing states. The revenue is derived in proportion to the share of each state in total onshore oil and gas production.

[8] The federal government had only asked for a ruling by the Supreme Court on the derivation rule for natural resource revenues that is embedded in the 1999 Constitution. As the ruling declared first line charges unconstitutional, the government has decided to commercialize the operations of Nigeria National Petroleum Corporation (NNPC) starting on May 8, 2002. Cash call payments are no longer paid out of the federation account but directly by NNPC. Under the commercialization arrangement, the NNPC retains oil revenues to cover its cash calls before remitting revenues to the federation account.

have thus delayed payments, particularly for debt service, for a number of months.[9] In October, the National Assembly passed a bill that requires the derivation grant calculation to be based on all oil and gas production (offshore and onshore).

13. **Progress on structural reforms has been mixed.** On the positive side, on January 1, 2002, the authorities adjusted the maximum retail price of gasoline above import parity and began charging the NNPC US$18 per barrel for crude oil used for domestic consumption, compared with a charge of US$9.5 in 2001. The upward adjustment in the retail price of petroleum is a step forward in the deregulation of the downstream petroleum sector. However, the regulatory agency that is supposed to evaluate the appropriate retail price level every quarter has left retail prices unchanged since April 2002, even though world market prices have increased substantially. As a result, domestic gasoline prices have fallen below import parity. No action on this front is expected until after the 2003 elections. Regarding public enterprise reform, while the privatization of enterprises in phase one of the privatization program is all but complete, there have been setbacks in the most recent privatization efforts (see Section III for a detailed discussion).

14. **Trade and tariff policies adopted during 2002 have increased overall tariff and nontariff protection of domestic producers of finished goods.** This is particularly the case with respect to food products, manufactures, and selected consumer goods. Nonetheless, tariff levels remain within World Trade Organization (WTO) tariff bindings under the Uruguay Round, which range from 40 percent to 150 percent. Some offsetting tariff reductions have been applied to capital equipment and intermediate goods, and the trade-weighted average tariff has declined marginally. This had the effect of increasing effective protection (Box 2).

15. **The current economic outlook is clouded further by considerable political uncertainty**. Local elections, which were to take place in August, have been delayed following problems with voter registration lists; presidential and parliamentary elections are expected to take place in March–April 2003, with primaries starting in December 2002. The current political situation makes it increasingly difficult for the government to resist spending demand pressures and imposes serious challenges to the conduct of monetary policy. The challenge will be for Nigeria, for the first time in its history, to have a peaceful and successful transition from one civilian, democratically elected administration to the next.

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[9] External debt service payments are now paid by the specific state government or federal government that incurred the indebtedness and not directly from national oil revenues deposited in the federation account.

Box 2. Trade Policy Developments

Tariff and trade measures approved during 2002 have set back efforts to liberalize the tariff regime with an increase in peak tariffs from 100 to 150 percent, and new import restrictions on poultry, textiles and fabrics, automobiles, refrigeration equipment and procurement of uniforms for either balance of payments reasons or health and safety concerns. Although the simple average tariff has increased to 34 percent, reductions of tariffs on selected raw materials and capital equipment have resulted in a slight reduction of the trade weighted average tariff to 17 ½ percent but also in an increase in effective protection. Tariff liberalization has lagged that reported in regional free trade initiatives particularly with respect to treatment of finished goods.

Summary of Trade and Tariff System
MFN Import Duties

	1995	1998	2000	2001	2002
			(In percent)		
Customs duties					
Unweighted average	24.4	26.3	28.6	28.3	34.5
Standard deviation	...	...	12.5	12.5	22.5
Range	0-150.0	0-150.0	0-100.0	0-100.0	2.5-150.0
Weighted average 1/ 2/	20	...	18.5	17.6	17.4
Customs duties and charges after rebate 3/					
Unweighted average	17.3	23.5	30.9	30.6	37.2
Weighted average	...	...	20.3	19.4	19.3

1/ Using 4 digit HS trade weights.
2/ Not including duty concessions.
3/ Includes duty rebate phased out in 1999, import surcharge of 7 percent, ECOWAS levy of ½ percent and product specific duties on automobiles and sugar.

Source: Staff estimates.

The general thrust of policies is to increase tariff protection to goods manufacturers and food processors, in light of high unused domestic capacity and to spur investment through reducing tariffs to the range of 5-15 percent for capital equipment. However, the tariff code is increasingly complex, with over 15 tariff bands, and with over 150 products carrying tariffs of 100 percent or higher there is significant scope for smuggling and corruption in customs administration. The authorities aim to converge with ECOWAS common external tariffs (5-20 percent) by 2007 and are studying the modalities and economic implications of such a strategy.

III. Report on the Discussions

16. **The focus of this year's discussions was on both short-term and medium-term prospects.** The authorities noted that political and social constraints continued to impede the development and implementation of economic reforms. The staff recognized the host of problems that Nigeria was facing, including, in particular, the considerable weakness of public sector institutions and the quality and morale of the public service. Against this background, the discussions centered on necessary conditions for achieving medium-term macroeconomic stability, together with structural reform and capacity building to set the stage for sustainable growth of the non-oil economy.[10]

A. Short-Term Outlook and Immediate Policy Challenges

17. **The authorities project real non-oil GDP to grow by 7.8 percent and overall GDP by 1.0 percent in 2002—significantly higher than the staff's projections of 5.3 percent, and -0.9 percent, respectively.** They supported their projections by citing strong growth in agriculture and in the service sectors. In response, the staff argued that available data on non-oil economic activity did not support such a high growth rate; over the past decade, the non-oil economy had not experienced annual growth rates exceeding 4 percent. For 2003, the authorities project real GDP growth at 4 percent, below the staff's projection of 4.5 percent. While the authorities and the staff were in agreement on the 2002 inflation outlook, the staff cautioned that inflation could pick up in the coming months if current fiscal and monetary policies continued.[11]

18. **In the oil sector, while production (excluding gas) has been cut by 16.4 percent to 1.89 million barrels a day (mbd) in 2002 in response to OPEC's reduced quota, Nigeria's production capacity has grown to 2.6 mbd.** Furthermore, the large investments in the sector are expected to increase production capacity to 3-4 mbd by the end of the decade, thereby raising capacity at a much faster rate than world demand. Consequently, there is currently substantial uncertainty in the Nigerian oil industry with regard to how the government intends to address the issue of increasing domestic capacity while adhering to the OPEC quota.

19. **The staff expressed concern about the current expansionary fiscal stance, especially given the historically high oil prices.** This policy, together with a smaller external reserve cushion, rising domestic debt, and a weak banking system, increases Nigeria's external vulnerability considerably.

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[10] These issues are covered in the accompanying selected economic issues paper.

[11] The CBN aims to lower the inflation rate to single digits by end-2003 and targets an average growth rate in M2 of about 15 percent in 2002–03.

20. **The staff noted that the immediate challenge for the government in the period ahead was to reinforce macroeconomic and financial stability until after the elections, when more far-reaching reforms could be put in place.** This implies implementing a federal budget for the remainder of 2002 and preparing a budget for 2003 that is consistent with restoring macroeconomic stability, accompanied by a prudent monetary and exchange rate policy. The staff urged the government to contain expenditure to the extent possible, and the CBN to tighten monetary policy and to stand ready to take action to maintain financial stability in the difficult period ahead. The authorities responded that they intended to restrain capital expenditure further in the remainder of 2002 and to reduce the budget deficit in 2003. The CBN indicated its broad agreement with the staff's assessment and said that it was prepared to issue its own certificates to mop up excess liquidity, and to allow interest rates and the exchange rate to adjust as necessary.

21. **The preparation of the 2003 budget is under way.** The authorities are aiming at a deficit of 2.5 percent of GDP at an oil price of US$20 per barrel. The staff estimates that, at current policies the budget deficit would amount to about 4 percent of GDP at an oil price of US$25 per barrel (the October World Economic Outlook (WEO) assumption for 2003), or about 7 percent of GDP at a price of US$20. It is not certain that a 2003 budget will be approved before the National Assembly is dissolved in early 2003, which would imply keeping monthly spending at the 2002 budget levels.

22. **The staff indicated that the 2003 budget should reflect the need to take the following actions:**

- Strengthen expenditure control, especially with respect to the wage bill. This would require holding line ministries responsible for their payrolls and strengthening procedures through which payments for salaries are released to agencies falling under ministries, so as to ensure that nonwage benefits are not included in the payroll.

- Verify the stock of wage and pension arrears and improve the reporting of the clearance of such arrears, as distinct from current wage payments.

- Examine the capital budget to determine whether the current projects are consistent with the objective of creating an enabling environment for private sector activity and growth, and whether they meet poverty reduction objectives. Low-priority projects that do not meet these objectives should be taken out of the budget.

- Ensure that no arrears are accumulated when monitoring the execution of the capital budget through the "due process" system.

23. **The staff also offered an alternative budget framework, according to which the 2003 deficit would be limited to some 2½ percent of GDP at the WEO oil price of US$25 per barrel or 5.9 percent of GDP at an oil price of US$20 per barrel.** This envisages the gradual implementation of reforms, including the sale of crude to domestic refineries at market prices and the initiation of measures to strengthen expenditure

management, particularly of the payroll. Such a fiscal stance would slow the decline in international reserves considerably in 2003 while laying the basis for reserve accumulation in the medium term.

B. Medium-Term Policy Issues

24. **While most oil-producing countries face problems in managing fiscal policy because of the high volatility of oil prices, some have fared better than others in delivering higher real per capita growth (Box 3 and Figure 5).** If soundly managed, oil revenue can translate into sustained, higher, noninflationary growth of the non-oil economy while also cushioning the domestic economy from sharp and unpredictable movements in oil prices and revenue.

25. **In Nigeria, government expenditure remains highly correlated with oil price developments, including the volatile boom-bust cycles.** At the same time, the sharp increases in public spending (from 18 percent of GDP in 1970 to 50 percent of GDP in 2001) have not been matched by a commensurate improvement in the country's standard of living, generating in the process a legacy of wasteful and low-quality capital spending. Physical infrastructure needs, in sectors such as electricity generation, telecommunications, and transportation, have been inadequately attended to, while essential social services have been neglected. These and other policies—such as a highly protective trade regime, controls on the exchange rate, and corruption—have altered incentive structures, led to distortions in private sector decision making, and undercut the growth prospects of the non-oil sectors of the economy. The consequence of these policies has been economic stagnation, which has further exacerbated political and social conflicts.

26. **Faced with this legacy, the democratically elected government has made a modest beginning, but more far-reaching reforms are needed to tackle Nigeria's deep-seated problems.** Against this backdrop, the staff discussed with the authorities and members representing Nigeria's civil society the following:

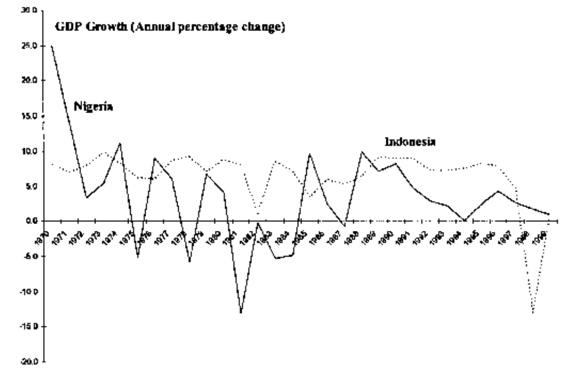
- different medium-term scenarios that compare the impact of a continuation of current policies ("muddle-through" scenario) against a sound policy scenario ("good-policy" scenario) on key macroeconomic variables to illustrate the implications of policy choices for the next few years;

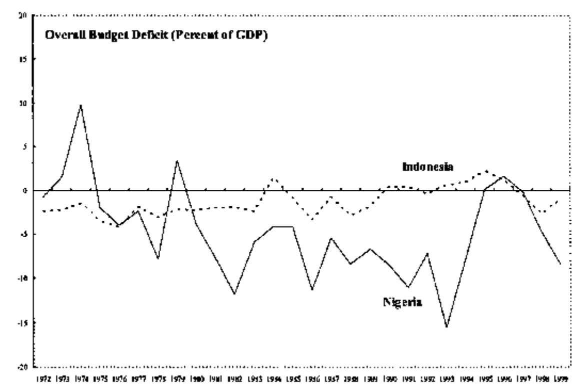
- policies and institutional mechanisms to help foster a more stable and predictable financial environment, drawing on the experience of other oil-producing countries; and

- corruption, potential reforms to promote good governance, and ways to enhance transparency and accountability starting with the oil sector.

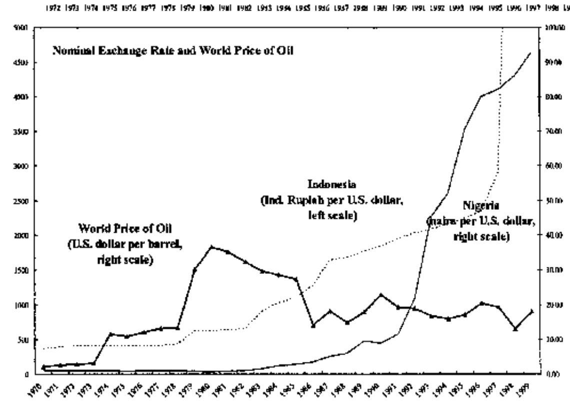
Box 3. A Comparison of Nigeria and Indonesia

Although Nigeria and Indonesia are both heavily populated oil-exporting countries, the economic development of the two countries diverged, with Indonesia becoming substantially wealthier. While real per capita GDP stagnated at about U$250 in Nigeria between 1960 and 1999, GDP per capita in Indonesia increased fourfold during the same period (from US$249 to US$ 962). Other indicators of human development, as reported in the table below, tell a similar story. Relatively prudent fiscal, monetary, and exchange rate policies, combined with market-oriented policies toward agriculture and light manufacturing, explain in part why Indonesia fared better than Nigeria in spite of the severe financial and economic crisis experienced by Indonesia in 1998 and the clear evidence of corruption and mismanagement. Very high macroeconomic volatility has also constrained Nigerian economic growth for the last three decades.

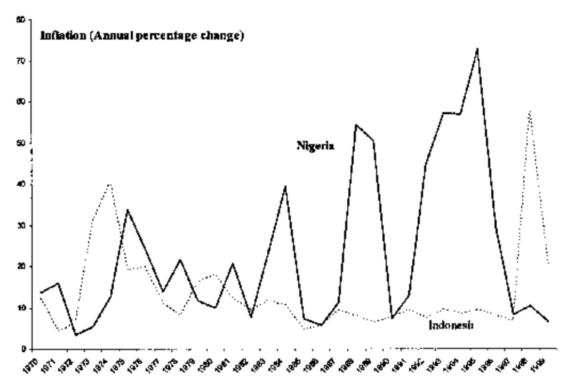




Following the oil booms, Indonesia pursued a loose rule of fiscal balance, while Nigeria experienced large increases in public spending and fiscal deficits. In Indonesia, the overall fiscal deficit fluctuated around 2 percent of GDP until 1990 and was roughly in balance during the 1990s. Nigeria's budget deficit increased dramatically from the early 1970s as expenditures rose faster than revenues. The federal government deficit has remained above 4 percent of GDP for most years since 1975, and sometimes substantially higher.



As a response to terms of trade shocks in the 1970s and 1980s, Indonesia focused on maintaining a competitive exchange rate through successive devaluations of its fixed exchange rate, which contrasted with Nigeria's consistently overvalued exchange rate. The fiscal stance eased the conduct of Indonesia's monetary policy, as



Box 3. A Comparison of Nigeria and Indonesia (concluded)

inflation remained within the single-digit range for most of the 1980s and the 1990s, even though two peaks (40.6 percent in 1974 and 18 percent) followed the oil booms. During the 1970s and 1980s, Indonesia maintained a convertible fixed exchange rate, adjusted with successive devaluations (1978, 1983, 1986, and more frequently throughout the 1990s) and reinforced by a progressive accumulation of foreign reserves. In Nigeria, the exchange rate was not adjusted in response to the terms of trade shocks and high domestic inflation, leading to a sharp revaluation of the real exchange rate. Only after depleting its foreign reserves was the country forced into devaluation (1986).

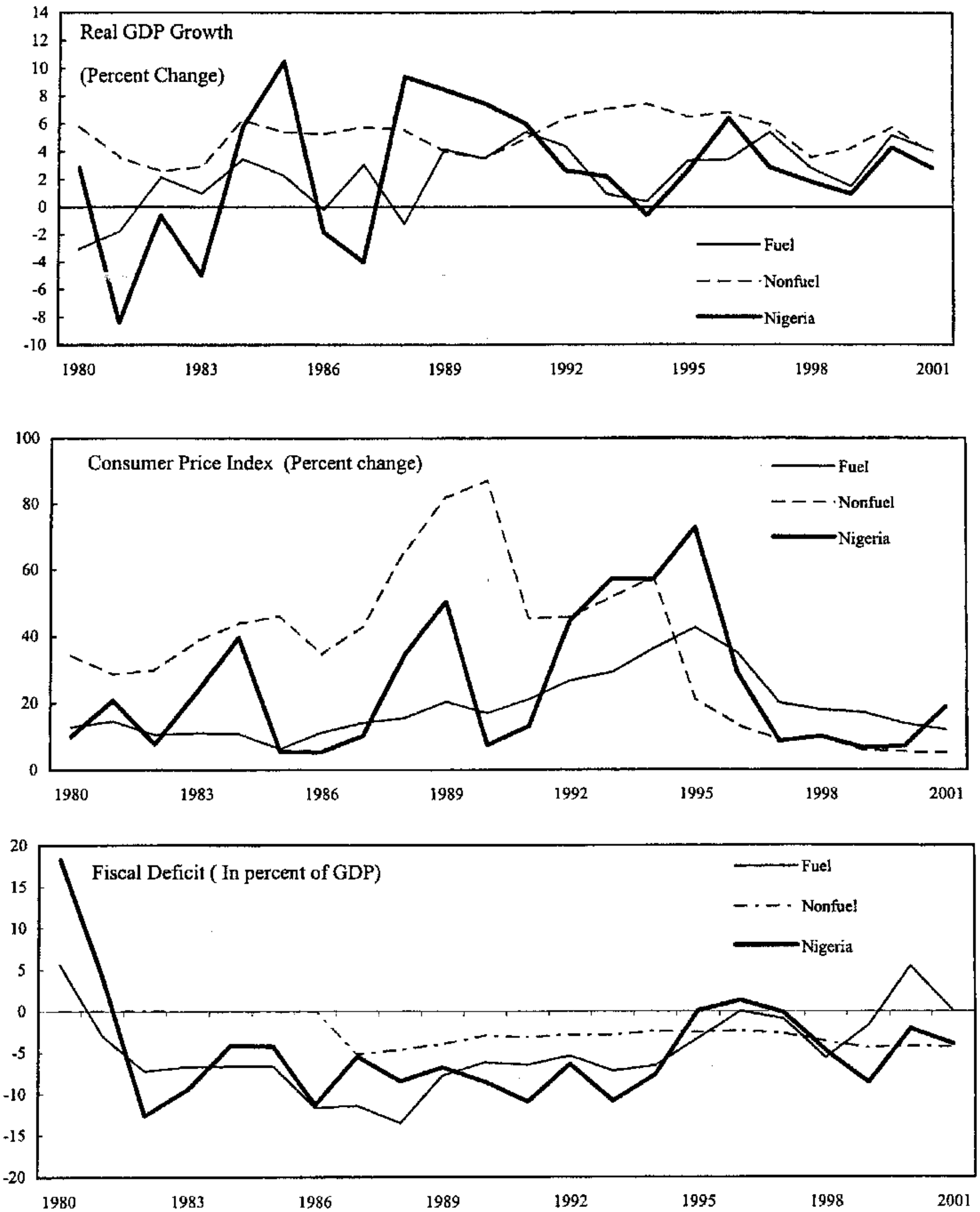
Indonesia pursued sectoral policies aimed at encouraging competitiveness of the non-oil sector, with special emphasis on agriculture and export-oriented industries. The Nigerian experience is substantially different, as large public investment projects and restrictive trade policies to have protected the domestic manufacturing sector. Consequently, the share of non-oil exports in total exports increased from 16 percent in 1970 to 87 percent in 1999 in Indonesia, while non-oil exports from Nigeria declined to 2 percent of total exports from 52.3 percent over the same period. Food imports account today for a larger proportion of total merchandise imports than in 1970 (27.0 percent, up from 8.3 percent in 1970).

Nigeria and Indonesia: Selected Indicators, 1960 – 99

	Nigeria					Indonesia				
	1960	1970	1980	1990	1999	1960	1970	1980	1990	1999
Economic development										
GDP per capita (constant 1995 U.S. dollars)	224	264	314	258	250	249	298	504	778	962
GDP per capita, PPP 1/	...	405	607	767	858	...	468	871	1,960	2,857
Social indicators										
Infant mortality (per thousands)	188.6	139.4	99.4	86.4	84.4	137.8	118.0	90.0	60.0	41.9
Life expectancy at birth (years)	39.7	42.9	45.8	49.1	47.5	41.5	47.9	54.8	61.7	65.7
Illiteracy rate (percent of adults)	...	79.9	67.1	51.4	37.6	...	43.7	30.7	20.3	13.7
Oil and non-oil sectors										
Oil revenue (percent total) 2/	...	26.3	81.1	72.6	76.3	...	20.3	68.2	42.0	29.4
Non-oil exports (percent total)	97.2	52.3	16.3	3.7	2.1	68.3	16.4	74.6	80.0	86.9
Food imports (percent merchandise imports) 3/	9.3	8.3	15.1	6.4	27.0	17.9	15.4	12.7	5.1	8.8

Sources (table and figures): World Bank *World Development Indicators*, 2002; and IMF, 2002 WEO database and *International Financial Statistics*.
1/ The series is available from 1975; 1975 data are reported for 1970.
2/ *CBN Statistical Bulletin* (Nigeria).
3/ When no data are available for the specific year of reference, the closest year with available data is used.

Figure 5. Nigeria Versus Fuel and Nonfuel Exporters: 1980–2001 1/



Source: IMF, World Economic Outlook, Summer 2002 database.

1/ Fuel exporters comprise Algeria, Angola, Bahrain, Congo, Equatorial Guinea, Gabon, Iran, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, Trinidad and Tobago, United Arab Emirates, and Venezuela. Nonfuel exports are developing countries excluding fuel exporters.

C. Medium-Term Macroeconomic Scenarios

27. **The muddle-through scenario represents largely unchanged policies,** under which the economy grows below potential, particularly in the non-oil-producing sectors of the economy, as structural reforms and growth-oriented policies (e.g., fiscal policy rule, privatization, addressing the severe infrastructure bottlenecks, trade liberalization, foreign exchange market and banking reforms)[12] are delayed. As a result, inflation stays above 12 percent, while international reserve losses generate additional pressures for trade and exchange restrictions, and, eventually, a sharp correction in the exchange rate. Even though consolidated government spending moderates somewhat to the already high level (as a percent of GDP) seen in 2001, the overall deficit remains unsustainably high, at 7-9 percent of GDP over the medium term. Public debt increases considerably by 2007, with the CBN financing a large part as interest rates in the primary market remain below market-clearing rates. Under this scenario, the confluence of falling oil prices, high spending, a sizable loss of foreign exchange reserves, and emerging signs of distress in the banking system would prove unsustainable.

Nigeria: Medium-Term Scenarios, 2002 - 07
(Annual percent changes, unless otherwise indicated)

	2002	Average 2003-06	2007
Muddle-through scenario			
Real GDP growth	-0.9	2.8	2.6
Non-oil GDP growth	5.3	2.8	2.8
Inflation (annual average)	13.4	15.6	12.6
Fiscal balance (in percent of GDP)	-5.8	-7.3	-8.7
External current account (in percent of GDP)	-8.6	-5.6	-4.2
Reserves (months of imports)	4.6	3.6	3.6
Good policy scenario			
Real GDP growth	-0.9	4.6	5.5
Non-oil GDP growth	5.3	5.3	6.8
Inflation (annual average)	13.4	10.0	6.7
Fiscal balance (in percent of GDP)	-5.8	0.0	1.2
External current account (in percent of GDP)	-8.6	-5.1	-3.4
Reserves (months of imports)	4.6	4.9	5.7
Memorandum items:			
US$ oil price per barrel	25.2	22.6	21.0
Oil and gas output growth rate	-14.0	2.7	2.0

28. **Under the good-policy scenario, the private sector responds positively to the above-mentioned market-oriented reforms and a more predictable policy environment.** Agricultural output rebounds sharply, with crop production (including export crops) achieving a growth rate of about 6 percent (and thereby reducing food imports) well above the current annual growth rate of 3-4 percent. As a result, net farm incomes and rural employment rise over the medium term. Manufacturing sector output, especially in industries that can easily substitute domestic inputs for imported inputs, such as textiles, food, sugar-based industries, and leather products, is also projected to rebound significantly, reversing a decade of declining capacity utilization. Overall private sector investment is projected to rise

[12] A recent World Bank Private Sector Assessment study highlighted the severe infrastructure constraints to private sector growth. Private enterprises surveyed raised this as the most critical constraint to their activities.

to about 17 percent of GDP, largely financed through higher domestic savings, reflecting an improvement in the fiscal position and higher income in the private sector.[13]

29. **The economy would gradually attain its potential growth rate, with non-oil GDP growth rising to almost 7 percent, as a result of rising investment and total factor productivity gains, and inflation declining to some 7 percent.** To return to a balanced budget, with oil prices at US$20 per barrel (discussed below) public expenditure would have to be cut, on average, by about 1½ percentage points of GDP per year. The contractionary effect on the economy would be more than offset by higher private sector spending, including foreign direct investment, in the non-oil producing sectors. Real interest rates would fall, owing to lower inflationary expectations, which, in turn, reflect the implementation of more prudent macroeconomic policies. This higher sustainable growth path, which is a necessary condition for employment creation and poverty alleviation, would have to be supplemented, however, by targeted social policies and by microeconomic and structural policies, particularly to promote agriculture and rural development.

30. **The authorities have made public their homegrown economic framework, developed following consultation with the Fund staff.** The framework—while still general in nature—is broadly consistent with the "good-policy" scenario. It highlights the importance of the poverty reduction strategy paper (PRSP) as central to achieving the authorities' stated objectives. The latter include, among other things, substantially higher GDP growth in the medium term, driven by the non-oil sector, single-digit inflation, a price-based fiscal policy rule based on a reference oil price, and civil service reform.

D. Fiscal Policy Framework

31. **The main macroeconomic challenge facing the government in the medium term is to strengthen the fiscal policy framework.** While some reforms are of a medium-term nature and may take time to complete, actions in the following key areas will need to be initiated in 2003. First, a fiscal rule, cast in a medium-term context, should be established. Second, a way should be sought to apply this rule to state and local governments. Third, the civil service needs to be reformed. Fourth, the public expenditure management system will have to be strengthened considerably, starting with the Federal Budget Office. Transparency and accountability should guide all fiscal actions.

32. **The authorities were in broad agreement as regards these medium-term policy issues, many of which are reflected in their homegrown policy framework.** The Fiscal Responsibility Bill, which aims at establishing a framework for a fiscal policy rule and harmonizing fiscal relations among the three levels of government, has recently been sent to the National Assembly. The staff welcomed these two initiatives, but noted that operational

[13] This increase reflects in part a broader coverage of private sector investment with a compensating change in the share of the government sector.

modalities will have to be developed and a campaign launched to ensure broad ownership within and outside government.

Fiscal policy rule

33. **To stabilize expenditure and hence provide a more conducive environment for both public and private sector activity, the staff proposed that a price-based fiscal policy rule cast in a medium-term budgetary framework be adopted, under which the budget would be balanced at a price of oil (of US$20 per barrel).**[14] Windfall revenues would be saved, and, conversely, the budget would run a deficit when the actual price fell below the benchmark price.[15] Nigeria's past experience with oil stabilization funds had not been positive, and the staff observed that, to make the rule effective, improving overall governance and accountability would be critical. Applying such a rule with some flexibility and paying close attention to improving governance, especially with regard to the management of oil revenue savings, would greatly enhance Nigeria's prospects for achieving and maintaining a stable macroeconomic environment.[16] However, given the current large fiscal imbalances, the full application of the rule would have to be gradual.

Fiscal federalism

34. **The Nigerian representatives noted that a substantial part of public expenditure in Nigeria (about 15 percent of GDP) takes place at the subnational levels.**[17] States and local governments have a constitutional responsibility to deliver essential social services (such as primary education, primary health, and rural infrastructure) that have a very strong and clear link with poverty reduction and longer-term growth. However, there is considerable concern that budget and procurement practices at the decentralized level are inadequate. Preliminary conclusions from the World Bank's public expenditure review of 14 states

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[14] Studies have shown that oil prices do not exhibit mean reversion. However, for the purpose of this exercise the price of US$20 has been selected because this has been the average oil price since the early 1980s. Also, during the past 11 years, two-thirds of the variability of the price has been within a price range of $15–$25 per barrel. Moreover, the non-oil primary deficit at this oil price would be compatible with the long-run target for a sustainable fiscal policy.

[15] A price-based rule has the strong merit of simplicity. Nevertheless, the authorities need to be mindful of the effects changes in oil production, the exchange rate and tax policy may have on budgetary revenue.

[16] See accompanying selected economic issues paper for a detailed discussion.

[17] Under the revenue-sharing arrangement, state and local governments automatically receive about half of the oil revenue.

suggest that budget preparation, implementation, monitoring, and auditing are in most cases very weak.

35. **A key issue, therefore, is how to apply the above fiscal rule at the subnational level.** The staff suggested that, based on the experience of other countries with federal systems, consideration could be given to initiating—following a public discussion—legislation of a fiscal rule at the national and/or the subnational level. Alternatively, a scheme by which the federal government provides inducements to state and local governments to buy into a fiscal policy rule could be considered. This could take the form of offering higher levels of capital spending to states that make a commitment to implement the fiscal rule. Another possibility would be for the federal government to implement a system of stable transfers to state and local governments linked to the provision of essential services and the establishment of floors for the transfers. The Nigerian representatives noted that, given the country's history and the evolution of relations between the federal and subnational governments, reaching consensus on the application of a fiscal rule at the subnational level was likely to be difficult and time-consuming. The staff, therefore, suggested that the fiscal rule should be applied first to the federal government.

The civil service

36. **The Nigerian representatives and the staff agreed that a comprehensive civil service reform program will have to be urgently developed with the support of the World Bank and other bilateral donors.**[18] Public employment in Nigeria grew rapidly between 1988 and 1998, a period during which ministries and agencies became virtually autonomous. Over the last four years, the reconstituted Office of the Head of Civil Service has made attempts to control employment; however, these have not been successful because of the absence of key wage and employment data, and of sufficient controls in ministries. A comprehensive review of the size and functions of departments within the civil service was initiated in September 2002, and the aim is to complete the review by December 2003. The staff noted that an audit and pay verification exercise conducted in 2001 was now out of date because of the lack of control on recruitment in the public sector and the sizable slippage in the wage bill.

Expenditure management

37. **The discussions on the 2003 budget have revealed that the budget process, in general, and the Federal Budget Office, in particular, remain very weak.** The Budget office has a very limited technical capacity to prepare realistic expenditure and revenue estimates; in addition, it does not have the capacity to monitor budget execution or to enforce

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[18] The core civil service of the federal government of Nigeria (ministries and departments falling directly under ministries) is estimated at about 250,000 employees. There could be at least another 800,000 employees in parastatals and in the military and police.

budget discipline. The Nigerian representatives are examining ways to strengthen the Federal Budget Office as a matter of high priority. The staff stressed the need to improve basic budget classification, including along economic, functional, and programmatic lines. This will become particularly important as Nigeria develops and begins to implement a poverty reduction strategy. Regarding budget execution, emphasis should be placed on reconciling warrants, mandates and transfers by the Office of the Accountant General in coordination with the CBN; these are reforms that are already under way, supported by Fund technical assistance. Once the budget has been approved, the Federal Budget Office should coordinate its actions with the Office of the Accountant General to enforce discipline on line ministries, in order to ensure that they remain within budgeted ceilings. It is also important that the budget office coordinate the preparation of the capital budget with the "due process" unit in the Office of the Presidency.

E. Good Governance

38. **The Nigerian representatives noted the progress made via the work of the Anti-Corruption Commission and the efforts under way to improve the quality of capital expenditure through the due process procedures.** The staff commented that there was a need to improve governance throughout the public sector where accountability and transparency were very poor,[19] and for broader institutional accountability in the budget execution process.

39. **The staff suggested that, as was the case in many other oil-exporting countries, the task of improving governance should start in the oil and gas sector.** This could include the publishing of annual audited reports and accounts of the national oil company and its subsidiaries, as well as those of private oil companies incorporated in Nigeria. The next step would be to audit and publish the accounts of federal government expenditure, so that the public could see the uses of oil (and non-oil) revenue. The staff of the Fund and the World Bank proposed that discussions be held by the government and the oil industry to design a methodology to achieve publication of comprehensive and credible data on oil sector financial flows, in the spirit of the recent initiative by nongovernmental organizations (NGOs) to encourage international oil companies to disclose information on revenue payments.[20] This proposal has so far received lukewarm support, but various players in the sector indicated that such a reporting framework would be acceptable, provided compliance was across the board. It was suggested by some representatives of the industry that the Fund

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[19] The 2002 Transparency International report places Nigeria next to last on its corruption perception index.

[20] The staff noted that British Petroleum had begun to publish a summary of its operations in Angola, thereby setting an important example of enhanced corporate governance that put pressure on other companies to do likewise.

and the World Bank staffs take the lead in developing the framework's modalities, in consultation with the government and the oil sector.

F. Monetary and Exchange Rate Policy

40. **While recognizing the burden that a volatile and expansionary fiscal policy placed on monetary policy, the staff noted that there remained scope for enhancing the effectiveness of the latter.** First, interest rates should be allowed to adjust to market conditions. This would reveal more clearly the consequences of an expansionary fiscal policy and that the CBN stood ready to tighten monetary conditions in order to achieve its monetary and inflation targets, as needed. The central bank has repeatedly missed its targets by wide margins, because of the financing of the budget deficit and its inability to sterilize the huge liquidity impact of government spending.

41. **The staff discussed with the CBN ways to strengthen the effectiveness of monetary policy instruments, drawing on recommendations made by MAE technical assistance.** It encouraged the CBN to lower the mandatory liquidity reserve requirement, currently at 40 percent, as this severely limited the bank's ability to effectively intermediate savings, imposed an implicit tax burden on banks, and encouraged false reporting. Instead, the staff urged the CBN to rely more on indirect instruments and to move toward open market operations (OMOs) on a daily basis, which would help improve the functioning of the secondary market for treasury bills and reduce the reliance of banks on the discount window for liquidity management. The CBN representatives noted that the central bank was gradually moving toward reliance on more market-based instruments, and that steps were being taken to harmonize discount window operations with OMOs. To this end, the CBN intends to begin OMOs on a daily basis in the period ahead, and an on-line trading desk is being put in place.

42. **The authorities underscored that the improvement in the functioning of the foreign exchange market since the introduction of the retail Dutch auction system had resulted in the narrowing of the spread with the parallel market rate.** They agreed with the staff that once sufficient experience had been gained, the CBN should consider moving to the next stage and fostering the development of a wholesale auction, which would greatly enhance the effectiveness of the interbank market for foreign exchange. Since the introduction of the Dutch auction for foreign exchange, the interbank and auction markets have been closely aligned, notwithstanding restrictions on access to the auction not present in the interbank market.[21]

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[21] The existence of an official exchange rate together with other exchange rates, e.g., interbank rate, gives rise to multiple currency practices in the absence of a mechanism to ensure that spreads between the official rate and the other rates do not exceed 2 percent at any given time. Similarly, the Dutch Auction System gives rise to a multiple currency practice. These are subject to Fund approval under Article VIII.

43. **Although a more flexible exchange rate policy has been adopted, and the naira has depreciated in real terms during 2002, the staff noted that the naira remained overvalued, given a real appreciation of almost 25 percent between end-1999 and end-2001.** Further flexibility in the exchange rate may be required to safeguard Nigeria's foreign exchange reserves.

44. **The Financial Sector Stability Assessment (FSSA) found that recent developments in the banking sector were of serious concern, and that there were increasing signs of distress (Box 4).** The banking sector's poor track record and the weak corporate governance, marked by insider lending, have undermined public confidence and encouraged cash-driven transactions. The report also notes that Nigeria is still one of the noncompliant countries as regards developing an appropriate anti-money-laundering legislative and regulatory framework.

45. **The authorities found the FSSA exercise to be very useful and are making considerable efforts to address the weaknesses identified in the report**. Among the key efforts are improving the transparency of banking supervision, overhauling the regulatory and supervisory framework governing the nonbanking sector, and upgrading the payment system. Furthermore, the proposed amendment to the Banks and Other Financial Institutions Act, which is before the National Assembly, would, if effectively implemented, greatly enhance the level of compliance with the Basel Core Principles. The CBN has begun strengthening its on-site supervision of the nonbank financial institutions and has launched an in-depth survey of the country's community banks (or microfinance institutions) that is expected to lay the basis for their restructuring. The authorities are cognizant of the high risk of abuse in the financial system and indicated that they intended to take action to combat money laundering. They stressed, however, that the fight against money laundering should be reciprocated by the industrialized countries, noting the difficulties Nigeria had faced in its efforts to recover from European banks the alleged looted Abacha funds. The staff urged the authorities to implement the recommendations in the FSSA, particularly with respect to banking supervision and monetary and financial policy transparency, including in the area of money laundering.

G. External Policies and Regional Integration

46. **The staff observed that, while Nigeria's stated objective was convergence with the Economic Community of West African States (ECOWAS) common external tariffs by 2006–07, the trade policies adopted in the 2002 budget had increased overall tariff and nontariff protection.**[22] At the same time, selected export incentives have been

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[22] The number of tariff duty rates over 50 percent has increased from 134 to nearly 200 tariff lines, although the weighted average tariff rate has fallen modestly in the past two years. However, as noted above, effective protection has increased.

Box 4. Financial System Stability Assessment

The Financial System Stability Assessment (FSSA) concludes that the Nigerian financial system is vulnerable to a number of risks, and that there are serious concerns about the soundness and stability of the banking system. The Nigerian anti-money-laundering (AML) legal framework and enforcement is also considered inadequate, making the system vulnerable to financial abuse. Inefficiencies, such as delays and backlogs, in operating the court system are also major impediments to the smooth functioning of the financial system. The authorities recognize most of the weaknesses noted in the report and have, on their own initiative, initiated reforms aimed at improving the soundness of the financial system. While welcoming these efforts, the FSSA emphasizes that more decisive actions are warranted, especially in banking, AML efforts, and the upgrading of the payment system. The key conclusions and recommendations of the report are summarized as follows:

- **Macroeconomic environment.** The financial system remains vulnerable to several external risks, including (i) the economy's high dependence on volatile oil proceeds; (ii) economic mismanagement, in particular fiscal imprudence; and (iii) political uncertainty. Given the large size and role of the government in economic activity and its virtual monopoly over the country's export earnings, **fiscal indiscipline is the single most important threat to the economy and the financial sector today**. Adopting a prudent, medium-term-oriented fiscal policy and introducing more market-based mechanisms in the foreign exchange market and the domestic money market would help to reduce vulnerabilities, remove distortions, and, hence, improve the efficiency of the financial system.

- **Banking sector. Recent developments in the banking sector, including increased signs and incidence of distress, are a cause for serious concern and call for decisive and expeditious actions to safeguard the stability and soundness of the banking system.** The observed distress in the banking system is likely to worsen if economic performance deteriorates. Hence, further banking distress, including a systemic problem in the banking sector, cannot be confidently ruled out. The banking system continues to be characterized by (i) weak corporate governance; (ii) widespread insider lending; (iii) dependence on the government for business; (iv) high levels of nonperforming loans and systemic underprovisioning; (v) persistent misreporting by many banks, which prevents detecting of emerging problems and precludes an accurate, risk-based analysis; and (vi) a high reliance on direct controls for prudential and liquidity management purposes, which has not only kept supervisors from making careful risk assessments of the industry, but has also stretched thin valuable supervisory resources.

- The FSSA recommends, among others, that the authorities (i) take strong measures to better control insider lending; (ii) adopt a zero tolerance policy for the misreporting, underprovisioning, and violation of existing rules; (iii) introduce risk-weighted capital adequacy requirements in line with the Basel Capital Accord; (iv) avoid open liquidity assistance to distressed banks; and (v) gradually reduce reliance on direct monetary controls (i.e., high liquid asset ratios) in managing liquidity in the financial system in favor of indirect instruments, such as open market operations, and strengthen monitoring of prudential limits such as net open foreign exchange exposures for risk assessment. In general, the FSSA recommends that the authorities adopt a risk-focused framework for supervision, including a forward-looking risk assessment. This would significantly improve Nigeria's compliance with the Basel Core Principles.

Box 4. Financial System Stability Assessment (concluded)

- **Nonbank financial institutions.** The nonbanking sector is small and declining, and many institutions are insolvent. The sector has been poorly supervised and needs to be rebuilt on solid grounds. A prerequisite is to establish a regulatory and supervisory environment conducive to growth. To this end, the creation of the Other Financial Institutions Department (OFID) within the Central Bank of Nigeria (CBN) is a first step in the right direction. The FSSA recommends that OFID begin assisting troubled institutions (such as community banks) in preparing and implementing a restructuring plan, and that those that do not meet all licensing criteria should be given three years to comply. Going forward, the various acts underpinning this sector may need to be amended to provide deposit insurance for fully licensed community banks.

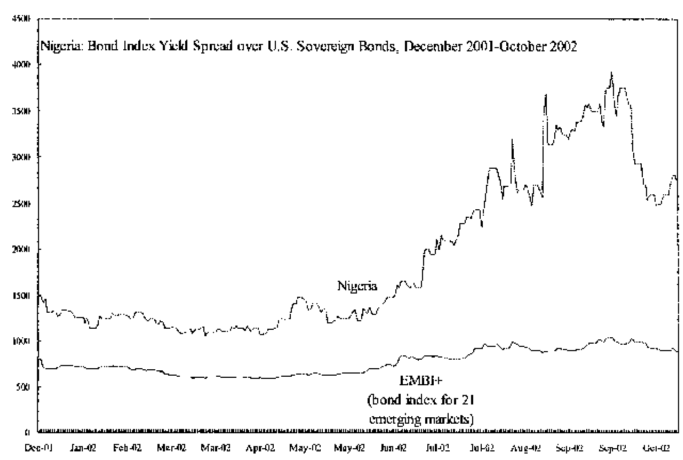
- **Anti-money-laundering framework.** Nigeria is on the Financial Action Task Force (FATF) list of noncompliant countries. The authorities recognize that there is a high risk of financial abuse in the financial system and have established an interministerial AML steering committee to spearhead their efforts. Legislation has also been drafted that would criminalize the financing of terrorism and create a Financial Crime Commission responsible for the implementation of the financial crime laws. The FSSA urges the authorities to quickly (i) enact comprehensive financial crime legislation; (ii) broaden under the current AML act/draft bill the definition of anti-money laundering and the scope of predicate offences; (iii) establish a Financial Intelligence Unit empowered to investigate all money-laundering activities and provide information to the competent authorities; and (iv) have the steering committee adopt an expedited action plan for carrying out needed reforms. Nigeria could benefit from technical assistance.

- **Payment system.** The lack of "failure-to-settle" rules could potentially expose the CBN to significant losses should a bank fail with its settlement account substantially overdrawn. The payment system is also hampered by the poor state of automation lack of timely, comprehensive, and consistent data. Upon recommendation and own initiative, the CBN plans to move to an automated check-clearing system and adopt a real-time gross settlement system (RTGS).

expanded, all of which can be viewed as an alternative to exchange rate action on the part of the authorities. The staff noted that frequent and ad hoc changes in duty rates and exemptions were highly inefficient and gave rise to abuse, and they urged the authorities to issue a clear statement of medium-term trade policies. The Nigerian representatives explained that the trade actions adopted in 2002 were temporary and for the most part health related. They noted that studies were under way to determine how to converge to the ECOWAS tariff structure by the terminal date.

47. **Regarding the proposed West Africa Monetary Zone, the Nigerian representatives noted that the government was working toward a common currency arrangement.** However, the original timetable for convergence is being reconsidered in light of the initial positions of several of the countries. In the case of Nigeria, the need for exchange rate unification and for greater flexibility of the exchange rate in order to absorb external shocks in the absence of fiscal discipline is inconsistent with the conditions necessary to join a currency union. The Nigerian representatives agreed that these issues will have to be addressed before Nigeria could join the proposed zone; the deadline for convergence has recently been postponed to mid-2005.

48. **The authorities continued to look for ways to lower the burden of its external debt through restructuring in the short term and a concessional rescheduling when the circumstances are opportune.**[23] To this end, the authorities are considering the scope for a voluntary restructuring of commercial debt. In August, bond spreads rose in response to uncertainties regarding Nigeria's intentions. The authorities noted that monthly payments are now decided on an ad hoc basis by a committee comprising of federal and state government officials. The staff reiterated its view that Nigeria should meet its debt service obligations to the fullest extent possible and urged the authorities to develop a mechanism to fund budgeted debt-service obligations on a timely basis. The staff also took note of the progress made in concluding Paris Club bilateral agreements, particularly the adoption of fixed interest rates with some creditors, which will reduce the volatility of future debt-service obligations, and they welcomed the authorities' intention to quickly conclude remaining bilateral agreements by end-March 2003.



[23] A debt sustainability analysis update appears in the accompanying selected issues paper.

49. **The medium-term external outlook remains challenging**. Export receipts, which are still largely dependent on oil notwithstanding prospective improvements of non-oil exports, will likely remain constrained by OPEC oil production quotas and a projected decline in prices. However, a strengthening of the fiscal position and a competitive exchange rate would contribute to a narrowing of the current account deficit to 3-4 percent of GDP over the medium term. While net capital inflows are expected to strengthen mainly on account of FDI, net debt service payments and the need to rebuild reserves indicate a continued need for exceptional financing. In order to bring debt service down to manageable levels over the medium term, the authorities will need to present a credible medium-term program focused on accelerating growth and addressing poverty as a basis for creditors to consider a further rescheduling. The staff noted that debt service obligations would remain relatively high until at least 2008/09 even if policy performance and growth improve, and that pending a resolution of recurring external debt arrears, new financing would likely remain very limited. In this context some illustrative concessional rescheduling scenarios were elaborated which would place external debt and debt service on a manageable and more sustainable path.

H. The Privatization Program

50. **The representatives of the Bureau of Public Enterprises (BPE) noted that the privatization of enterprises in the first phase of the privatization program was all but complete, and that several enterprises under the second phase had recently been privatized.** Recent setbacks in the privatization of the Nigeria Telecommunications Company (NITEL) and several other parastatals have provided BPE with a number of lessons that should strengthen the process going forward. Among these are the following: (i) the need to allow for sufficient time for premarketing of the enterprise; (ii) the importance of thorough due diligence on the part of bidders; and (iii) the need to prevent political interference in the privatization process. The privatization of NITEL and the national power company (NEPA), together with the commercialization of NNPC and the rehabilitation and privatization of the oil refineries, is of critical importance to private sector growth. The BPE should intensify its effort, including putting in place the necessary regulatory and legal framework, so that the public will begin benefiting from the fruits of privatization. The staff also supported the BPE's efforts to carry out its activities in a transparent and professional manner, without actual or perceived political interference, which is key to engendering investor confidence.

I. Interim Poverty Reduction Strategy Paper

51. **Given Nigeria's federal system, the staff was of the view that a major challenge in developing a poverty reduction strategy with broad national support will be the adoption of an effective participatory process**. It is, therefore, critical that the interim poverty reduction strategy paper (I-PRSP) specify such a process in the run-up to the preparation of the full PRSP. A roadmap for preparing an (I-PRSP) has been developed, and a preliminary document has been drafted. The staffs of the World Bank and the Fund have

provided comments on the draft, and the Nigerian PRSP coordinating committee is working on a revised version of the document.

52. **By reorienting federal and subnational governments' budgets toward growth-enhancing productive spending and toward the building of human capital, the poverty reduction strategy can raise long-term growth prospects, particularly in the non-oil sector.** Because of its participatory nature, and the ensuing reforms in public expenditure management, the PRSP process has the potential to strengthen overall governance and accountability. In this regard, the homegrown economic framework highlights the importance of the PRSP as an instrument for framing the government's policy objectives. The Nigerian representatives indicated that they would consider initiating the process in a few states on a voluntary basis. To maintain an adequate momentum in the PRSP process, the staff advised that a PRSP awareness campaign be launched.

J. Capacity-Building and Data Issues

53. **At the urging of the staff, the authorities have created an Economic Technical Team, consisting of all key federal ministries and government agencies dealing with economic issues.** The objective is to enhance the quality of policy formulation, analysis, and policy coordination, and to ensure a more effective monitoring of policy implementation. While a ministerial committee had previously been created, this did not lead to greater coordination of economic policymaking, particularly at the technical level. The new Economic Technical Team is expected to fill the vacuum that had existed in the policymaking and monitoring area. The staff held a seminar with the newly created team on fiscal policy rules, fiscal federalism, and trade reform.

54. **The staff observed that technical assistance had not been as effective as intended because of weaknesses in the current framework on the part of both the providers and the Nigerian recipients.** There is, on the providers' side, an occasional lack of policy coordination and understanding of the reality on the ground, and, on the Nigerian side, a lack of ownership. The staff urged the government to make full use of the technical assistance being provided by the Fund in the Office of the Accountant General. Both the authorities and technical assistance providers need to seek ways to improve the delivery of assistance to Nigeria, with the aim of strengthening the government's institutional capacity.

55. **The ability of Nigeria's statistical agencies to compile statistics has been seriously impaired by inadequate funding and capacity, and a lack of coordination among the various statistical agencies.** In particular, the lack of comprehensiveness in the coverage of data on fiscal operations hampers accurate monitoring of the fiscal developments at the national and subnational levels. The staff recommends that concerted efforts be made by the national authorities to implement the main recommendations of the recent government finance statistics missions which focus on addressing the operational needs of analysts. Statistics are also deficient in the areas of national accounts, particularly private investment, and balance of payments. The staff urged the authorities to complete the first phase of the metadata exercise under the Fund's General Data Dissemination Standards (GDDS) project

for selective countries in Africa, and to identify technical assistance needs; it also offered technical assistance support to help complete this phase. The Nigerian representatives indicated that the Federal Office of Statistics (FOS) would take advantage of this opportunity to rebuild the country's economic database.

IV. Staff Appraisal

56. **The change that began in May 1999 with the return of civilian rule has given Nigeria an exceptional opportunity to break away from the financial indiscipline of the past.** It has provided a basis to undertake the deep structural reforms needed to renew macroeconomic stability and rebuild confidence in the economy, sustain growth, and reduce poverty.

57. **However, the legacy of weak policies in the 1980s and 1990s continues to pose daunting obstacles to the achievement of rapid and sustainable growth in Nigeria.** Part of this legacy is that government expenditure and oil revenues have been highly correlated and volatile, with oil spending booms followed by busts. Furthermore, poor governance and corrupt practices have greatly weakened institutions and rendered the delivery of public goods and services ineffective. In addition, the absence of a predictable and sound medium-term fiscal policy has undermined the conduct of monetary and exchange rate policy, while also weakening the key elements for a successful private sector. The consequences of these policies have been particularly visible in Nigeria's falling poverty indices, poor social indicators, degraded infrastructure, and small share of manufacturing in the economy, as well as in the declining importance of agriculture as the backbone of the economy.

58. **There have been some encouraging developments since 1999 in both institution building and certain aspects of macroeconomic performance.** The launching of the privatization program, the creation of the Anti-Corruption Commission, and the institutional reinforcement of due process in the screening of capital projects are particularly welcome. In the macroeconomic area, estimated real non-oil GDP growth has picked up in 2001 and 2002; the annual average inflation rate, which had been contained in 1999 and was rekindled in 2000 to double-digit rates, declined in 2002; and exchange rate policy has become more market determined with the introduction of a retail auction system for foreign exchange.

59. **Nonetheless, overall economic performance has been marked by macroeconomic imbalances.** In particular, the overall stance of fiscal policy is highly expansionary, notwithstanding efforts by the executive to contain capital spending, and is particularly troublesome in the context of the historically high oil prices, suggesting that current fiscal policies are unsustainable. Furthermore, the confluence of this type of fiscal policy, a smaller reserve cushion, and a banking system with many weak institutions, heightens considerably Nigeria's vulnerability to an oil price downturn, particularly in the period leading up to the elections.

60. **The immediate challenge for the government is to reinforce macroeconomic and financial stability until after the elections, when more far-reaching reforms can be put**

in place. This implies containing expenditure in the remainder of 2002 and preparing a budget for 2003 that is consistent with restoring macroeconomic stability. These actions will have to be accompanied by a tightening of monetary policy and implementation of a prudent exchange rate policy to safeguard Nigeria's external reserves.

61. **The main macroeconomic challenge facing the government in 2003 and beyond is the strengthening of the fiscal policy framework.** Four aspects of this framework will need to be tackled simultaneously:

- **There is a pressing need to stop the large swings in expenditure during boom and bust cycles.** To this end, the staff proposes that a price-based fiscal policy rule be adopted, which, together with the provisions of the draft Fiscal Responsibility Bill, would help enforce fiscal discipline. To apply the rule on a consolidated basis, the government will need to explore mechanisms to elicit the cooperation of the states in its implementation.

- **Transparency and accountability should be a guiding principle for all fiscal operations.** It will be important to start in the oil and gas sector by publishing the annual audited reports and accounts of the national oil company, as well as those of the private oil companies working in Nigeria. A credible and easy-to-understand aggregated summary of the financial flows of the sector would then be made available to the general public. This should be followed by the publication of audited accounts of the federal government and state governments, to enable the public to see how the oil (and non-oil) revenue is utilized.

- **Public expenditure will have to be streamlined and its efficiency enhanced, both at the federal and the state and local government levels.** Civil service reform should be a top priority for both the federal and state governments.

- **To enhance the effectiveness of the budget process, the budget office will need to be strengthened as a matter of priority**. Budget preparation, execution, and monitoring will have to be considerably reinforced, and budgetary discipline enhanced.

62. **The CBN needs to align its monetary policies more closely with fiscal developments**. Given the current expansionary fiscal stance and the lagged effects of monetary growth on inflation, the CBN should adopt a tighter monetary stance, mop up the excess liquidity in the banking system. and adhere to its monetary aggregate targets. The effectiveness of the instruments by which monetary policy is implemented should also be enhanced. The CBN demonstrated in the second half of 2001 and early 2002 that prompt actions to contain liquidity can work in Nigeria and can bring about a decline in inflation. The staff encourages the CBN to move toward open market operations on a daily basis. This would also help improve the functioning of the secondary market for treasury bills and reduce banks' reliance on the discount window for managing liquidity. The authorities should also take steps to lengthen the maturity structure of treasury bills. Finally, it is

important to let markets clear and to allow interest rates on treasury bills to rise whenever bank liquidity is in excess of target levels.

63. **The introduction of the Dutch auction is a positive step toward the liberalization of the foreign exchange market.** The staff underscores the importance of taking further steps to foster a single, unified foreign exchange market. In particular, this would involve the development of a wholesale auction system in which banks are allowed to bid for foreign exchange on their own account—with the necessary regulations maintained regarding open positions and the soundness of banks. Unification of the markets would also be fostered by a relaxation of export and import administrative requirements. The issues of the-still overvalued naira, the insufficient flexibility of the exchange rate for absorbing external shocks, and the lack of fiscal discipline would have to be addressed decisively before Nigeria would be in a position to join the proposed West African Monetary Zone.

64. **The authorities should be commended for carrying out the FSSA exercise, and are encouraged to follow through on the core recommendation put forward in the report**. In addition to safeguarding deposits and facilitating an efficient payment system, a strong banking system is more conducive to the effective conduct of monetary policy and the development of interbank market transactions. The authorities should take actions to safeguard the stability and soundness of the banking system and address identified weaknesses in prudential regulations and in anti-money-laundering policies.

65. **The authorities should take the earliest opportunity to restate their commitment to trade liberalization and the phased removal of trade prohibitions consistent with Nigeria's objective of convergence with the ECOWAS common external tariffs by 2006–07.** They ought to build upon the progress made to simplify the tariff system, reduce peak and average tariffs, cut discretionary exemptions while avoiding frequent changes in tariffs. Non-oil exports are primarily being hurt by the sustained revaluation of the real effective exchange rate over the last several years. At the same time, high tariff barriers and a complex tariff system increase incentives to operate in the informal economy, while the considerable discretionary exemptions encourages rent seeking.

66. **The authorities' efforts to work cooperatively with all their creditors to reach a solution to the current debt-servicing difficulties are deserving to be supported.** However, they should strive to meet their external debt-service obligations to the fullest extent possible. Bringing debt service down to manageable levels over the medium term will require implementing a credible medium-term program focused on accelerating growth and addressing poverty as a basis for creditors to consider a further rescheduling. These measures might be most effective in the context of a Fund-supported program.

67. **While the overall approach by the BPE has been commendable, the staff is concerned about the recent setbacks in the privatization of NITEL and several other parastatals**. In some cases, these developments have reflected insufficient due diligence on the part of bidders and political interference with the privatization process. The privatization of NITEL and NEPA, together with the commercialization of NNPC and the rehabilitation

and privatization of the oil refineries, is of critical importance in boosting economic activity in Nigeria. The BPE is to be commended for its efforts to carry out its responsibilities in a transparent and professional manner. Noninterference with the process will be key to generating domestic and foreign investor interest in the enterprises to be privatized.

68. **Developing a poverty reduction strategy with broad national support in Nigeria will require extensive consultations at all levels of government.** The PRSP process offers significant possibilities for public expenditure management reforms and the setting of expenditure priorities in federal and subnational budgets. By making government's budgets more pro-poor and growth-enhancing, in particular, with respect to investments in human capital, the PRSP has the potential to raise long-term growth prospects, especially in the non-oil sector. The staff welcomes the publication of the government's homegrown economic framework and encourages the authorities to use the budget and the PRSP process to achieve its objectives.

69. **The capacity of Nigeria's statistical agencies to compile economic statistics is weak, reflecting underfunding over the years and the insufficient priority that has been accorded to this activity.** Deficiencies span many areas, including national accounts, particularly private investment, consolidated government finance, and the balance of payments. The reliability and timeliness of economic statistics need to be improved to support the monitoring of macroeconomic developments and policy formulation. Nigeria is urged to complete the first phase of the metadata inventory exercise under the GDDS project.

70. **The Fund remains committed to helping build capacity in Nigeria.** There is a general sense that technical assistance has not been as effective as had been hoped. On the part of the providers there has been an occasional lack of policy coordination and of realism regarding the government's administrative capacities, and, on the Nigerian side, a lack of ownership. Ways to improve the delivery of technical assistance have to be found, with the aim of strengthening the government's institutional capacity. Progress in these areas would be important for the conduct of economic policy in Nigeria and would also facilitate monitoring under any future Fund-supported program. In this regard, the staff welcomes the creation of the Economic Technical Team to enhance policy formulation and monitoring.

71. **It is expected that the next Article IV consultation discussions with Nigeria will be held on the standard 12-month cycle.**

Table 1. Nigeria: Selected Economic and Financial Indicators (Good-Policy Scenario), 2000–07

	2000	2001	2002 1/	2003	2004	2005	2006	2007
	(Annual percentage changes, unless otherwise specified)							
National income and prices								
Real GDP (at 1990 factor cost)	4.2	2.9	-0.9	4.5	4.2	4.6	5.0	5.5
Oil GDP	6.6	0.5	-14.0	4.8	2.0	2.0	2.0	2.0
Non-oil GDP	3.0	4.1	5.3	4.4	5.1	5.6	6.1	6.8
Agriculture	2.9	3.8	5.3	4.0	4.2	4.6	5.0	5.8
Industry	3.6	6.5	7.0	6.0	6.3	6.8	7.0	7.5
Services	2.9	3.8	5.0	4.5	6.0	6.5	7.2	7.8
Real GDP per capita	1.4	0.2	-3.6	1.7	1.5	1.8	2.2	3.0
GDP per capita (in U.S. dollars)	327	322	316	314	310	313	319	330
GDP deflator (period average)	22.5	7.4	11.3	9.0	6.1	7.3	7.0	6.3
Non-oil GDP deflator (period average)	7.8	20.7	13.4	12.2	10.4	9.0	8.7	6.7
Consumer price index (annual average)	6.9	18.9	13.4	12.2	10.4	9.0	8.7	6.7
Consumer price index (end of period)	14.5	16.5	13.8	11.7	8.9	9.0	7.9	5.9
External sector								
Exports, f.o.b.	64.9	-16.1	-16.9	6.6	-6.0	1.5	0.6	5.2
Imports, f.o.b.	6.8	11.2	8.3	3.0	-1.8	4.8	0.6	6.4
Non-oil export volume	-7.1	4.1	5.3	6.4	7.1	7.6	8.1	8.8
Oil export volume 2/	7.4	-4.3	-22.6	6.2	2.6	2.6	2.6	2.5
Volume of import of goods and nonfactor services	9.7	11.3	8.6	-0.5	-5.0	2.1	-0.7	4.1
Terms of trade	128.4	114.5	117.5	113.7	102.0	98.9	93.9	93.2
Nominal effective exchange rate (end of period; - indicates depreciation) 3/	0.2	-3.1	-14.5	...	...	...	...	...
Real effective ex. rate (end of period; - indicates depreciation) 3/	12.2	24.7	-9.1	...	...	...	...	...
Consolidated government operations 4/								
Total revenue and grants	95.2	15.6	-5.2	25.8	6.8	7.9	6.5	8.8
Petroleum revenue	119.8	8.0	-8.1	30.2	5.2	6.4	4.1	7.7
Nonpetroleum revenue	28.4	50.7	4.3	12.7	12.2	12.7	13.7	11.8
Total federal expenditure and net lending	42.6	44.3	1.3	16.2	0.6	5.3	6.6	8.2
Current expenditure 5/	39.6	36.6	4.6	13.9	2.1	6.2	6.4	7.5
Capital expenditure and net lending 5/	52.9	68.7	-8.3	24.4	-3.3	2.7	7.1	10.1
Money and credit								
Net domestic assets 6/	-25.4	12.7	32.0	14.1	4.8	5.5	8.7	8.9
Net domestic credit 6/	-22.9	34.6	28.2	21.8	11.2	13.0	16.1	14.9
Net credit to consolidated government	-42.3	11.4	22.4	11.8	-4.9	-7.2	-4.4	-5.3
Net credit to the federal government	-43.1	9.5	22.4	11.8	-4.9	-7.2	-4.4	-5.3
Credit to the rest of the economy	19.3	23.0	5.9	10.0	14.4	16.8	14.7	13.6
Broad money	48.2	27.2	19.4	17.1	16.0	15.1	15.3	13.9
Velocity (non-oil GDP/end-of-period broad money)	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Treasury bill rate (percent; end of period) 7/	16.1	25.9	14.5	...	...	...	...	...
Discount rate (percent; end of period) 7/	14.0	20.5	18.5	...	...	...	...	...
	(In percent of GDP; unless otherwise specified)							
Investment and saving								
Investment	17.7	20.1	23.3	23.6	23.2	25.4	26.4	26.4
Public fixed investment	9.3	14.1	11.7	12.8	11.1	10.2	9.7	9.5
Private fixed investment	8.4	5.9	11.6	10.9	12.0	15.2	16.7	16.9
Gross national savings	27.7	22.9	14.7	17.8	17.9	20.1	22.5	23.0
Public	22.2	16.9	13.0	16.3	16.7	16.1	15.0	14.3
Private	5.4	5.9	1.7	1.5	1.2	4.0	7.5	8.6
Consolidated government operations 4/								
Total revenues and grants	45.0	46.9	40.2	44.3	42.7	41.0	38.8	37.6
Of which: petroleum revenue	37.0	36.1	30.0	34.2	32.5	30.7	28.5	27.3
Total expenditure and net lending	38.6	50.2	46.0	46.8	42.5	39.8	37.8	36.4
Overall balance (commitment basis)	6.4	-3.3	-5.8	-2.5	0.2	1.1	1.0	1.2
Primary balance	13.0	2.8	1.2	3.6	5.5	5.9	5.3	4.8
Gross domestic debt	21.0	21.4	25.0	25.0	21.2	16.8	13.7	10.6
External sector								
Current account balance	10.0	2.8	-8.6	-5.8	-5.3	-5.3	-3.9	-3.4
External debt outstanding	72.2	70.0	71.2	68.5	67.1	64.0	60.0	55.7
External debt service due after rescheduling 2000–01								
(in percent of exports of goods and nonfactor services)	15.3	17.1	18.1	16.8	18.0	18.5	17.7	15.7
	(In millions of U.S. dollars, unless otherwise specified)							
Current account balance	4,173	1,194	-3,667	-2,537	-2,334	-2,441	-1,872	-1,741
Overall balance of payments	2,240	-96	-4,907	-1,403	-301	-527	-217	-8
Gross international reserves (end of period)	9,400	10,423	7,233	6,690	7,482	8,202	8,903	9,764
(equivalent months of imports, c.i.f.)	7.1	7.3	4.6	4.2	4.8	5.1	5.5	5.7
Price of Nigerian oil (U.S. dollars per barrel)	28.2	24.3	25.2	25.0	22.5	22.0	21.0	21.0
Production of crude oil (million barrels per day)	2.249	2.26	1.89	1.98	2.02	2.06	2.10	2.15
Interbank Foreign Exchange Market/DAS exchange rate (naira per U.S. dollar; average) 7/	102.2	112.0	127.6	...	...	...	...	...
Nominal GDP at market prices (in billions of naira)	4,279	4,747	5,250	5,990	6,639	7,459	8,389	9,420

Sources: Nigerian authorities; and Fund staff estimates and projections.

1/ Based on WEO oil price of US$25.2 per barrel and the 2002 budget approved by the National Assembly on March 27, 2002.
2/ The reduction in export volumes is larger than the reduction in total production, due to an increase in domestic allocation of crude oil to NNPC in 2002 from 2001.
3/ 2002 data are based on latest observations mainly in July 2002.
4/ Consists of the federal, state, and local governments.
5/ Assumes that two-thirds of state and local government expenditure is recurrent expenditure.
6/ In percent of broad money at the beginning of the period.
7/ 2002 data are based on latest observations mainly on October 31, 2002 (for Dutch auction system-exchange rate, the midpoint between lowest and highest bid rates is reported).

Table 2. Nigeria: Fiscal Operations (Cash Basis), 2000–03

	2000	2001	2002				2003	
			H1	H2	Annual			
			Actual	Proj.	National Assembly	Staff proj.	Unchang. policies	Adjust. scenario
	(In billions of naira)							
Total revenue	1,927	2,227	931	1,180	1,843	2,111	2,529	2,655
Petroleum revenue	1,585	1,712	647	927	1,315	1,574	1,943	2,050
Government crude receipts	947	934	305	416	588	721	870	870
Petroleum profit tax and royalty	526	613	183	313	343	496	684	684
Petroleum profit tax	333	406	107	214	208	321	482	482
Royalty	193	207	76	99	135	175	202	202
Upstream gas sales and NLNG	23	27	18	19	45	36	58	58
Other oil revenue	...	5	16	17	13	34	10	10
Domestic crude (net of tax on petroleum products)	89	134	125	162	327	287	321	428
Nonpetroleum revenue	342	515	284	253	528	537	586	605
Customs and excise (includes import duty)	116	171	90	86	180	176	205	209
Companies income tax	51	69	38	50	90	88	98	100
Value-added tax (VAT)	58	92	51	53	90	104	114	128
Education tax	8	16	2	8	10	10	7	7
Federal government independent revenue	38	44	55	6	60	61	52	52
State and local governments' internal revenue	46	69	39	39	78	78	88	88
Customs levies	0	24	10	10	20	20	21	21
Petroleum tax	25	30	0	0	0	0	0	0
Distribution to federal, state and local governments								
Federal government revenue	1,413	1,422	570	727	1,123	1,279	1,521	1,619
States and local governments' revenue	513	805	361	453	720	831	1,008	1,035
Total consolidated expenditure	1,560	2,246	1,048	1,319	2,300	2,367	2,769	2,717
Total federal expenditure	1,066	1,404	687	849	1,579	1,536	1,761	1,682
Federal government recurrent expenditure	874	1,085	549	609	1,087	1,158	1,403	1,323
Goods and services	372	403	239	233	444	472	543	501
Personnel cost	279	285	201	180	352	381	436	410
Overhead cost	71	118	38	53	92	91	106	91
Other	22	...	...	...	0	...	0	0
Interest payments	187	152	107	132	220	239	307	268
Domestic	104	118	86	87	134	173	191	152
Foreign, cash	83	34	20	46	86	66	116	116
Transfers	315	530	203	244	423	447	553	553
NNPC cash calls	260	442	169	209	350	378	487	487
NNPC priority projects	25	38	6	5	2	11	12	12
National Judicial Council	10	0	11	5	28	16	17	17
Transfer to Niger Delta Dev. Comm.	20	10	6	7	13	13	9	9
Customs levies	0	24	10	10	20	20	21	21
Education Fund	0	16	2	8	10	10	7	7
Federal government capital expenditure	192	318	130	240	492	370	358	358
Domestically financed	177	312	122	231	487	353	319	319
Foreign financed	15	6	9	9	6	18	40	40
Net lending (loans to states in 2002 to service ext. debt)	0	0	7	0	0	7	0	0
State and local governments, incl. special funds	494	843	361	470	720	831	1,008	1,035
Overall balance (cash basis)	367	-19	-117	-140	-456	-256	-240	-62
Financing	-379	25	110	140	456	250	240	62
External	-76	-198	-24	-20	-76	-45	-123	-123
Borrowing	15	6	9	9	6	18	40	40
Amortization, cash	-91	-204	-33	-29	-82	-62	-162	-162
Domestic	-321	137	134	160	154	295	363	185
Net claims on the federal government	-301	99	152	143	...	295	...	...
Net claims on state and local governments	-20	38	-17	17	...	0	...	...
Privatization proceeds	18	86	0	0	200	0	0	0
Recovered funds	0	0	0	0	179	0	0	0
Statistical discrepancy	-12	5	-7	0	0	-7	0	0

Table 2. Nigeria: Fiscal Operations (Cash Basis), 2000–03

	2000	2001	2002				2003	
			H1	H2	Annual			
			Actual	Proj.	National Assembly	Staff proj.	Unchang. policies	Adjust. scenario
			(In percent of GDP; unless otherwise indicated)					
Total revenue	45.0	46.9	35.5	44.9	35.1	40.2	42.2	44.3
Petroleum revenue	37.0	36.1	24.7	35.3	25.0	30.0	32.4	34.2
Government crude receipts	22.1	19.7	11.6	15.8	11.2	13.7	14.5	14.5
Petroleum profit tax and royalty	12.3	12.9	7.0	11.9	6.5	9.4	11.4	11.4
Petroleum profit tax	7.8	8.6	4.1	8.2	4.0	6.1	8.1	8.1
Royalty	4.5	4.4	2.9	3.8	2.6	3.3	3.4	3.4
Upstream gas sales and NLNG	0.5	0.6	0.7	0.7	0.9	0.7	1.0	1.0
Other revenue	0.0	0.1	0.6	0.6	0.2	0.6	0.2	0.2
Domestic crude (net of tax on petroleum products)	2.1	2.8	4.8	6.2	6.2	5.5	5.4	7.1
Nonpetroleum revenue	8.0	10.8	10.8	9.6	10.1	10.2	9.8	10.1
Customs and excise (includes import duty)	2.7	3.6	3.4	3.3	3.4	3.3	3.4	3.5
Companies income tax	1.2	1.4	1.4	1.9	1.7	1.7	1.6	1.7
Value-added tax (VAT)	1.4	1.9	1.9	2.0	1.7	2.0	1.9	2.1
Education tax	0.2	0.3	0.1	0.3	0.2	0.2	0.1	0.1
Federal government independent revenue	0.9	0.9	2.1	0.2	1.1	1.2	0.9	0.9
State and local governments' internal revenue	1.1	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Customs levies	0.0	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Petroleum tax	0.6	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Total consolidated expenditure	36.4	47.3	39.9	50.3	43.8	45.1	46.2	45.4
Total federal expenditure	24.9	29.6	26.2	32.4	30.1	29.3	29.4	28.1
Federal government recurrent expenditure	20.4	22.9	20.9	23.2	20.7	22.1	23.4	22.1
Goods and services	8.7	8.5	9.1	8.9	8.5	9.0	9.1	8.4
Personnel cost	6.5	6.0	7.7	6.9	6.7	7.3	7.3	6.8
Overhead cost	1.7	2.5	1.5	2.0	1.7	1.7	1.8	1.5
Other	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest payments	4.4	3.2	4.1	5.0	4.2	4.5	5.1	4.5
Domestic	2.4	2.5	3.3	3.3	2.6	3.3	3.2	2.5
Foreign, cash	1.9	0.7	0.8	1.7	1.6	1.3	1.9	1.9
Transfers	7.4	11.2	7.7	9.3	8.1	8.5	9.2	9.2
NNPC cash calls	6.1	9.3	6.4	8.0	6.7	7.2	8.1	8.1
NNPC priority projects	0.6	0.8	0.2	0.2	0.0	0.2	0.2	0.2
National Judicial Council	0.2	0.0	0.4	0.2	0.5	0.3	0.3	0.3
Transfer to Niger Delta Dev. Comm.	0.5	0.2	0.2	0.3	0.2	0.3	0.2	0.2
Customs levies	0.0	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Education Fund	0.0	0.3	0.1	0.3	0.2	0.2	0.1	0.1
Federal government capital expenditure	4.5	6.7	5.0	9.1	9.4	7.1	6.0	6.0
Domestically financed	4.1	6.6	4.6	8.8	9.3	6.7	5.3	5.3
Foreign financed	0.4	0.1	0.3	0.3	0.1	0.3	0.7	0.7
Net lending (loans to states in 2002 to service ext. debt)	0.0	0.0	0.3	0.0	0.0	0.1	0.0	0.0
State and local governments, incl. special funds	11.5	17.8	13.8	17.9	13.7	15.8	16.8	17.3
Overall balance (cash basis)	8.6	-0.4	-4.4	-5.3	-8.7	-4.9	-4.0	-1.0
Financing	-8.8	0.5	4.2	5.3	8.7	4.8	4.0	1.0
External	-1.8	-4.2	-0.9	-0.8	-1.4	-0.9	-2.0	-2.0
Borrowing	0.4	0.1	0.3	0.3	0.1	0.3	0.7	0.7
Amortization, cash	-2.1	-4.3	-1.3	-1.1	-1.6	-1.2	-2.7	-2.7
Domestic	-7.5	2.9	5.1	6.1	2.9	5.6	6.1	3.1
Privatization proceeds	0.4	1.8	0.0	0.0	3.8	0.0	0.0	0.0
Recovered funds	0.0	0.0	0.0	0.0	3.4	0.0	0.0	0.0
Statistical discrepancy	-0.3	0.1	-0.3	0.0	0.0	-0.1	0.0	0.0
Memorandum items:								
Non-oil primary balance (in percent of non-oil GDP)	-30.3	-35.6	-25.6	-38.0	-31.5	-31.8	-31.1	-30.4
Nominal GDP (in billions of naira)	4,279	4,747	2,625	2,625	5,250	5,250	5,990	5,990
Non-oil GDP (in billions of naira)	2,541	3,193	1,906	1,906	3,812	3,812	4,464	4,464

Sources: Nigerian authorities; and Fund staff estimates and projections.

Table 3. Nigeria: Medium-Term Fiscal Operations (Good-Policy scenario), 2000–07

	2000	2001	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.
	(In billions of naira)							
Total revenue	1,927	2,227	2,111	2,655	2,834	3,057	3,256	3,543
Petroleum revenue	1,585	1,712	1,574	2,050	2,156	2,293	2,387	2,571
Government crude receipts	947	934	721	870	864	932	978	1,058
Petroleum profit tax, royalty, etc.	526	613	496	684	643	678	689	737
Petroleum profit tax	333	406	321	482	446	469	472	504
Royalty	193	207	175	202	197	210	217	232
Upstream gas and NLNG	23	27	36	58	64	74	96	126
Other oil revenue	0	5	34	10	10	10	10	10
Domestic crude	89	134	287	428	575	598	614	641
Nonpetroleum revenue	342	515	537	605	678	764	869	972
Tax revenue	304	470	476	553	627	717	817	920
Taxes on international trade and transactions	116	195	196	230	252	284	320	357
Import duties and excises	116	171	176	209	230	260	294	329
Customs levies	0	24	20	21	23	24	26	28
Taxes on net income, profits, and capital gains	105	154	176	194	222	255	289	325
Companies' income tax	51	69	88	100	119	141	166	193
Education tax	8	16	10	7	8	9	11	13
State and local governments' internal revenue 1/	46	69	78	88	95	104	112	119
Domestic taxes on goods and services	83	122	104	128	152	178	208	239
Value-added tax (VAT)	58	92	104	128	152	178	208	239
Petroleum tax	25	30	0	0	0	0	0	0
Nontax revenue	38	44	61	52	52	47	52	52
Distribution to federal, state and local governments								
Federal-retained revenue	1,413	1,422	1,279	1,619	1,700	1,808	1,915	2,064
State and local governments' revenue	513	805	831	1,035	1,134	1,249	1,340	1,479
Total consolidated expenditure	1,652	2,384	2,414	2,805	2,823	2,972	3,168	3,427
Total federal expenditure	1,158	1,541	1,583	1,770	1,689	1,723	1,827	1,948
Federal government recurrent expenditure	966	1,223	1,285	1,420	1,318	1,359	1,414	1,483
Goods and services	372	403	472	501	532	572	631	693
Personnel cost	279	285	381	410	435	464	510	560
Overhead cost	71	118	91	91	98	108	121	133
Other	22	0	0	0	0	0	0	0
Interest payments due	279	289	365	365	355	356	356	340
Domestic	104	118	173	152	128	114	102	78
Foreign	175	172	193	213	227	242	254	261
Transfers	315	530	447	553	431	431	427	450
NNPC cash calls	260	442	378	487	356	350	338	355
NNPC priority projects	25	38	11	12	13	15	17	19
National Judicial Council	10	0	16	17	19	21	22	24
Transfer to Niger Delta Dev. Comm	20	10	13	9	12	12	12	12
Customs levies	0	24	20	21	23	24	26	28
Education Fund	0	16	10	7	8	9	11	13
Federal government capital expenditure	192	318	291	350	372	364	413	466
Domestically financed	177	312	274	310	304	317	357	401
Foreign financed	15	6	18	40	68	48	56	64
Net lending	0	0	7	0	0	0	0	0
State and local governments' expenditure	494	843	831	1,035	1,134	1,249	1,340	1,479
Overall balance (commitment basis) 2/	275	-157	-304	-151	11	85	88	116
Financing	-287	162	297	151	-11	-85	-88	-116
External	16	-60	81	-26	26	4	-34	-10
Borrowing	15	6	18	40	68	48	56	64
Amortization due	-175	-192	-168	-186	-204	-242	-245	-229
Arrears/rescheduling	176	125	232	120	162	198	155	154
Domestic	-321	137	295	185	-89	-154	-109	-151
Net claims on federal government	-301	99	...	...	...	...	...	...
Net claims on state and local governments	-20	38	...	...	...	...	...	...
Privatization proceeds	18	86	0	0	53	65	55	45
Recovered funds	0	0	0	0	0	0	0	0
Carryover of unspent capital mandates 3/	...	...	-79	-8	0	0	0	0
Statistical discrepancy	-12	5	-7	0	0	0	0	0

Table 3. Nigeria: Medium-Term Fiscal Operations (Good-Policy scenario), 2000–07

	2000	2001	2002	2003	2004	2005	2006	2007
			Proj.					
			(In percent of GDP; unless otherwise indicated)					
Total revenue	45.0	46.9	40.2	44.3	42.7	41.0	38.8	37.6
Petroleum revenue	37.0	36.1	30.0	34.2	32.5	30.7	28.5	27.3
Government crude receipts	22.1	19.7	13.7	14.5	13.0	12.5	11.7	11.2
Petroleum profit tax, royalty, etc.	12.3	12.9	9.4	11.4	9.7	9.1	8.2	7.8
Petroleum profit tax	7.8	8.6	6.1	8.1	6.7	6.3	5.6	5.4
Royalty	4.5	4.4	3.3	3.4	3.0	2.8	2.6	2.5
Upstream gas and NLNG	0.5	0.6	0.7	1.0	1.0	1.0	1.1	1.3
Other oil revenue	0.0	0.1	0.6	0.2	0.2	0.1	0.1	0.1
Domestic crude	2.1	2.8	5.5	7.1	8.7	8.0	7.3	6.8
Nonpetroleum revenue	8.0	10.8	10.2	10.1	10.2	10.2	10.4	10.3
Tax revenue	7.1	9.9	9.1	9.2	9.4	9.6	9.7	9.8
Taxes on international trade and transactions	2.7	4.1	3.7	3.8	3.8	3.8	3.8	3.8
Taxes on net income, profits, and capital gains	2.4	3.2	3.4	3.2	3.4	3.4	3.4	3.4
Domestic taxes on goods and services	1.9	2.6	2.0	2.1	2.3	2.4	2.5	2.5
Nontax revenue	0.9	0.9	1.2	0.9	0.8	0.6	0.6	0.5
Total consolidated expenditure	38.6	50.2	46.0	46.8	42.5	39.8	37.8	36.4
Total federal expenditure	27.1	32.5	30.2	29.5	25.4	23.1	21.8	20.7
Federal government recurrent expenditure	22.6	25.8	24.5	23.7	19.8	18.2	16.9	15.7
Goods and services	8.7	8.5	9.0	8.4	8.0	7.7	7.5	7.4
Personnel cost	6.5	6.0	7.3	6.8	6.5	6.2	6.1	5.9
Overhead cost	1.7	2.5	1.7	1.5	1.5	1.5	1.4	1.4
Other	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest payments due	6.5	6.1	7.0	6.1	5.3	4.8	4.2	3.6
Domestic	2.4	2.5	3.3	2.5	1.9	1.5	1.2	0.8
Foreign	4.1	3.6	3.7	3.5	3.4	3.2	3.0	2.8
Transfers	7.4	11.2	8.5	9.2	6.5	5.8	5.1	4.8
NNPC cash calls	6.1	9.3	7.2	8.1	5.4	4.7	4.0	3.8
NNPC priority projects	0.6	0.8	0.2	0.2	0.2	0.2	0.2	0.2
National Judicial Council	0.2	0.0	0.3	0.3	0.3	0.3	0.3	0.3
Transfer to Niger Delta Dev. Comm	0.5	0.2	0.3	0.2	0.2	0.2	0.1	0.1
Customs levies	0.0	0.5	0.4	0.4	0.3	0.3	0.3	0.3
Education Fund	0.0	0.3	0.2	0.1	0.1	0.1	0.1	0.1
Federal government capital expenditure	4.5	6.7	5.5	5.8	5.6	4.9	4.9	4.9
Domestically financed	4.1	6.6	5.2	5.2	4.6	4.2	4.3	4.3
Foreign financed	0.4	0.1	0.3	0.7	1.0	0.6	0.7	0.7
Net lending	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
State and local governments' expenditure	11.5	17.8	15.8	17.3	17.1	16.7	16.0	15.7
Overall balance (commitment basis) 2/	6.4	-3.3	-5.8	-2.5	0.2	1.1	1.0	1.2
Financing	-6.7	3.4	5.7	2.5	-0.2	-1.1	-1.0	-1.2
External	0.4	-1.3	1.6	-0.4	0.4	0.1	-0.4	-0.1
Borrowing	0.4	0.1	0.3	0.7	1.0	0.6	0.7	0.7
Amortization due	-4.1	-4.0	-3.2	-3.1	-3.1	-3.2	-2.9	-2.4
Arrears/rescheduling	4.1	2.6	4.4	2.0	2.4	2.7	1.8	1.6
Domestic	-7.5	2.9	5.6	3.1	-1.3	-2.1	-1.3	-1.6
Privatization proceeds	0.4	1.8	0.0	0.0	0.8	0.9	0.7	0.5
Recovered funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Carryover of unspent capital mandates 3/	...	...	-1.5	-0.1	0.0	0.0	0.0	0.0
Statistical discrepancy	-0.3	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Non-oil primary balance (in percent of non-oil GDP)	-30.3	-35.6	-29.8	-30.2	-27.7	-25.2	-23.4	-22.5
Target for overall balance (permanent price rule)	...	5.5	5.7	6.5	3.2	2.5	1.2	1.2
Deviation from target (permanent price rule)	...	-8.8	-11.5	-9.0	-3.1	-1.4	-0.2	0.1
Nominal GDP (in billions of naira)	4,279	4,747	5,250	5,990	6,639	7,459	8,389	9,420
Non-oil GDP (in billions of naira)	2,541	3,193	3,812	4,464	5,179	5,959	6,870	7,826

Source: Nigerian authorities; and Fund staff estimates and projections.

1/ State and local governments collect their own revenue (such as income tax and property tax).

2/ External debt service is on a commitment basis. Capital spending for 2002 excludes the cash overhang of N 160 billion accumulated in 2001.

3/ This reflects the drawdown of unspent capital mandates to finance capital expenditure committed in previous years. Insufficient data prevent the inclusion of actual commitments in 2000-01.

Table 4. Nigeria: Monetary Survey, 2000–03 1/ 2/

	2000	2001	2002 Q1	2002 Q2	2002 Aug.	Proj. 2002	Proj. 2003
	(In billions of naira; end of period)						
Net foreign assets	1,165	1,322	1,326	1,249	1,001	1,130	1,178
Central Bank of Nigeria (net)	957	1,035	1,053	950	683	801	811
Foreign assets	1,091	1,156	1,215	1,346	1,024	940	966
Foreign liabilities	-134	-122	-162	-396	-342	-140	-155
Commercial and merchant banks (net)	208	288	273	299	318	330	366
Net domestic assets	-111	20	131	279	556	441	662
Net domestic credit	472	830	1,005	1,066	1,131	1,201	1,544
Consolidated government (net) 3/	-116	2	102	109	212	296	481
Claims	814	926	932	859	833	924	...
Deposits	-930	-924	-830	-751	-622	-655	...
Federal government (net)	-124	-25	112	127	223	269	454
Claims	806	899	916	847	813	898	...
Deposits	-930	-924	-804	-721	-590	-628	...
State and local governments	8	27	16	12	20	27	...
Nonfinancial public enterprises	1	1	5	2	2	1	1
Other financial institutions	5	6	6	5	5	5	5
Claims on private sector	583	821	865	920	881	898	1,056
Other items (net)	-583	-810	-874	-787	-575	-760	-882
Broad money	1,035	1,316	1,423	1,502	1,528	1,571	1,839
Narrow money	650	817	836	872	885	961	1,125
Quasi money	385	499	587	630	644	610	714
Bonds and money market instruments (of banks)	19	26	33	25	29	...	...
Capital accounts	572	667	812	804	768	...	...
Of which: CBN's revaluation account	202	216	285	288	270	...	...
	(Contribution to broad money growth in percent; unless otherwise stated)						
Net foreign assets	73.8	15.2	13.6	-2.2	-21.9	-14.6	3.0
Net domestic assets	-25.4	12.7	-0.7	21.4	44.1	32.0	14.1
Net domestic credit	-22.9	34.6	20.9	29.9	35.2	28.2	21.8
Net credit to the consolidated government 3/	-42.3	11.4	6.8	15.6	25.7	22.4	11.8
Net credit to the federal government	-43.1	9.5	6.8	15.6	25.7	22.4	11.8
Claims on private sector	19.3	23.0	14.3	15.6	9.4	5.9	10.0
Other items (net)	-2.5	-21.9	-21.7	-8.5	8.9	3.8	-7.7
Broad money (percent change since year's end)	48.2	27.2	8.2	14.1	16.1	19.4	17.1
Claims on private sector (percent change since year's e	30.1	40.9	26.4	27.2	7.3	9.4	17.6
Velocity (GDP/broad money) 4/	4.1	3.6	3.7	3.5	3.4	3.3	3.3
Velocity (non-oil GDP/broad money)	2.5	2.4	2.7	2.5	2.5	2.4	2.4
Money multiplier	2.4	2.3	2.7	2.2	2.2	2.2	2.2
Nominal GDP at market prices (in billions of naira)	4,279	4,747	5,250	5,250	5,250	5,250	5,990
Non-oil GDP at market prices (in billions of naira)	2,541	3,193	3,812	3,812	3,812	3,812	4,464
Reserve money (in billions of naira)	427	572	523	696	686	714	836

Sources: Central Bank of Nigeria (CBN); and Fund staff estimates and projections.

1/ Consolidated accounts of the CBN, commercial banks, and merchant banks.

2/ Based on the revised money and banking time series constructed by the Central Bank of Nigeria beginning in 1992.

3/ Consolidated government includes the federation account, federal, state, and local governments, and special funds

4/ Velocity is calculated as the ratio of GDP at market prices to broad money. Calculated velocity in 2000 is now higher than in EBS/00/153 (7/26/00) because of the revision of nominal GDP implied by the change in the terms of trade.

Table 5. Nigeria: Medium-Term Balance of Payments, 2000–07

	2000	Est. 2001	Proj. 2002	2003	2004	2005	2006	2007
Adjustment scenario before rescheduling				(In millions of U.S. dollars)				
Trade balance	10,327	5,646	1,586	2,162	1,457	1,036	1,039	921
Exports	21,395	17,949	14,912	15,891	14,939	15,159	15,247	16,036
Oil	20,151	16,574	13,306	14,029	12,951	12,988	12,713	13,036
Gas	576	708	886	1,063	1,107	1,195	1,461	1,815
Other	668	666	720	799	882	976	1,073	1,185
Imports	-11,068	-12,303	-13,326	-13,729	-13,482	-14,122	-14,208	-15,115
Oil related	-1,926	-1,828	-2,506	-2,820	-1,951	-1,788	-1,626	-1,626
Gas related	-772	-889	-964	-893	-967	-1,042	-1,089	-1,157
Other	-8,370	-9,586	-9,855	-10,016	-10,564	-11,292	-11,493	-12,332
Services (net)	-7,722	-6,226	-7,064	-6,659	-5,952	-5,858	-5,533	-5,549
Factor services	-3,981	-2,482	-2,956	-2,302	-2,114	-2,068	-1,795	-1,752
Nonfactor services	-3,741	-3,744	-4,109	-4,358	-3,838	-3,790	-3,738	-3,797
Private transfers (net)	1,703	1,798	1,834	1,981	2,179	2,397	2,636	2,900
Official transfers (net)	-135	-25	-22	-20	-18	-16	-15	-13
Current account balance	4,173	1,194	-3,667	-2,537	-2,334	-2,441	-1,872	-1,741
Official capital (net)	-1,569	-1,657	-1,228	-1,047	-918	-1,222	-1,119	-926
Disbursements	149	56	142	286	456	300	330	363
Amortization due	-1,719	-1,713	-1,370	-1,333	-1,374	-1,522	-1,449	-1,289
Other capital flows (net)	1,502	1,796	1,950	2,615	2,545	2,858	2,962	3,162
Direct and portfolio investment	1,502	1,796	1,950	2,515	2,345	2,458	2,462	2,462
Private borrowing (net)	0	0	0	100	200	400	500	700
Short-term capital (net)	-295	-647	-524	-434	406	278	-188	-504
Capital account balance	-362	-509	198	1,134	2,033	1,914	1,656	1,732
Errors and omissions	-1,571	-781	-1,439	0	0	0	0	0
Overall balance	2,240	-96	-4,907	-1,403	-301	-527	-217	-8
Financing	-2,240	96	4,907	1,403	301	527	217	8
Net reserves (increase -)	-3,959	-1,023	2,991	543	-792	-720	-701	-861
Financing gap 1/	1,719	1,119	1,916	860	1,093	1,247	917	869
Net accumulation of arrears (decrease -)	-20,383	373	1,916	...	...	...	...	...
Reschedulings 1/	22,102	746	0	...	...	...	...	...
				(In percent; unless otherwise indicated)				
Memorandum items:								
Current account (in percent of GDP)	10.0	2.8	-8.6	-5.8	-5.3	-5.3	-3.9	-3.4
Non-oil current account/GDP	-24.0	-26.6	-27.0	-26.3	-26.6	-26.6	-25.2	-24.7
Non-oil current account/ non-oil GDP	-33.7	-33.6	-31.8	-30.8	-30.7	-30.8	-29.2	-29.1
Oil and gas sector exports/GDP	51.2	42.3	34.6	36.0	33.2	32.3	30.9	30.5
Non-oil imports/GDP	-20.7	-23.5	-24.0	-23.9	-25.0	-25.7	-25.1	-25.4
Primary balance-GDP ratio	14.1	6.4	-4.9	-2.3	-1.8	-2.0	-0.8	-0.5
Gross official reserves (in millions of U.S. dollars)	9,400	10,423	7,233	6,690	7,482	8,202	8,903	9,764
(In months of imports of goods and nonfactor services)	7.1	7.3	4.6	4.2	4.8	5.1	5.5	5.7
Debt service /exports and goods and nonfactor services	15.3	17.1	18.1	16.8	18.0	18.5	17.7	15.7
Debt service after rescheduling /exports goods and nonfi	7.7	13.2	...	...	...	...	...	...
Interest/exports goods and nonfactor services	7.7	8.1	9.7	9.0	9.5	9.2	9.0	8.4
Debt/GDP	72.2	70.0	71.2	68.5	67.1	64.0	60.0	55.7
Debt/exports and nonfactor service 2/	191.9	161.2	158.4	172.0	180.0	177.4	175.4	167.9
Debt/consolidated revenue	160.3	149.2	177.0	156.5	155.1	152.6	149.8	142.2
Debt service paid	1,714	2,128	1,021	2,000	1,811	1,796	2,033	1,893
Stock of external debt	30,234	29,684	30,393	29,921	29,638	29,358	28,819	28,388
Oil exports (million barrels per day)	1.95	1.87	1.45	1.54	1.58	1.62	1.66	1.70
Oil export price (U.S. dollars per barrel)	28.2	24.3	25.2	25.0	22.5	22.0	21.0	21.0
GDP (in millions of U.S. dollars)	40,496	40,862	41,052	41,883	42,288	43,893	45,873	48,631

Sources: Nigerian authorities; and staff estimates and projections.

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

2/ Three-year moving average of exports.

Table 6. Nigeria: Selected Economic and Financial Indicators (Muddle-Through Scenario), 2002–07 1/

	2002 2/	2003	2004	2005	2006	2007
	(Annual percentage changes; unless otherwise specified)					
National income and prices						
Real GDP (at 1990 factor cost)	-0.9	3.5	2.6	2.4	2.5	2.6
Oil GDP	-14.0	4.8	2.0	2.0	2.0	2.0
Non-oil GDP	5.3	3.0	2.9	2.5	2.7	2.8
Agriculture	5.3	3.0	2.9	2.5	2.6	2.7
Industry	7.0	3.5	3.4	3.1	3.2	3.3
Services	5.0	2.8	2.7	2.4	2.8	2.9
Real GDP per capita	-3.6	0.7	-0.1	-0.3	-0.2	0.1
GDP per capita (in U.S. dollars)	316	310	300	297	295	297
GDP deflator (period average)	11.3	12.4	10.7	12.2	11.3	11.1
Non-oil GDP deflator (period average)	13.4	16.8	16.4	15.2	14.0	12.6
Consumer price index (annual average)	13.4	16.8	16.4	15.2	14.0	12.6
Consumer price index (end of period)	13.8	16.4	15.9	14.6	13.4	12.0
External sector						
Exports, f.o.b.	-16.9	6.6	-6.0	1.5	0.6	5.2
Imports, f.o.b.	8.3	4.8	-3.9	4.2	-0.3	5.3
Non-oil export volume	5.3	6.4	7.1	7.6	8.1	8.8
Oil export volume 3/	-22.6	6.2	2.6	2.6	2.6	2.5
Volume of import of goods and nonfactor services	8.6	1.9	-4.1	2.5	-0.9	3.5
Terms of trade	117.5	113.7	102.0	98.9	93.9	93.2
Nominal effective exchange rate (end of period; - indicates depreciation) 3/	-14.5	...	...	...	...	...
Real effective ex. rate (end of period; - indicates depreciation) 4/	-9.1	...	...	...	...	...
Consolidated government operations 5/						
Total revenue and grants	-5.2	19.8	0.3	7.5	6.5	8.7
Petroleum revenues	-8.1	23.5	-2.1	5.9	3.9	7.5
Nonpetroleum revenue	4.3	9.1	8.2	12.3	13.9	11.7
Total federal expenditure and net lending	1.3	21.0	9.2	9.6	9.0	10.4
Current expenditure 5/	4.6	18.8	5.1	11.4	9.7	11.1
Capital expenditure and net lending 6/	-8.3	32.0	24.8	3.7	6.7	7.8
Money and credit						
Net domestic assets 7/	32.0	27.1	13.2	12.6	11.4	8.3
Net domestic credit 7/	28.2	36.8	20.9	19.0	16.9	13.0
Net credit to consolidated government 7/	22.4	4.2	5.8	5.2	7.0	3.8
Net credit to the federal government 7/	22.4	4.3	5.8	5.2	7.0	3.8
Credit to the rest of the economy 7/	5.9	32.6	15.1	13.9	9.9	9.3
Broad money	19.4	20.3	19.8	18.1	17.1	15.8
Velocity (non-oil GDP/end-of-period broad money)	2.4	2.4	2.4	2.4	2.4	2.4
Treasury Bill rate (percent; end of period) 8/	14.5	...	...	...	...	...
Discount rate (percent; end of period) 8/	18.5	...	...	...	...	...
	(In percent of GDP)					
Investment and saving						
Investment	23.3	23.1	22.2	22.3	21.7	21.3
Public fixed investment	11.7	12.3	11.5	10.3	9.4	8.9
Private fixed investment	11.6	10.9	10.7	12.1	12.3	12.4
Gross national savings	14.7	17.3	16.9	17.0	17.8	17.8
Public	13.0	14.3	11.0	9.7	8.5	7.7
Private	1.7	3.0	5.9	7.3	9.3	10.1
Consolidated government operations 4/						
Total revenue and grants	40.2	41.3	36.4	34.0	31.7	30.2
Of which: petroleum revenue	30.0	31.8	27.3	25.1	22.9	21.6
Total expenditure and net lending	46.0	46.1	44.2	42.1	40.2	38.9
Overall balance (commitment basis)	-5.8	-4.8	-7.9	-8.1	-8.5	-8.7
Primary balance	1.2	1.8	-0.7	-0.7	-1.0	-1.3
Gross domestic debt	25.0	21.4	23.5	26.3	29.5	33.3
External sector						
Current account balance	-8.6	-6.0	-5.7	-5.9	-4.5	-4.2
	(In millions of U.S. dollars; unless otherwise specified)					
Current account balance	-3,667	-2,537	-2,334	-2,441	-1,872	-1,741
Overall balance of payments	-4,907	-1,403	-301	-527	-217	-8
Gross international reserves (end of period)	7,233	5,410	5,278	5,170	5,196	5,580
(equivalent months of imports, c.i.f.)	4.6	3.7	3.8	3.5	3.5	3.6
Price of Nigerian oil (U.S. dollars per barrel)	25.2	25.0	22.5	22.0	21.0	21.0
Production of crude oil (million barrels per day)	1.89	1.98	2.02	2.06	2.10	2.15
IFEM/DAS exchange rate (naira per U.S. dollar; average) 7/	127.6	...	...	...	...	...
Nominal GDP at market prices (in billions of naira)	5,250	6,120	6,970	8,018	9,159	10,449

Sources: Nigerian authorities; and Fund staff estimates and projections.

1/ The muddle-through scenario applies from 2003 onward.
2/ Based on WEO oil price of US$25.2 per barrel and the 2002 budget approved by the National Assembly on March 27, 2002.
3/ The reduction in export volumes is larger than the reduction in total production, due to an increase in domestic allocation of crude oil to NNPC in 2002 from to 2001.
4/ 2002 data are based on latest observations mainly in July 2002.
5/ Consists of the federal, state, and local governments.
6/ Assumes that two-thirds of state and local government expenditure is recurrent expenditure.
7/ In percent of broad money at the beginning of the period.
8/ 2002 data is based on latest observation mainly in October 31, 2002 (for Dutch auction system exchange rate, the midpoint between lowest and highest bid rates is reporte

Table 7. Nigeria: Frequently Used Indicators of Stability and Vulnerability in the Financial and External Sectors, 1998–2002

(In percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	Proj. 2002	Latest 2002	1/
Financial indicators							
Domestic public debt (in billions of naira) 2/	404	795	898	1,016	1,312	...	
Domestic public sector debt 2/	14.3	23.6	21.0	21.4	25.0	...	
Domestic credit	11.0	18.7	11.0	17.5	22.9	21.5	*
Broad money (M2; percent change over preceding December)	24.9	30.7	48.2	27.2	19.4	16.1	*
Private sector credit (percent change over preceding December)	17.9	22.3	30.1	40.9	9.4	14.6	*
Three-month treasury-bill rate (in percent, end of period)	13.0	17.0	13.0	20.5	...	14.5	***
Deposit money banks' prime lending rate (in percent, average)	18.5	19.0	21.3	26.0	...	26.2	***
Deposit money banks' maximum lending rate (in percent; average)	...	...	26.7	31.2	...	31.8	***
Three-month deposit rate (in percent; end of period)	10.6	12.7	10.5	17.9	...	14.9	***
Consumer price index (in percent; end of period)	11.9	0.2	14.5	16.5	13.8	12.3	*
Banking sector total assets (in billions of naira)	761	1,108	1,627	2,011	...	...	
Nonperforming loans as percent of total assets	19.4	25.4	22.6	16.0	...	...	
External indicators							
Exports (goods in current U.S. dollar; percent change, 12-month basis)	-36.3	28.7	64.9	-16.1	-16.9	...	
Imports (goods in current US$, percent change, 12-month basis)	-21.3	40.4	6.8	11.2	8.3	...	
Term of trade (percent change; 12-month basis)	-27.0	31.3	59.2	-10.8	2.6	...	
Current account balance	-6.3	-9.1	10.0	2.8	-8.6	...	
Capital and financial account balance	-2.6	-2.1	-0.9	-1.2	0.5	...	
Net foreign assets of commercial banks (in billions of U.S. dollars)	1.4	1.6	1.9	2.5	2.5	2.5	*
Gross official reserves (in billions of U.S. dollars)	7.1	5.4	9.4	10.4	7.2	8.0	*
Central bank foreign currency position (in billions of U.S. dollars; end of perio	5.0	5.0	8.7	9.1	6.2	5.4	*
Official reserves in months of imports of goods and nonfactor services	7.4	4.4	7.1	7.3	4.6	...	
Ratio of reserve money to reserves	40.4	53.6	41.2	48.4	58.7	73.1	*
Ratio of broad money to reserves	343.3	130.0	100.0	111.3	167.1	146.4	*
Total external debt	95.7	87.2	72.2	70.0	71.2	...	
Ratio of external debt service to exports of goods and nonfactor services	38.9	29.8	15.3	17.1	18.8	...	
Exchange rate (per U.S. dollar; average)	21.9	90.6	74.7	72.6	74.0	....	
Exchange rate (per U.S. dollar; end of period) 4/	86.0	98.7	110.1	113.5	130.0	127.6	**
Parallel market exchange rate premium (in percent; average)	...	7.2	9.0	18.3	...	13.5	**
Real effective exchange rate depreciation (-) (percent change over preceding D	1.7	-51.6	12.2	24.7	...	-9.1	***
Financial market indiciators							
Stock market capitalization (end of period)	6.1	5.1	4.0	3.6	...	...	
Stock market capitalization (percent change; end of period)	-14.4	3.0	77.5	36.5	...	1.5	****
Foreign currency debt rating (Moody's)	not rated	not rated	not rated	not rated	not rated	not rated	
Spread against U.S. dollar benchmark bond (basis points, end of period)	...	...	1,236	1,584	2,478	...	

Sources: Central Bank of Nigeria (CBN); Bloomberg; EMDB; and Fund staff estimates.

1/ Latest observations are as follow: *: August 2002, **: Oct. 31, 2002, ***:July 2002, ****: June 2002.

2/ Outstanding stock of federal government debt, incl. treasury bills and development stocks. Ninenty-one-day treasury bills account for 57 percent of public debt. The figure does not include banks' loans to the federal government or state and local governments.

3/ Net foreign assets plus foreign exchange (FX) credit to government and banks', less deposit money banks FX deposits at the CBN. Does not include FX position arising from off-balance sheet operations.

4/ The naira was devalued at end-December 1998 as the authorities undertood exchange market reforms.

Nigeria: Relations with the Fund

(As of October 31, 2002)

I. **Membership Status:** Joined: 03/30/1961; Article XIV

II. **General Resources Account:**	**SDR Million**	**%Quota**
Quota	1,753.20	100.00
Fund Holdings of Currency	1,753.12	100.00
Reserve position in the Fund	0.14	0.00

III. **SDR Department:**	**SDR Million**	**%Allocation**
Net cumulative allocation	157.16	100.00
Holdings	0.98	0.62

IV. **Outstanding Purchases and Loans:** None

V. **Latest Financial Arrangements**:

Type	Approval Dates	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Aug. 04, 2000	Oct. 31, 2001	788.94	0.00
Stand-By	Jan. 09, 1991	Apr. 08, 1992	319.00	0.00
Stand-By	Feb. 03, 1989	Apr. 30, 1990	475.00	0.00

VI. **Projected Obligations to Fund**:
(SDR Million; based on existing use of resources and present holdings of SDRs):

		forthcoming			
	2002	2003	2004	2005	2006
Charges/interest	0.88	3.45	3.46	3.45	3.45
Total	0.90	3.50	3.50	3.50	3.50

VII. **Implementation of HIPC Initiative**: Not Applicable.

VIII. **Safeguards Assessments**:
Under the Fund's safeguards assessment policy, Central Bank of Nigeria (CBN) was subject to a full safeguards assessment with respect to the Stand-By arrangement, which expired on October 31, 2001. The assessment, which included an on-site visit, was completed on November 28, 2001. The assessment concluded that substantial risks may exist in the legal structure and independence of the Central Bank, and in its financial reporting framework. Implementation of the measures by the CBN needs to be monitored by staff.

IX. **Exchange Rate Arrangement**:

Nigeria's current exchange rate arrangement is classified in the Fund's annual report on *Exchange Arrangements and Exchange Restrictions* as a managed float with no preannounced target for the exchange rate of the naira. The interbank foreign exchange market (IFEM)is segmented into two submarkets. The Central Bank of Nigeria (CBN) sells foreign exchange to legitimate end users through banks that bid , with requests having to be supported by the required documentation. The open Nigerian interbank market (NIFEX) is the market for foreign exchange obtained from other sources than the CBN, including non-oil exports and personal transfers, and the NIFEX rate is freely negotiable among commercial banks, as well as among customers. On February 20, 2001, the CBN issued a circular that forbids banks from transferring funds obtained from the CBN to other banks through NIFEX, effectively segmenting the two markets. On July 22, 2002, the authorities adopted the Dutch auction system (DAS) for selling official foreign exchange to end users. The DAS is a sealed bid multiple price auction system with the marginal rate being the rate that clears the market. Auctions take place twice a week; the CBN announces the amount on offer the day before the auction, and the auction results the day after. Funds purchased from the CBN shall be used for eligible transactions only, subject to stipulated documentation requirements. Such funds are not transferable in the IFEM.

Currently, there are four exchange rates: the DAS auction rate, the NIFEX rate quoted by a group of commercial banks, the *Bureaux de change* rate, and the parallel market rate.

The following exchange rates were quoted on October 25, 2002:

IFEM	N 127.6 = US$1;
NIFEX	N 127.6 = US$1; and
Bureaux de change/parallel market	N 138.5 = US$1.

The exchange rate for the SDR on November 6, 2002 was N 145.09 = SDR 1.

X. **Article IV Consultation**

Nigeria is on the standard 12-month Article IV consultation cycle. The last Article IV consultation discussions were held in Lagos and Abuja during the period March 8–23, 2001. The staff report (SM/01/171, SM/01/187) was discussed by the Executive Board and the consultation concluded on June 29, 2001.

XI. **Technical Assistance (TA) Since 1999**:

Department	**Purpose of TA mission**	**Duration**
MAE	Exploratory TA mission	March 28–April 10, 1999
FAD	Exploratory TA mission	April 6–April 16, 1999
STA	Exploratory TA mission	April 6–April 19, 1999
FAD	Management of government deposits	May 9–15, 1999
STA	Preliminary multisector mission	July 6–July 20, 1999
FAD	Fiscal and budget management	August 10– 28, 1999

STA	Multisector statistics mission	September 6–21, 1999
MAE	Foreign exchange market reform	September 16–21, 1999
MAE	Banking supervision	December 1999
FAD	Fiscal regime for oil and gas	February 8–26, 2000
STA	Balance of payments statistics	November 8–21, 2000
FAD	Resident treasury advisor	Nov. 25, 2000–Feb. 25–2001 and April 8, 2001–July 7, 2001
FAD	Resident budget advisor	January 11–March 11, 2001
FAD	Fiscal federalism	January 24–Feb. 11, 2001
STA	Government finance statistics	January 21–Feb. 3, 2001
FAD	Expenditure management	February 2–10, 2001
STA	Money and banking statistics	March 22–April 4, 2001
MAE	Foreign exchange management	May 28–June 8, 2001
FAD	Resident budget advisor	October 2000 – Dec. 2001
MAE	Financial sector assessment program	Dec. 5 – Dec. 15, 2001
MAE	Financial sector assessment program	Feb. 4 – Feb. 20, 2002
FAD	Public expenditure management	Jan. 29 – Feb. 8, 2002
STA	Government finance statistics	Feb. 28 – March 13, 2002
FAD	Resident budget advisor	Apr. 19 – on going, 2002

XII. **Resident Representative**:

Mr. Gary Moser came on duty as Senior Resident Representative in Abuja on February 26, 2002.

Nigeria: Relations with the World Bank Group

World Bank strategy of assistance to Nigeria

The Bank's Board of Executive Directors approved an update of the World Bank's joint interim strategy for Nigeria in June 2001. The three main pillars of this interim strategy are the following: (i) strengthening economic governance; (ii) promoting private sector-led growth; and (iii) expanding delivery of basic social services to the poor through the empowerment of local communities. The strategy also envisages working with state and local governments.

Key benchmarks for monitoring progress in implementation of this strategy include the following: (i) macroeconomic stability; (ii) a sustainable budget for 2002, with an improved poverty focus; (iii) improved systems for budget formulation and execution and progress in overhauling, public procurement; (iv) progress on privatization; (v) vigorous work by the Federal Anti-Corruption Commission on its mandate; and (vi) the combining of multiple poverty initiatives into a unique strategy. In June 2002, a staff assessment indicated that, despite some gains, progress in achieving these benchmarks had overall been less than anticipated. A subsequent discussion by the Bank Board of this assessment led to a scaling back of the Bank's lending envelope for fiscal year (FY) 2002 from the base case of $400 million to a low case of $200 million.

It is anticipated that in early FY 04, the Board will revisit this issue. It would be unrealistic to expect that substantial progress can be made on key elements of the reform agenda in the run-up to local and national elections in early 2003. In the current increasingly polarized political context, it is extremely difficult to build the consensus around reforms that would allow effective implementation. However, success in conducting the elections and a smooth assumption of office of newly elected administrations will be a historic event in Nigeria. This is likely to be an important factor in the staff assessment informing the next Board discussion. Assuming good progress toward preparation of a poverty reduction strategy paper (PRSP), a full Country Assistance Strategy is planned for calendar-year 2003.

Given the current low-case lending scenario and the difficult political context, the World Bank is focusing its attention in FY 02 on analytic and advisory services to provide the analytic underpinnings for relaunching a serious policy dialogue with the government after the elections. In particular, the Bank is working with other donors to prepare a series of notes on a wide range of policy issues and challenges that Nigeria faces over the next few years. This will be used as an instrument to engage in dialogue with policymakers soon after the elections.

World Bank-IMF relations

The IMF and World Bank staffs maintain a close collaborative relationship on Nigeria. Both institutions are coordinating their policy advice to the government in several different areas. The Bank staff is regularly invited to, and does, join IMF macroeconomic missions, and both are members of a multidonor thematic group on economic governance that seeks to coordinate donor advice and work in this area. In the financial sector, a joint Financial Sector Assessment Program (FSAP) has been conducted. In 2001, Bank staff joined FAD staff in a mission to determine how the newly created Budget Office could be strengthened. Bank staff also participated in and coauthored a report, "Options for Reform of Nigeria's Fiscal Federalism Arrangements," in 2001. The PRSP is also another area of close collaboration between the two institutions.

Under the erstwhile Stand-By Arrangement, the IMF took the lead in the area of macroeconomic stability with the dialogue on structural measures, coordinated with the World Bank. In the absence of a successor IMF-supported program, a detailed matrix stipulating areas where each institution will take the lead in supporting key structural measures, including several areas of joint responsibility such as fiscal transparency, fiscal federalism, budget procedures and institutions, and public debt management has not been agreed.

Lending activities

The World Bank's Nigeria portfolio consists of ten credits, totaling about $785 million. Operations cover activities in education, health, privatization, water, urban development, transport, energy, and economic management. Two credits in the portfolio (the Economic Management and Capacity Building Project and the Privatization Support Project) are focused on economic management and on support for the government's privatization effort. A State Governance and Capacity Building Project, focused on building economic management capacity at the state level, is expected to be ready for approval by the Bank's Board of Executive Directors early in FY 04.

The Economic Management and Capacity Building Project (EMCAP). The EMCAP (US$20 million in IDA financing and cofinancing of US$19.6 million from the U.S. Agency for International Development, the U.K. Department for International Development, the European Union, and Japan) was approved in May 2000. It supports strengthening of key aspects of economic management, including economic and poverty statistics, public expenditure management, public procurement, and external audit and oversight of federal government fiscal operations, including by the legislature and legal and judicial reform. Under the EMCAP, value-for- money audits of selected items of federal government spending (both recurrent and capital) and a corruption survey have been carried out. Other key activities that are being supported include the revision of the 1958 Finance (Management and Control) Act, implementation of procurement reforms, and installation of an integrated Financial and Economic Management Information System.

Privatization Support Credit. The $112 million IDA credit was approved by the World Bank Board in June 2001. The aim of the Privatization Support Credit is to strengthen the overall institutional and policy framework for public enterprise divestiture and improve the institutional capacity of the Bureau of Public Enterprises, the agency responsible for privatization. The project also provides financing for advisory services for privatization of the power sector (the Nigerian Electric Power Authority) and the telecommunications sector (divestiture of the national telecommunications companies, NITEL and M-Tel). In addition, the project supports the divestiture of Lagos State Water through concessioning (an IFC mandate) and rehabilitation of the water supply system in Lagos.

Nonlending activities

The World Bank has placed increased emphasis on its nonlending activities. Work in this area has focused on public expenditure management—through public expenditure reviews at both federal and state levels, a report on state finances, and a report on the states' governance and capacity. Other elements of this work include a study of selected issues in fiscal federalism; a report on managing volatility; a pilot survey of service delivery in basic health in Lagos and Kogi States; a private sector assessment; a rural sector strategy; and a report on the linkages between environment and poverty. A series of policy notes is being prepared for discussion with the government after the elections in 2003.

IFC activities

The IFC's portfolio of projects in Nigeria, which comprises some US$184 million, invested in 26 companies, represents the IFC's largest commitment in sub-Saharan Africa. This covers operations in the areas of general investment—including hotels, transportation, manufacturing, health care, oil services, and telecommunications—the financial sector, and the small- and medium-sized enterprises (SME) sector. Currently, the IFC is in discussions with MTN Nigeria to provide a US$100 million package to assist in the financing of the company's GSM network. The IFC is working to close an innovative financing package to support local contractors for a Shell Production and Development Company-operated joint venture. This US$30 million facility is designed to assist in the augmentation of local content in the Nigerian oil exploration and production sector. Support for local content in the Nigerian oil sector is also evidenced by another IFC operation, which will provide a US$50 million support package to a large, Nigerian-owned oil service company.

World Bank Institute activities (WBI)

Nigeria is one of the WBI's six focus countries in Africa. In line with the World Bank's strategy, the WBI is currently implementing a multiyear program in Nigeria with two entry points: (i) empowering communities and providing security to the poor, and (ii) promoting good governance. Specific activities include workshops on public expenditure management and accountability; courses to strengthen the oversight committees of the legislature and support establishment of a legislative Budget Research Office; investigative journalism courses for the media; and coalition building to fight corruption. To further support the implementation of the World Bank's strategy in Nigeria, the WBI will rely in two new instruments: (i) the Capacity Enhancement Needs Assessment (CENA); and the Country Capacity Enhancement Strategy (CCES). The CENA is being carried out this fiscal year in the context of community-driven development activities. A CCES will be fleshed out during the preparation of the full Country Assistance Strategy.

Nigeria: Statistical Issues

1. Nigeria's statistical base suffers from serious deficiencies that hamper surveillance, policy design, and monitoring. These deficiencies particularly affect the national accounts, government finance, money and banking, and the external accounts, including debt. Numerous problems prevent the compilation of timely, accurate, and internally consistent data, in particular inadequate budgetary resources and insufficient use of computerization in the compilation of statistics.

National accounts

2. Annual national accounts statistics are published by the Federal Office of Statistics (FOS) with about a one-year lag. The national accounts statistics are of poor quality, largely owing to a deterioration in business and household surveys. Estimates of value added for agriculture, mining (oil), industry, transportation, and financial and other services are based on old surveys, with extrapolations that use out-of-date ratios and other indicators. Many sectoral deflators are not soundly based and have a number of inconsistencies. In the past, the use of the official exchange rate has resulted in a gross understatement of value added in the oil and export sectors. The expenditure accounts suffer from unreliable external trade and government budgetary data.

Prices

3. The official monthly consumer price index (CPI) is a composite of urban and rural price data, and the consumption weights are based on the 1985/86 National Consumer Survey. Some data on producer prices are collected, but these statistics are not comprehensive and no producer price index is compiled. As a consequence, some sectoral GDP deflator indices are based not on producer prices, but on consumer price subindices and ad hoc assumptions. Expenditure deflators also suffer from methodological shortcomings.

Government finance

4. Fiscal data in Nigeria have historically been opaque and complicated not only by the federal structure, but also by a multiplicity of off-budget funds and by accounting practices that underestimate the actual size of public expenditure. The multisector statistics mission that visited Nigeria during September 6-21, 1999 noted that the most pressing shortcomings related to inadequate data coverage, and the lack of monthly and quarterly compilation and timeliness.

5. A government finance statistics (GFS) mission in early 2001 found that the authorities had implemented few of the recommendations made by the multisector statistics mission that had visited Nigeria in 1999.

6. Following the creation of a National Committee on Government Finance Statistics (NCGFS), another GFS mission visited Abuja in March 2002 and found no further progress had been made by the NCGFS, notably owing to insufficiently clear institutional arrangements and lack of staff. The mission also identified inconsistencies and difficulties of interpretation across the various source data. The mission conducted a compilation exercise using data for 2000 that showed substantial room for progress in improving the consistency of source data and reconciling between above- and below-the-line data. This exercise compiled data for the consolidated central government and general government, making a special effort to capture the numerous special funds and dedicated accounts that carry out large financial transactions. It used the new *Government Finance Statistics Manual,* 2001 (*GFSM* 2001) framework (but on a cash basis), which has the advantages of integrating stocks and flows and facilitating the presentation of the consolidation of fiscal data.

7. The mission also laid out a detailed three-stage "action plan" and recommended the taking of immediate action to expand the NCGFS and increase GFS unit staffing; improve the consistency of OAGF and central Bank of Nigeria (CBN) source data; expand CBN work to reconcile government financing data (available in-house); and have the GFS unit document an inventory of source data. The action plan suggested that a second step focus on improving the reporting of state and local government operations, as well as ensuring adequate GFS dissemination and that a third step focus on a more complete application of the *GFSM* 2001.

Monetary accounts

8. The authorities have taken steps to implement the key recommendations of past STA money and banking technical assistance missions and the 1999 STA multisector mission. However, a March 2001 follow-up mission found that problems remained, in particular regarding the consistency of the interbank positions. Large and volatile discrepancies in interbank positions, both among the commercial and merchant banks and between the CBN and the commercial and merchant banks, distort monetary aggregates and undermine the usefulness of monetary statistics for policy analysis and decision making.

Balance of payments

9. Balance of payments statistics are compiled from the foreign exchange records in the banking system and from data derived from surveys. However, oil sector data are weakened by the low response rate to survey requests from oil businesses. In the non-oil sectors, only enterprises with foreign capital participation are surveyed. The estimates of non-oil imports of goods and services are based on banking data. Private capital movements are underrecorded, and data on external debt service are inaccurate. Moreover, the trade data reported by the FOS (based on customs data) sharply differ from those reported by the Central Bank of Nigeria (based on banking data). The 1999 STA multisector mission identified actions to be taken for improving the quality of balance of payments data. However, a November 2000 follow-up mission found that no progress had been made by the authorities in implementing the recommendations of the 1999 STA mission. Except for some

methodological changes, the compilation of balance of payments continues to be severely affected by organizational weaknesses and resource constraints in the FOS, customs and the Central Bank of Nigeria.

External debt

10. To address problems with the data on external debt, a United Kingdom-financed technical assistance effort was launched in October 1998. After initial delays, a Debt Management Office was established in August 2000, and good progress has been made in verifying individual loan accounts with creditors' statements and improving the efficiency of debt management in Nigeria. An audit of Nigeria's loan portfolio for correctness and duplication was carried out after the two separate databases of the Federal Ministry of Finance and the Central Bank of Nigeria were merged. In September 2000, the process of reconciling Nigeria's external obligations to multilateral creditors began. Following the Paris Club agreement of December 13, 2000, the verification of individual loan accounts with each individual Paris club creditor was also launched and, by October 2001, was reported to be complete. The full reconciliation of Nigeria's external debt with creditors' statements was expected to be completed by early 2003.

Nigeria: Core Statistical Indicators
(As of October 28, 2002)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of latest Observation	10/25/02	08/02	09/02	09/02	09/02	10/25/02	08/02	07/02	12/01	12/01	2001	12/01
Date received	10/25/02	09/02	11/02	11/02	11/02	10/25/02	09/02	11/02	02/02	02/02	10/02	02/02
Frequency of data 1/	D	M	M	M	M	D	M	M	Q	M	A	A
Frequency of reporting 1/	D	M	M	M	M	D	M	M	Q	M	A	A
Source of data 2/	B	A	A	A	A	B	A	A	A	A	A	A
Mode of reporting 3/	I	M	M	M	M	I	C	V	V	C	V	V
Confidentiality 4/	C	C	C	C	C	C	C	C	C	B	C	B
Frequency of publication 1/	D	M	M	M	M	D	M	A	A	A	A	A

1/ D – Daily; W – Weekly; M – Monthly; Q – Quarterly; A – Annually; V – on mission.
2/ A – Direct reporting by central bank or relevant ministry; B- Private sector publications on the Internet.
3/ C – cable or fax; M – mail; V – staff visit; I - Internet.
4/ B – for use by the staff and the Executive Board; C – unrestricted use.

Nigeria: Selected Social and Demographic Indicators

	Nigeria Latest Single Year		Sub-Saharan countries Latest Single Year	Low-income countries
	1980–85	1994–2000	1994–2000	
Income, population, poverty and income distribution				
Income				
Gross national income per capita (U.S. dollars)	360	260	470	410
Gross national income per capita (idem, PPP terms)	...	800	1,600	1,980
Total population, midyear (millions)	83.2	126.9	658.9	2,459.8
Growth rate (percent annual average 1965-99)	3.1	2.7	2.6	2.0
Urban population (percent of population)	30.7	44.0	34.4	1.9
Poverty (percent of population)				
National head count index	43.0	...	...	...
Urban head count index	31.7	...	...	...
Rural head count index	49.5	...	...	...
International poverty line 1/	...	70.2	...	...
Share of income or consumption				
Lowest quintile (percent of income or consumption)	...	4.4	...	...
Highest quintile (percent of income or consumption)	...	55.7	...	...
Social indicators				
Access to safe water (percent of population)				
Total	...	57	55	76
Urban	...	81	82	88
Rural	...	39	41	70
Life expectancy at birth (years)				
Total	47	47	47	59
Male	46	46	46	58
Female	49	48	47	60
Mortality				
Infant (per thousand live births)	90	84	91	76
Under 5 (per thousand live births)	196	153	162	115
Immunization rate (percent of children under 12 months)				
Measles	17	41	53	57
DPT	16	26	46	57
Child malnutrition (percent under 5 years)	...	27	...	...
Public expenditures				
Health (as percent of GDP)	...	0.8	2.4	1.2
Education (as percent of GDP)	1.1	0.6	3.6	3.4

Source: World Bank, *World Development Indicators*, 2002.

1/ Population below US$1 per day in percent.

Nigeria: Fund Technical Assistance since 2000 and Technical Cooperation Action Plan (TCAP)

In the **public expenditure management** area, several Fund technical assistance missions since April 1999 have assisted the authorities in establishing a basis for reforming budget management and treasury operations. A budget advisor completed a short-term assignment (January—March 2001) to review the Federal Ministry of Finance's (FMOF) capacity for **budget preparation and implementation**. Following this assistance, the authorities established a Budget Office in the FMOF responsible for overseeing all aspects of budget preparation and implementation. An FAD mission in June 2001 identified areas for improvement is strengthening the operations of the Budget Office and improving the call circulars for the 2002 budget. A subsequent FAD review mission in 2002 noted the dangers in advancing the treasury component of the technical assistance without developing parallel areas in the budget formulation. In particular, there is a need to build budget preparation expertise in the Budget Office, as well as to improve the collaboration among the various players in the budget formulation and execution process.

In the area of **treasury operations**, a resident advisor completed an assignment (December 2000-November 2001); however, take-up of the technical assistance by the Nigerian authorities was slow, with only limited progress. After an FAD mission in February 2001 advised on short-term priority measures to improve **cash and payroll management**, and to **automate the Accountant General's Office** (AGO), a peripatetic treasury advisor was assigned for initially two visits of three months each during April-December 2002. In particular, the focus is on (i) improving expenditure reporting, including by reconciling fiscal data; (ii) strengthening expenditure control, including through measures to avoid arrears and increase the control over the payroll; (iii) rationalizing the cash management system, particularly in the execution of the capital budget; and (iv) automating the current accounting and reporting system. The advisor will continue to provide guidance during the implementation of these reform measures in coordination with the World Bank Economic Management Capacity Building Project (EMCAP), whose resources will be needed for the automation of the AGO.

The United Nations Development Program (UNDP)/IMF program has been providing initial technical support for the establishment of a **Budget Monitoring and Price Intelligence Unit** (BMPI) in the Office of the President to assist in ensuring that costs of major budget items are accurate and that contracts are awarded only after **due process** has been followed. A short-term mission (January—February 2001) examined options for improving the **intergovernmental fiscal system** in Nigeria, and training opportunities in fiscal decentralization have been provided.

Nigeria agreed in late 2001 to participate in a project for 14 anglophone African countries, funded by the U.K. Department for International Development (DFID) and executed by the Fund. The project is organized around the General Data Dissemination Standards (GDDS) as a framework for statistical development. The major requirement for participation in the GDDS is the production of metadata—describing current statistical practices and plans for improving those practices, and identifying gaps and areas for technical and financial assistance. The authorities sent a first set of metadata in February 2002, which were, however, deemed as incomplete. The agreement was that the authorities would send a revised set with plans for improvement by the end of April 2002. The authorities are still revising their metadata. The Fund has received a further set of metadata, but it is expected that a Fund staff located in the Nairobi regional office—and specializing in the GDDS--will assist the authorities in early December 2002 or early 2003 in filling out the metadata, so that they can fulfill the requirement for participation. The authorities are keenly interested in receiving technical support as quickly as possible in the area of data compilation as this has been neglected in the past and there is need for upgrading the current statistical system. It is expected that the Fund together with donor countries, will assist the Federal Office of Statistics (FOS), starting perhaps as early as the end of 2002, in upgrading its data system so to bring it in line with the GDDS. In addition, the DFID is—under a three-phase program--providing technical assistance to the FOS in national accounts, and on the devising of a new household survey, which will form the basis for a new consumer price index.

Nigeria: Tentative Work Program, December 2002–June 2003

Staff visits and Executive Board meetings	
Executive Board discussion of 2002 Article IV consultation	December 18, 2002
Staff visit	January—February 2003
Staff visit	June 2003
Technical assistance	
FAD advisor–Office of the Accountant General of the Federation	December 2002–May 2003
STA assistance to complete metadata for GDDS project	December 2002
World Bank	
Country Assitance Strategy	2003
States' finance study	December 2002
Board presentation on Partnership For Eradication of Polio	January 2003
Macroeconomic update note	February 2003
Report on Pilot Survey of Primary Health Service Delivery	March 2003
Board presentation on joint staff assessment (JSA) and interim poverty reduction strategy paper (I-PRSP)	June 2003
Education Country Status Report	June 2003
Discussion with Nigerian government of policy notes on public expenditure management, private sector assessment, rural sector strategy, and linkages between environment and poverty	June 2003
Capacity Enhancement Needs Assessment (CENA)	Ongoing
Country Capacity Enhancement Strategy (CCES)	2003

Statement by the IMF Staff Representative
December 18, 2002

1. This statement provides additional information that has become available since the issuance of the staff report (SM/02/361) on November 25, 2002. This information does not alter the thrust of the staff appraisal.

2. **A Supplementary Appropriations Bill for 2002 of about N 89.5 billion (1.7 percent of GDP) has been passed by the National Assembly and signed by the President.** The major components include about N 28 billion for the Independent National Electoral Commission, N 24 billion for military pensions and N 12.5 billion for foreign embassies. Given that the recurrent expenditure authority will expire at end-year, it is unclear how much of these expenditures will be spent or how they will be financed in 2002. The capital component, however, which is estimated at about N 46 billion (0.9 percent of GDP) can be committed and carried over to next year. In the event that a significant portion of the appropriations is spent in 2002 without offsetting cuts elsewhere, the fiscal outcome will be worse than the staff projections contained in the staff report.

3. **President Obasanjo has submitted the 2003 Appropriations Bill to the National Assembly.** The Bill is ambitious, targeting an overall deficit of 0.6 percent of GDP, implying a sizeable tightening of the fiscal stance relative to the projected outturn for 2002, and a stronger adjustment than envisaged in the staff report. Total consolidated expenditure is envisaged to decline by 7.6 percentage points of GDP, with major expenditure cuts in the payroll, capital spending and domestic interest payments. However, the underlying policy changes to support the expenditure cuts are yet to be elaborated. The budget proposal assumes an oil price of US$21 per barrel, compared to the current price of about US$25-26 per barrel. The President also announced that the government will seek to establish a fiscal rule to stabilize the levels of both capital and recurrent expenditure.

4. **On November 26, the Federal Government announced a buyback auction for the government's par Brady bonds, and associated oil warrants, on a voluntary basis.** The par bonds have a face value of about US$2 billion, and mature in 2020. The expiration date of the buyback offer has been extended from December 6 to December 20, 2002 to allow time for several large bond holders to consider the offer, and because of a U.K. court ruling that associates of the former head of state Sani Abacha could tender their holdings. The floor price for the offer is approximately US$660 for each US$1,000 of principal, of which approximately US$430 is principal and interest collateral. The government has not indicated the amount or average price of the bonds which they expect to buy back. In the short term,

the cost of the buyback would have a modest effect on the level of reserves. If all the bonds were bought back at the floor price, the cash payment would be around US$470 million.

5. **On December 14, 2002, the President signed the anti-money laundering legislation into law immediately following the adoption of the bill by the Senate.** The House of Representatives had earlier approved the bill on December 11, 2002.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/01
FOR IMMEDIATE RELEASE
January 2, 2003

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2002 Article IV Consultation with Nigeria

On December 18, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Nigeria.[1]

Background

A 12-month Stand-By Arrangement for the period July 2000-June 2001 was approved on August 4, 2000. The first review was initially postponed as the program went off track. Directors agreed to a three-month extension of the program until end-October 2001. A staff visit in September to complete the first review under the arrangement found that key program objectives for end-June 2001 had been missed, including lowering inflation to single digits, establishing fiscal discipline, and maintaining a market-based exchange system. The Stand-by Arrangement lapsed at end-October 2001.

The Stand-by Arrangement was replaced by an informal staff-monitored program for a six-month period between October 2001 and March 2002. Targets were set, including the passage of a satisfactory budget for 2002, the containment of reserve money growth, and the narrowing of the differential between the official and parallel foreign exchange rates. A staff review of developments carried out in February–March 2002 found that key end-December 2001 targets had not been met. The authorities and the staff agreed to end the informal staff-monitored

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

program, citing the risk that appropriate macroeconomic polices might not be implemented in 2002, particularly in light of the upcoming presidential elections.

Overall economic performance in 2001 was marked by macroeconomic imbalances. The overall fiscal balance turned from a surplus of 3 percent in 2000 to a deficit of 2.5 percent of GDP in 2001, the external account deteriorated by 8 percentage points of GDP, and inflation accelerated from an average rate of 6.9 percent in 2000 to 18.9 percent in 2001. As fiscal policies became expansionary, the authorities were faced with several policy options. These included implementing offsetting monetary policies, allowing the exchange rate to devalue, or accepting a loss in international reserves. In the event, the authorities continued to implement an inflexible exchange rate policy, which led to a sharp widening in the differential between the official and parallel rates. There was some tightening in monetary policy in the second half of 2001 and early 2002. Real GDP is estimated to have increased by 2.9 percent in 2001, driven largely by the non-oil producing sector, which grew by 4.1 percent, as the agriculture sector performed well and public spending increased rapidly.

In 2002, the staff projects non-oil GDP to grow by over 5.3 percent, in part reflecting a strong agricultural output, boosted by good rains. Overall GDP is expected to decline by about 0.9 percent, largely owing to lower oil production occasioned by the smaller OPEC oil quota. As a result of the tightening of monetary policy in late 2001 and early 2002, the inflation rate declined in the first eight months and is expected to fall eventually to 13.8 percent by end-2002.

The overall expansionary fiscal policy stance remains highly expansionary in 2002, notwithstanding efforts by the executive to contain capital spending. The consolidated cash fiscal deficit of the three tiers of government is expected to reach 4.9 percent of GDP in 2002 (5.8 percent on a commitment basis). The deficit is projected to be financed by a drawdown in government deposits in the banking system and the issuance of short-term debt.

Monetary policy has accommodated the fiscal stance, thereby risking a reversal of the recent gains in lowering inflation. Broad money rose by 17½ percent during the first nine months of the year, compared with a targeted rate of 11½ percent for the same period. Aggregate bank credit to the federal government increased ten-fold during that period, in part because the banking sector's treasury bill holdings rose sharply as the Central Bank of Nigeria (CBN) sold most of its holdings to mop up excess liquidity.

The lax financial policies led to a steep loss of international reserves in the first half of 2002. In view of the rapid reserve loss, the authorities undertook a series of small devaluations during June and July and introduced on July 22 a Dutch auction system. In a contradictory move, the CBN eased monetary policy by lowering the minimum rediscount rate by 200 basis points to 18½ percent and lowered the cash reserve requirement by 300 basis points to 9½ percent but only to those banks that had increased their credit to the real sector by at least 20 percent over the level at end-June. In any event, the new auction system for foreign exchange has helped slow reserve loss while allowing the exchange rate to be more market determined. Overall, international reserves are projected to decline from US$10.4 billion in 2001 to about US$7.2 billion in 2002. The spread between the official and parallel market rate has narrowed to below 10 percent.

Progress on structural reforms has been mixed. On the positive side, the authorities on January 1, 2002, adjusted the maximum retail price of gasoline above import parity and began charging the Nigeria National Petroleum Corporation US$18 per barrel for crude oil used for domestic consumption compared with the US$9.5 charged in 2001. The hike in the retail price of petroleum is a step forward in the deregulation of the downstream petroleum sector. However, the regulatory agency in charge of evaluating the appropriate retail price level every quarter has left retail prices unchanged since April 2002. As a result, domestic gasoline prices have fallen below import parity.

The trade and tariff policies adopted in 2002 suggest an increase in overall tariff and nontariff protection of domestic producers of finished goods, and, therefore, a setback to the government's liberalization efforts. Furthermore, the results on public enterprise reform have been mixed. While the privatization of enterprises in the early phases of the program is all but complete, there have been setbacks in recent privatization efforts, especially with regard to privatizing public utilities, such as the Nigeria Telecommunications Company (NITEL), and the rehabilitation and privatization of the electricity company, NEPA.

The Financial System Stability Assessment (FSSA) concluded that the Nigerian financial system was vulnerable to a number of risks, such as fiscal indiscipline, the economy's high dependence on volatile oil prices, and financial abuse. The report noted that there were serious concerns about the soundness and stability of the banking system, and that the current Nigeria anti-money-laundering framework and enforcement were inadequate. The inefficiencies in the court system, such as delays and backlogs, are also major impediments to the smooth functioning of the financial system.

Executive Board Assessment

Directors agreed with the thrust of the staff appraisal. They considered that the Nigerian economy faces enormous challenges, including in particular the recent legacy of weak policies and institutions, which the authorities have only begun to address. Encouraging aspects of macroeconomic developments since 2001 include a pick-up in non-oil GDP growth, a fall in inflation, and the introduction of a more market-oriented exchange rate policy. Also, progress is being made in institution building, legal reforms, and privatization.

Notwithstanding these encouraging signs, Directors expressed concern that progress has been sporadic, and consequently, macroeconomic imbalances remain large and persistent, and poverty and social indicators are declining. Directors considered that the authorities face a double challenge. In the period to the upcoming elections in March-April 2003, it will be critical to strengthen economic policy management and avoid macroeconomic and financial instability by containing the fiscal deficit and implementing a prudent monetary policy and more flexible exchange rate policy, while moving forward with greater transparency and improved governance. For the medium term, it will be critical to put in place a coherent plan of action to realize Nigeria's considerable growth potential and to reduce poverty. The plan of action will need to be far-reaching, and include: a credible fiscal framework; measures to strengthen institutional capacity, the financial sector, and external and domestic debt management; reform of the civil service; and rebuilding of the physical infrastructure. Also, going forward, good governance will be crucial for strengthening domestic ownership and investor confidence, especially given the key role of Nigeria in the peer review mechanism envisaged under NEPAD. In that regard, Directors urged the authorities to build on the progress achieved by the creation of the Anti-Corruption Commission.

Directors expressed concern that the overall stance of fiscal policy remains highly expansionary—despite efforts to contain capital spending at the executive level—and that the external sector has seen a sharp deterioration in the current account, along with significant foreign exchange reserve losses. These developments are particularly worrisome given the recent relatively high oil prices and the fact that mechanisms for saving excess oil proceeds have not been put in place. Together with a smaller external reserve cushion and a weak banking system, the current fiscal policy stance heightens Nigeria's vulnerability to an oil price downturn. Accordingly, fiscal consolidation remains a priority, and Directors urged the authorities to strengthen expenditure control, especially with regard to the wage bill, while providing for adequate social spending, reprioritizing the capital budget, and ensuring that no new arrears are accumulated.

Directors agreed that a core challenge facing the government in 2003 and beyond is to address the boom-and-bust cycles that have characterized fiscal policies in Nigeria. In this context, they considered that the adoption of policy-based rules, in particular an oil price-based fiscal rule cast in a medium-term context, will contribute to ensuring greater fiscal discipline. While acknowledging that the application of a fiscal rule at the sub-national level will be difficult and time-consuming, Directors urged the authorities to work actively to secure the support and cooperation of state governments, so that it can be applied on a consolidated basis and be effective. In this context, Directors welcomed the draft Fiscal Responsibility Bill, which aims at establishing a framework for fiscal policy rules and harmonizing fiscal relations among all levels of government, and urged the authorities to mobilize broad support for its early enactment. Directors also encouraged the authorities to publish annual audited reports and accounts of the national oil company in order to allow a more effective and transparent monitoring of the receipt of oil revenue.

Directors commended the CBN for actions taken during the course of 2001 and early 2002 to contain inflation. For the period ahead, however, they saw a need for the CBN to stand ready to tighten monetary policy and to use available monetary instruments more actively. To improve the effectiveness of monetary policy, Directors encouraged the authorities to consider developing open market operations further, tightening access for banks to the discount window, and lowering gradually the high mandatory liquidity reserve requirement. Directors also urged the authorities to review their domestic debt management policy with the aim, among other things, of lengthening the maturity structure of treasury bills.

Directors welcomed the introduction of the Dutch auction exchange rate system, which is a key first step in promoting increased flexibility in the management of the exchange rate. They noted that the spread between the official rate and the parallel rate has narrowed and that the real exchange rate has depreciated modestly, but emphasized that further exchange rate flexibility will be required to safeguard Nigeria's external reserves. Directors also urged the authorities to eliminate the multiple currency practices and take further steps to establish a single, unified foreign exchange market.

Directors commended the authorities' participation in the Financial Sector Assessment Program, and welcomed the authorities' commitment to make concerted efforts to address weaknesses identified in the Financial System Stability Assessment report, particularly with respect to banking supervision, anti-money laundering, and upgrading of the payment system. They urged speedy passage and effective implementation of the proposed amendment of the Banks and Other Financial Institutions Act, which will help promote banks' compliance with the Basel Core Principles. In light of the vulnerability of the financial system to criminal abuse, Directors welcomed the authorities' determination to fight money-laundering and the financing of terrorism, and encouraged them to implement rigorously the financial crime legislation recently signed by the President.

Directors regretted the recent increase in Nigeria's tariff and nontariff protection, which can act as a brake on the development of the non-oil sector. They urged the authorities to renew their commitment to trade liberalization by simplifying the tariff regime, lowering the peak and average tariffs, and avoiding ad hoc changes, consistent with the objective of convergence with the ECOWAS common external tariff by 2006-07.

Directors were of the view that a firm political resolve to implement far-reaching reforms designed to promote financial stability and encourage growth will be crucial in helping Nigeria strengthen its international credibility and re-establish confidence. Establishing a track record of sound performance in the context of a comprehensive program will also be helpful in preparing the way for negotiations on a possible medium-term debt restructuring. Directors noted with concern the build-up of arrears to bilateral official creditors, and urged the authorities to aim to ensure prompt, timely, and equitable repayment of debt obligations. They took note of the announced intention to make small payments to these creditors this year, and urged the authorities to conclude the remaining Paris Club bilateral agreements as soon as possible.

Directors commended the authorities on the progress made with privatization, and urged them to pursue this path drawing on the lessons from some recent setbacks. They agreed with the view that privatization of the national telecommunications and power companies, as well as the commercialization of the national oil company, may be critical for boosting private sector growth. Directors noted that investor interest in the enterprises concerned will be heightened if the privatization process is seen to be pursued in a transparent and professional manner, without actual or perceived political interference.

Directors were of the view that the preparation of an Interim Poverty Reduction Strategy Paper (I-PRSP) should play a key role in helping the authorities develop policy reforms aimed at reducing poverty and enhancing sustainable growth. To be effective, the participatory process underlying the I-PRSP should be broad, and based on policy coordination among government agencies. Federal and sub-national government spending priorities should be reoriented toward raising the long-term growth prospects of the economy, with targeted social policies and structural reforms aimed at developing the non-oil producing sectors—and in particular, agriculture—which will foster employment creation and help with poverty alleviation. Directors welcomed the publication of the government's homegrown medium-term economic framework, and expressed the hope that it can be speedily integrated into the PRSP process, which is designed to help frame the authorities' medium-term policy objectives and strengthen public expenditure management and overall transparency and accountability .

Directors emphasized that the technical support of the Fund and other development partners will continue to have a crucial role in helping the authorities to build institutional capacity and follow through effectively on reforms. They expressed disappointment at the limited impact thus far of technical assistance in Nigeria, and urged the authorities to take steps to enhance ownership and ensure adequate follow-up on recommendations. Improved coordination among providers and recipients, and better understanding of the capacity constraints facing Nigeria, along with prioritization of technical assistance projects, will be helpful in this respect. In this context, Directors welcomed the establishment of the Economic Technical Committee to improve policy coordination among the various government agencies.

Directors noted that the ability of Nigeria's statistical agencies to compile statistics on fiscal operations, national accounts, and the balance of payments is seriously impaired. They urged the authorities to provide the necessary funding for statistical agencies on a priority basis, to lay the groundwork for effective monitoring of macroeconomic developments and policy formulation. Directors welcomed the authorities' agreement to accept technical assistance, including from the Fund, to rebuild the country's economic database.

It is expected that the next Article IV consultation with Nigeria will be held on the standard 12-month cycle.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Nigeria: Selected Economic Indicators

	1999	2000	2001	2002 1/
Real economy				
Real GDP (at 1990 factor cost, change in percent)	0.9	4.2	2.9	-0.9
Non-oil real GDP (change in percent)	4.2	3.0	4.1	5.3
GDP per capita (in U.S. dollars)	294.0	327.0	322.0	316.0
Production of crude oil (million barrels per day)	2.110	2.249	2.26	1.89
Consumer price index (change in percent; end of period)	0.2	14.5	16.5	13.8
Gross domestic investment (percent of GDP)	21.6	17.7	20.1	23.3
Consolidated government operations (in percent of GDP)				
Total revenues and grants	29.3	45.0	46.9	40.2
Of which: petroleum revenue	21.4	37.0	36.1	30.0
Total expenditure and net lending	34.4	38.6	50.2	46.0
Overall balance (commitment basis)	-5.1	6.4	-3.3	-5.8
Primary balance	3.2	13.0	2.8	1.2
Gross domestic debt	23.6	21.0	21.4	25.0
Money and credit				
Net domestic assets 2/	17.2	-25.4	12.7	32.0
Net credit to consolidated government 2/	41.8	-42.3	11.4	22.4
Credit to the rest of the economy 2/	21.6	19.3	23.0	5.9
Broad money (change in percent)	30.7	48.2	27.2	19.4
Discount rate (percent; end of period) 3/	18.0	14.0	20.5	18.5
External sector				
Current account balance (in percent of GDP)	-9.1	10.0	2.8	-8.6
External debt service due after rescheduling 2000-01 (In percent of GNFS exports)	29.8	15.3	17.1	18.1
Export of crude oil (million barrels per day)	1.81	1.95	1.87	1.45
Price of Nigerian oil (U.S. dollars per barrel)	18.0	28.2	24.3	25.2
Real effective exchange rate (End of period; '-' indicates depreciation) 4/	-9.6	12.2	24.7	-9.1
Fund Position (as at October 31, 2002)				
Quota (in millions of SDRs)				1,753.2
Outstanding purchases and loans (in millions of SDRs)				0.0
Exchange rate (as at October 31, 2002)				
Exchange rate regime	Managed float with no pre-announced target			
DAS rate (Dutch auction, ex-IFEM, naira per U.S. dollar)				127.6
NIFEX rate (open interbank market, naira per U.S. dollar)				126.5
Parallel market rate (naira per U.S. dollar)				137.0

Sources: Nigerian authorities; and IMF staff estimates and projections.

1/ Staff projections.
2/ In percent of broad money at the beginning of the period.
3/ 2002 data is based on latest observation, that is, October 31, 2002 (for DAS exchange rate, the mid-point between lowest and highest bid rates is reported).
4/ 2002 data is based on latest observation, that is, July 2002.