



# The resource conundrum

Why is oil-exporting Nigeria in crisis  
with high oil prices?

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## Executive summary

**This paper examines in great detail the impact of the Russia-Ukraine war on the Nigerian economy for the purpose of informing experts and non-experts alongside providing recommendations to the government<sup>1</sup>.** Specifically, it evaluates the trade, monetary, fiscal and macroeconomic conditions of the economy since the war began, as well as debt vulnerabilities, whilst discussing the official response so far, and seeking to forge a path for the government and its international partners.

**Nigeria's monetary and fiscal conditions have deteriorated since the war began.** As a major oil producer, one could expect that Nigeria would benefit, without nuance, from higher energy prices. This has not been the case: declining oil production at a time when oil prices led to less of an export boost than expected. Moreover, the rise in the global price of food and fertilisers has translated to higher input costs for households and firms. Meanwhile, spending on oil imports and other merchandise imports, as well as various services (for instance, medical payments and tuition fees) are significant enough to have increased the demand for foreign exchange, consuming most of the increase in income associated with being an oil-exporter and causing a depreciation of the naira.

**Households in Nigeria, regardless of their income strata, experience a decline in average real income due to increases in prices of food, fertiliser and fuel since the Russia-Ukraine war began.**

**On monetary policy, the CBN's financing of the government deficit has also created a weakness that has questioned its independence and made the naira increasingly vulnerable to speculation.** Put together, tolerating these domestic economic weaknesses has contributed to the depreciation of the naira, which is not completely reflected in the official foreign exchange market. With stagnation in non-oil revenues and continuous increase in public spending, the government has had to increasingly turn to debt to finance its development needs. The IMF classified Nigeria's debt as sustainable but points out that threats exist over the medium run, due to the high ratio of interest payments to public revenue<sup>2</sup>.

**The analysis presented in the paper shows that war will have a positive impact on real income at the macro level.** Considering the increase in prices experienced in the first half of 2022, real income at the macro level is expected to increase by 3.6% in 2022 while multi-year simulations find that real income will increase by 3.9% in 2023 and 2024, as Nigeria gains from being a net exporter of fuel and natural gas and loses on the basis that it is a net importer of food commodities such as wheat.

**However, the results at the household level are quite different: the ultra-poor households are worst hit by the war – food expenses are taking a higher share of their income.** Further analysis shows that all households experience a decline in average real income (welfare gains are negative). But the lowest

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<sup>1</sup> The author wishes to thank Rabah Arezki for his advice on this paper and Theodore Humann for excellent research assistance

<sup>2</sup> IMF, 2022. 2021 Article IV Consultation – Press Release; Staff Report; Staff Statement, and Statement by the Executive Director for Nigeria.

quintile households suffer the most from higher expenditure, (3.3% relative to 1.4% for the top quintile) while they experience a decline in average real income (-0.4%).

## Introduction

**Nigeria, the largest country in Sub-Saharan Africa in population and in GDP faces a storm of multiple crises.** For many countries in the region, Russia's invasion of Ukraine has set off an increase in energy and food costs, with deteriorating fiscal and external positions. Historically, Nigeria has benefitted from oil price windfalls. This time, it is failing to reap the gains of the higher oil prices. Why is it the case? In examining Nigeria's vulnerabilities, this paper shows that this concept is more complex than simple trade exposures.

**Worse, it is experiencing a multiplicity of crises, including high inflation, rising fiscal deficits and falling investment.** The pressures from a rising dollar and higher global interest rates are leading to imported inflation and financial outflows. The direct impact is strongest on the poor: the rise in the prices of fuel, food and fertiliser has disproportionately affected poor households, who spend a relatively larger share of their income on transport and food.

**The reasons for these economic weaknesses are complex, and this paper covers several aspects, from macroeconomic imbalances to the household level impact of the war.** From an exports' perspective, Nigeria's oil production has turned from a strength to a challenge. Previously among the top-6 Organization of the Petroleum Exporting Countries (OPEC), the country has faced declining production in recent times and is presently unable to meet its OPEC production quota. In addition, it exports crude oil but is a large importer of refined products, having failed to develop domestic refinement capacity.

**Nigeria's inability to emerge as a success story is underpinned by its overreliance on oil for exports and public revenues, as well as poor governance in the oil sector and public sector.**

### What is economic vulnerability?

In the immediate aftermath of the war in Ukraine, countries with large financing needs and food imports bill received a lot of attention. The case of Nigeria shows that the concept of economic vulnerability is more complex: the fact that the largest oil exporter on the continent was unable to transform this price windfalls into economic gains, and might even suffer from one of the largest macroeconomic shocks, is puzzling. This exploration will lead to a later paper analysing dynamics for oil exporters.

**At the same time, the environment of domestic economic weaknesses has put pressure on the exchange rate, causing the naira to depreciate by up to 60% in the parallel market relative to the rate offered at the official exchange rate window.** This comes in conjunction with external factors including the tightening monetary policy in developed economies, strengthened US dollar, and an increase in investor risk aversion (emanating in part, from the upcoming 2023 general elections). The downward trend of the naira not only pushes inflation but has led the Central Bank to intervene more in the official foreign exchange market, adding pressures on reserves. Despite monetary policy rate hikes, the Central Bank has been unable to stabilise prices due to a weak monetary transmission mechanism.

**Simply put, the country's inability to emerge as a success story is underpinned by its overreliance on oil for exports and public revenues, as well as poor governance in the oil sector and public sector.**

Because oil *'fuels the economy'* - accounting for four-fifths of export earnings and two-fifths of public revenues, no other sector has the ability to compensate for weak growth in oil exports.

**In addition, previous earnings both from oil and non-oil sectors have been depleted.** Those two mistakes complicate the task of financing fuel and food imports, stabilise the exchange rate, and absorb capital outflows. The common factors behind the poor performance of the oil sector and more generally in the public sector are a weak rule of law, high corruption, and poor regulatory governance. High deficits financed by monetary advances from the central bank also reveal an inefficient macroeconomic framework.

**This paper's objective is twofold: it examines the short-term impacts of the war in Ukraine on Nigeria's fiscal and trade positions, as well as its debt levels.** The assessment of the nature and extent of the impact of the shocks uses macro- and micro-level approaches: the former examines the effects on real income and the latter the effects on households in Nigeria. The second broad objective is to discuss the policy responses of the Nigerian government and to provide advice on how policy gaps can be filled by the government and international partners.

**As part of the recommendations, to ensure that oil revenue plays a more critical role in counter-cyclical policies, contribution rates for the Excess Crude Account and Sovereign Wealth Funds will need to be increased and withdrawals should require additional oversight, including parliamentary approval.** Furthermore, improved economic governance in the form of public expenditure and revenue reforms, civil service reforms, commitment to tougher anti-corruption enforcement, and overall institutional development is also required. With regards to food security, the government can assist farmers - who mostly operate on a small scale - to expand production and value addition by upskilling them on modern farming practices and value chain development while solving perennial issues around land tenure security and more broadly, land governance.

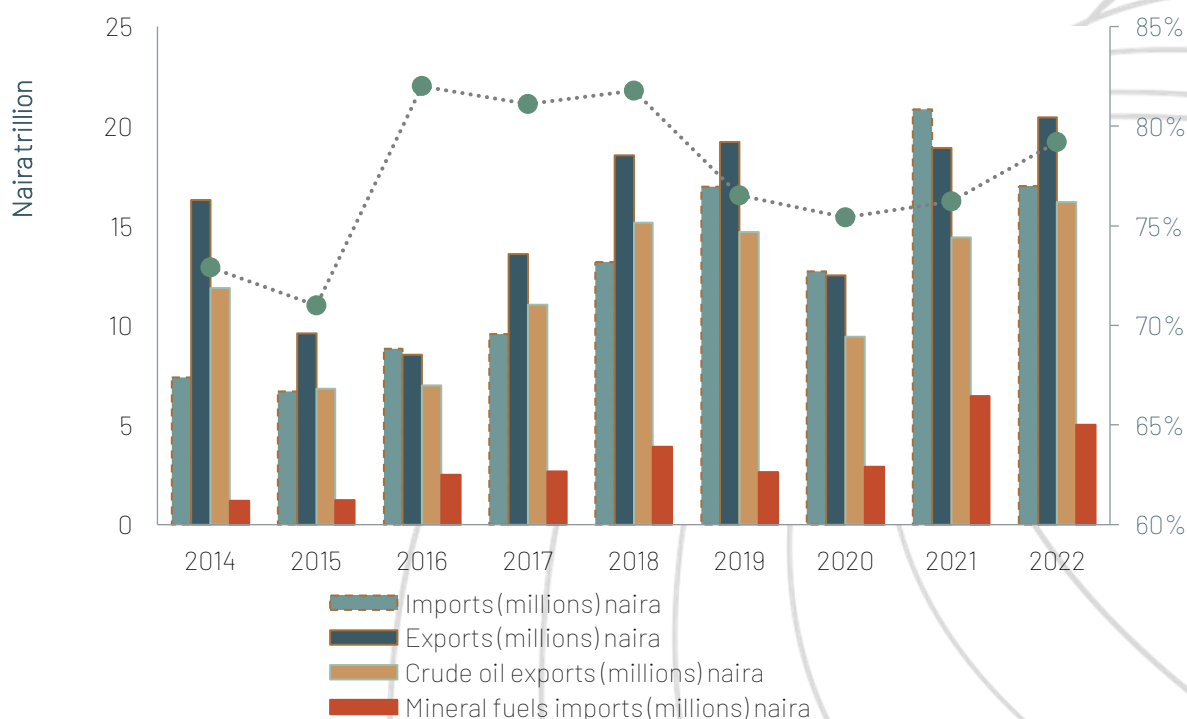
# 1. External pressure builds up

The main apparent direct effect of the war in Ukraine is through prices. For various reasons, however, this direct effect was moderate. While we could expect a boost to Nigeria's exports due to the importance of oil, the effect is muted by the need to import refined oil products. At the same time, with a relatively small food import bill, the negative effect is contained.

## Little benefits from the terms of trade booms due to the lack of supply response in the oil sector

**As a key oil and gas exporter in the region, one could expect a large positive impact of global energy demand on Nigeria.** In fact, Nigeria's trade balance continues to improve as (crude oil) exports rise amid declining imports. Crude oil exports increased from 12.4% of GDP to 13.1% between the first and second quarters of 2022 from 8.6% in the fourth quarter of 2021 (Figure 1). Non-crude oil exports, on the other hand, have stagnated at 3% of GDP since end-2021. Trade surpluses in Nigeria are thus linked to the price of oil: in general, positive when prices are high, and in deficit when oil price declined, such as in 2016 and 2020.

FIGURE 1. OVERALL AND CRUDE OIL TRADE BALANCE AS A SHARE OF GDP, PERCENT (%); 2018-2022Q3



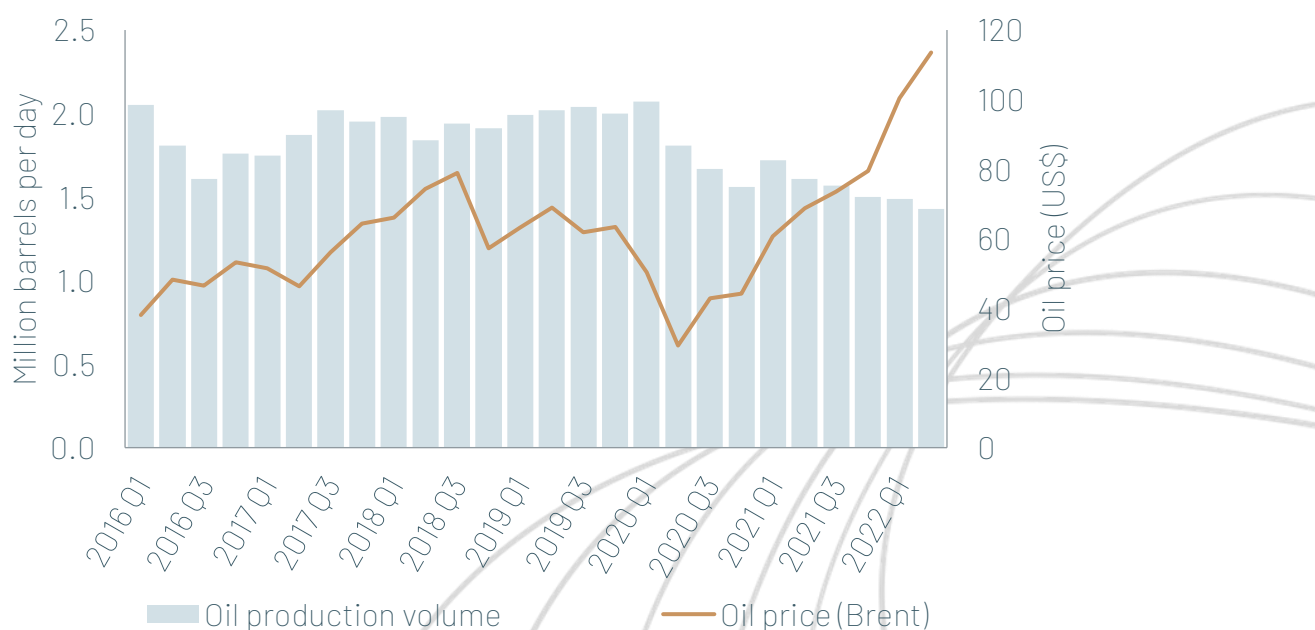
Source: National Bureau of Statistics, 2018 - 2022

**Official data shows that crude oil production has declined significantly in recent times - from about 2 million barrels per day in the first quarter of 2020 to 1.4 million in the second quarter of 2022 (see Figure 2).** It is also worse than oil production in 2009-2010 period under persistent and heavy militant

attacks in the Niger Delta. Organised oil theft, conflict and insecurity, and artisanal oil refining, which have been common occurrences in oil-producing regions, are worsening (see Asuni, 2009)<sup>3</sup>. This has led to a spate of divestments by international oil companies including Shell, ExxonMobil, and Total with some of them moving to solely offshore operations while others have exited the country altogether<sup>4</sup>.

**If production volumes had remained the same as they were in 2020, Nigeria would have benefitted from increased crude oil exports of up to NGN1.5 trillion (US\$3.5 billion) in the second quarter of 2022 alone.** To put this in context, this is twice the value of the Eurobond issuance in March 2022, or about 10% of the 2022 budget. Due to the fact that as oil production declines the real trade balance worsens as well, the naira continues to depreciate even as the country enjoys a favourable trade balance. In summary, the increase in crude oil prices merely compensated for reduced quantities, making up for what could be a much larger trade deficit.

**FIGURE 2. CRUDE OIL PRODUCTION VOLUME AND BRENT CRUDE OIL PRICE; 2016Q1 – 2022Q2**



Source: National Bureau of Statistics, 2022. National Gross Domestic Report.

## And vulnerability stems from the need to import refined oil products, food and fertilisers

*At the same time, Nigeria is a net importer of food and fertilisers, which prices have also risen globally with the war in Ukraine. Worse, it imports large quantities of refined oil as it has little domestic refining capacity.*

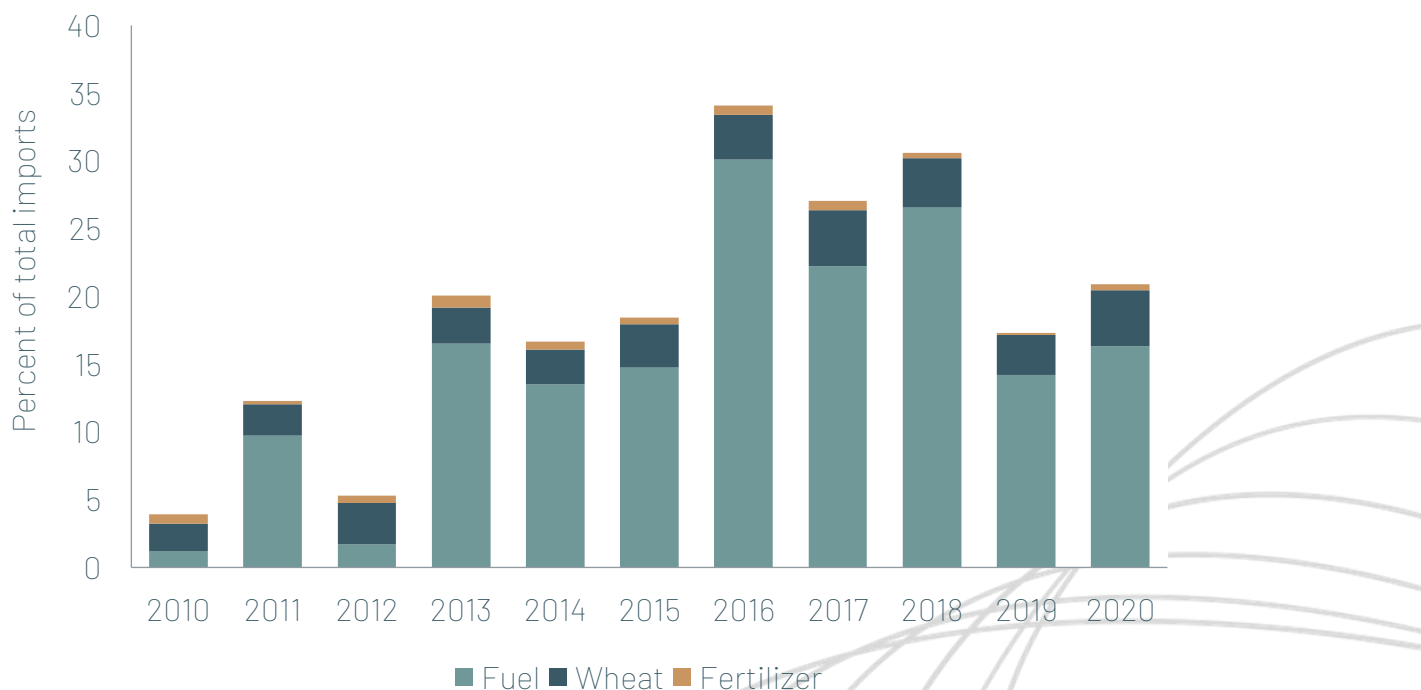
<sup>3</sup> Asuni, J.B., 2009. Blood oil in the Niger Delta (Vol. 229). United States Institute of Peace.

<sup>4</sup> Arise, 2022. Why International Oil Companies Are Leaving Nigeria; Deputy Oil Minister Sylva. Retrieved from: <https://www.arise.tv/why-international-oil-companies-are-leaving-nigeria-deputy-oil-minister-sylva/>

On the imports side, the first-order effects of the war on Nigeria comes from its imports of oil and gas, grains and fertilisers – whose global supply has been affected by the war.

**Most significantly, Nigeria is a large importer of fuel.** In the past decade, fuel import as a share of goods imports has averaged 17% (see Figure 3), pointing to the dominant use of imported fuel in the economy as local refineries are largely inactive<sup>5</sup>.

**FIGURE 3. NIGERIA’S FUEL, WHEAT AND FERTILISER IMPORTS AS A SHARE OF GOODS IMPORTS, 2010 – 2020**



Although wheat and fertiliser imports as a share of goods imports are much lower at 4% and 1%, the rise in the global price of these commodities has translated to higher input costs for households and firms causing sustained increments in the prices of commodities.

*To summarise, spending on oil imports and other merchandise imports, as well as various services (for instance, medical payments and tuition fees) are significant enough to have increased the demand for foreign exchange, consuming most of the increase in income associated with being an oil-exporter and causing a depreciation of the naira.*

<sup>5</sup> Source: The Observatory of Economic Complexity, World Bank's World Integrated Trade Solution, World Development Indicators



## 2. With a weak monetary framework

*External pressures have had ripple effects on an already weak macroeconomic framework: imported inflation and a delayed response by the Central Bank has allowed prices to soar, while economic growth is deteriorating.*

### The largest source of concern are reserves and the exchange rate

**Beyond effects through the trade channel, Nigeria's vulnerabilities concentrate on the financial channel, especially as central banks in advanced economies have tightened their policies.** They have contributed to exchange rate volatility through the rise in advanced economy yields, a strengthening in the US dollar, and an increase in investor risk aversion. Higher global interest rates have had a negative impact on the value of the Nigerian naira against the dollar and the pound. Since February 2022, the naira has depreciated by 6.5% at the official exchange rate window from NGN415/US\$1 to NGN442/US\$1 in November 2022, and by up to 60% at the parallel market<sup>6</sup>. A keenly contested presidential election has also raised concerns among international investors as interest parties hold their positions and are keeping an eye out for the outcome of the elections.

**In addition, considering that the official exchange rate is not market-determined, the CBN is unable to adequately supply foreign exchange at the rate specified in the official window.** A clear example is Emirates Airline suspending its Nigeria operations in November 2022 (for the second time in 2022), because of the inability of the government to repatriate its funds<sup>7</sup>.

**In addition, the multiple currency practice the CBN has maintained over the years mandates that it intervenes in the foreign exchange market.** This is due to the necessity to stabilise the exchange rate at the official window (the Nigerian Autonomous Foreign Exchange [NAFEX] window) once market forces determine otherwise<sup>8</sup>. Multiple currency practice in this instance refers to the several windows through which foreign exchange is traded. However, such foreign exchange interventions have been shown to exacerbate negative exchange rate volatility rather than stem volatility<sup>9</sup>. It also has implications on foreign reserves – since February 2022, Nigeria's foreign reserves have declined by 10% from US\$39.6 billion to US\$36 billion in November 2022<sup>10</sup>. Even before the war, total reserves in 2020 barely covered up to 6 months of imports (see Figure 4).

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<sup>6</sup> Central Bank of Nigeria, 2022. Exchange rate. Retrieved from: <https://www.cbn.gov.ng/rates/ExchRateByCurrency.asp>

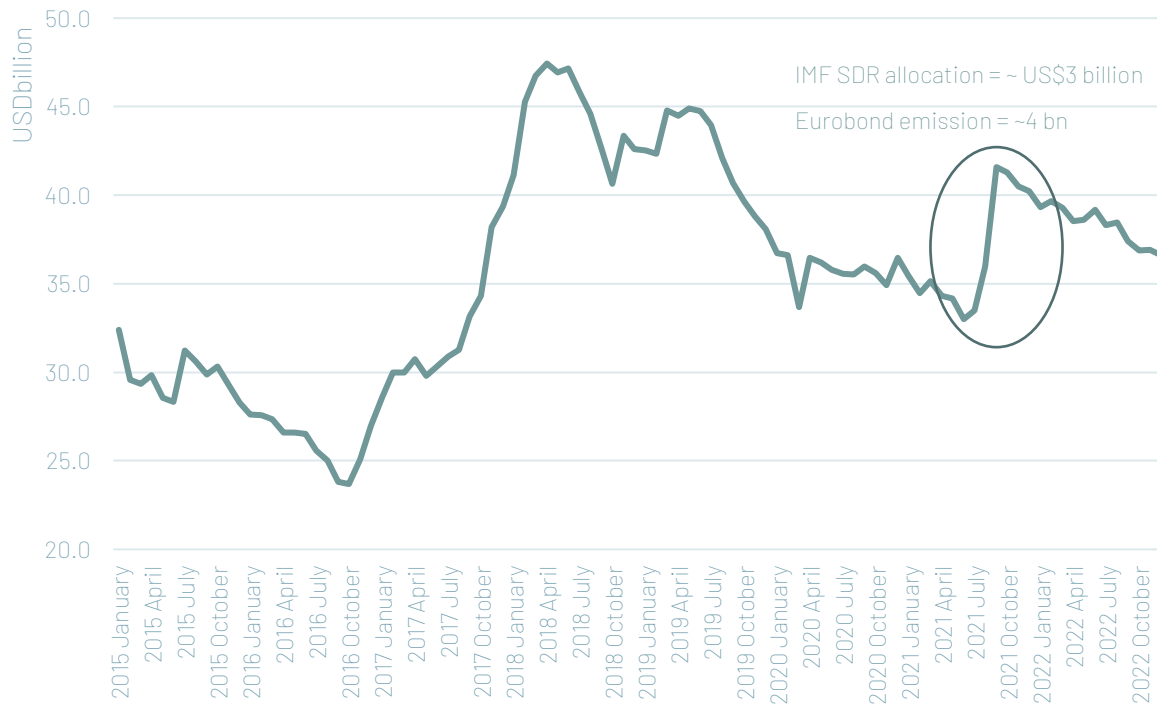
<sup>7</sup> Ayodele, 2022. Emirates Airlines suspends flight operations to Nigeria over foreign exchange crisis. Retrieved from: <https://nairametrics.com/2022/11/03/emirates-airlines-suspends-flight-operations-to-nigeria-over-foreign-exchange-crisis/>

<sup>8</sup> Aitalohi, G., 2021. Resilience through Reforms. The World Bank.

<sup>9</sup> Mohanty, M.S., 2013. Market Volatility and Foreign Exchange Intervention in EMEs: What Has Changed? - An Overview. An Overview (October 2013). BIS Paper, (73a).

<sup>10</sup> Central Bank of Nigeria, 2022. Gross and Liquid Reserves.

FIGURE 4. NIGERIA'S TOTAL RESERVES IN MONTHS OF IMPORTS, 2010-2023



Source: Central Bank of Nigeria, IMF

## Pressures on the naira cause domestic inflation

**Nigeria's inflation has accelerated since the onset of the war – from 15.7% in the first quarter of 2022 to 20.3% in the third quarter of 2022, and further to 21.5% in the fourth quarter of 2022<sup>11</sup>.** This represents an alarming 37% growth in inflation since the beginning of the war. The situation is even more dire for food products as the growth rate of food inflation reached 32.5% between the first and third quarters of 2022 - food inflation increased from 17.2% to 22.8% during the period. The steep rise in the prices of food have implications for malnutrition, food insecurity and poverty. Most people living in poverty reduce their consumption of high-quality nutritious foods in the face of rising food prices and for those that do not, an even higher share of their income is spent on food expenses pushing them further into poverty<sup>12</sup>.

## Monetary policy with conflicting objectives is limited in its reaction

**In response to the rising inflation, the CBN increased the policy rate for the fourth time in 2022, in November, by 100 basis points, to 16.5%, adding up to a cumulative 500 basis points since February 2022.** The central bank also increased the minimum cash reserve ratio (CRR) by 500 bps, to 32.5%, from 27.5% previously to reduce money supply to curb inflation, but

**Unenlightened monetary policy decisions have created domestic economic weaknesses that underline the exchange rate volatility**

<sup>11</sup> National Bureau of Statistics, 2022. CPI and Inflation Report.

<sup>12</sup> Iannotti, L.L., Robles, M., Pachón, H. and Chiarella, C., 2012. Food prices and poverty negatively affect micronutrient intakes in Guatemala. *The Journal of Nutrition*, 142(8), pp.1568-1576.

kept the liquidity ratio unchanged at 30%<sup>13</sup>. Until recently, CBN had difficulties limiting money supply growth, which was 21% y-o-y in August, 2022. In other words, in addition to imported and domestic supply factors, there is a significant monetary component behind the inflationary spiral. This makes the increase in the policy rate as well as the minimum CRR notable because they can potentially be good tools for curbing money supply and more broadly speaking, inflation.

**The limitations of the overall framework of the Central Bank of Nigeria's (CBN) monetary policy actions are due to two factors: its role in financing ongoing government deficits, and in providing direct credit.** There has been a persistent rise in money supply: broad money has increased from 2.5% of GDP between 2012-2016 to 3% between 2017-2021<sup>14</sup>. At the same time, the CBN's loan provision programmes have made cheap credit available to nearly all sectors. Presently, the CBN guarantees at least 16 financing interventions cutting across multiple sectors including agriculture, entertainment, and manufacturing. These financing interventions provide loans to firms at interest rates lower than what is available at commercial banks but they are taken as grants in most cases and are consequently not paid back by borrowers.

**The CBN's financing of the government deficit has also created a weakness that has questioned its independence and made the naira increasingly vulnerable to speculation.** Credit to the government, or ways and means finance, has increased from negative terms to 1% of GDP in the past decade<sup>15</sup>. Put together, tolerating these domestic economic weaknesses has contributed to the depreciation of the naira which is not completely reflected in the official foreign exchange market. The Central Bank has also redesigned the naira and is phasing out the old currency notes as a way to ensure that money in circulation is within the formal banking system. This move is expected to curb inflation and, at the same time, to address age-long concerns such as illicit financial flows.

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<sup>13</sup> Central Bank of Nigeria, 2022. Monetary Policy Decisions. Retrieved from: <https://yourbudgit.com/infographics/the-2023-proposed-budget-breakdown/>

<sup>14</sup> National Bureau of Statistics, 2022.

<sup>15</sup> National Bureau of Statistics, 2022.

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### 3. And a deteriorating fiscal sector unable to meet its objectives

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*After inflation, the second main effect of the crisis is through the deficit. Two sources dominate: high costs of finance which lead to high debt service and increasing costs of the fuel subsidy.*

#### Rising oil subsidy payments and cost of debt service have deteriorated the government's fiscal position

**Budget deficit, after free running inflation, is a major cause for concern. Estimates show that Nigeria's fiscal deficit remains high and could increase to -6.2% of GDP in 2022 from -6.0% in 2021 and -4.7% in the pre-pandemic 2019<sup>16</sup>.** The root cause of high fiscal deficits in Nigeria is twofold: persistently low revenues and low-efficiency spending. Government revenues remain low partly because of the lukewarm tax payment behaviour - Nigeria has one of the lowest tax-to-GDP ratios globally at 5.5% in 2020, despite being Africa's largest economy<sup>17</sup>. Low trust in government and bureaucracy is one of the main factors. Oil revenues, which used to be a major source of income for the government, are now declining, even in a high-price environment. This is due to over-ambitious oil production targets in budget documents alongside persistent and heavy reliance on Excess Crude Oil savings owing to non-oil revenue underperformance.

**In addition, higher global oil prices have had severe consequences on government spending through subsidies on petroleum products.** Fuel subsidy payments were estimated at US\$15.5 billion cumulatively between 2006 and 2019, but projections show that payments could reach US\$13.6 billion in 2022 alone and US\$15.2 billion in 2023<sup>18</sup>. Oil prices in 2023 will play a significant role in future deficits. Projections show that the shortfall in oil revenue could lead to a fiscal deficit of US\$21.3 billion at end-2022, under the assumption that the crude oil price continues to maintain the current level averaging US\$104.7 per barrel<sup>19</sup>. However, a 20% decline in crude oil prices from US\$104.7 would result in the fiscal deficit for year 2022 increasing to US\$21.6 billion. Meanwhile, a 10% increase in the crude oil price will reduce the fiscal deficit to US\$21.1 billion<sup>20</sup>.

**However, the largest item in the government budget is debt service payments.** Spendings on other budget items have increased as well - debt service payments remain the largest budget item in both 2021 and 2022 (NGN3.12 trillion [US\$7.06 billion] in 2021 and NGN3.9 trillion [US\$8.8 billion] in 2022). At the

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<sup>16</sup> IMF, 2022. Regional Economic Outlook. Sub-Saharan Africa. Living on the Edge.

<sup>17</sup> OECD, 2022. Revenue Statistics in Africa 2022 — Nigeria. Retrieved from: <https://www.oecd.org/tax/tax-policy/revenue-statistics-africa-nigeria.pdf>

<sup>18</sup> Nigeria Extractives Industries Transparency Initiative (NEITI), 2020. Oil and Gas Industry Report. Retrieved from: <https://neiti.gov.ng/cms/wp-content/uploads/2022/03/NEITI-OGA-2020-Report.pdf>

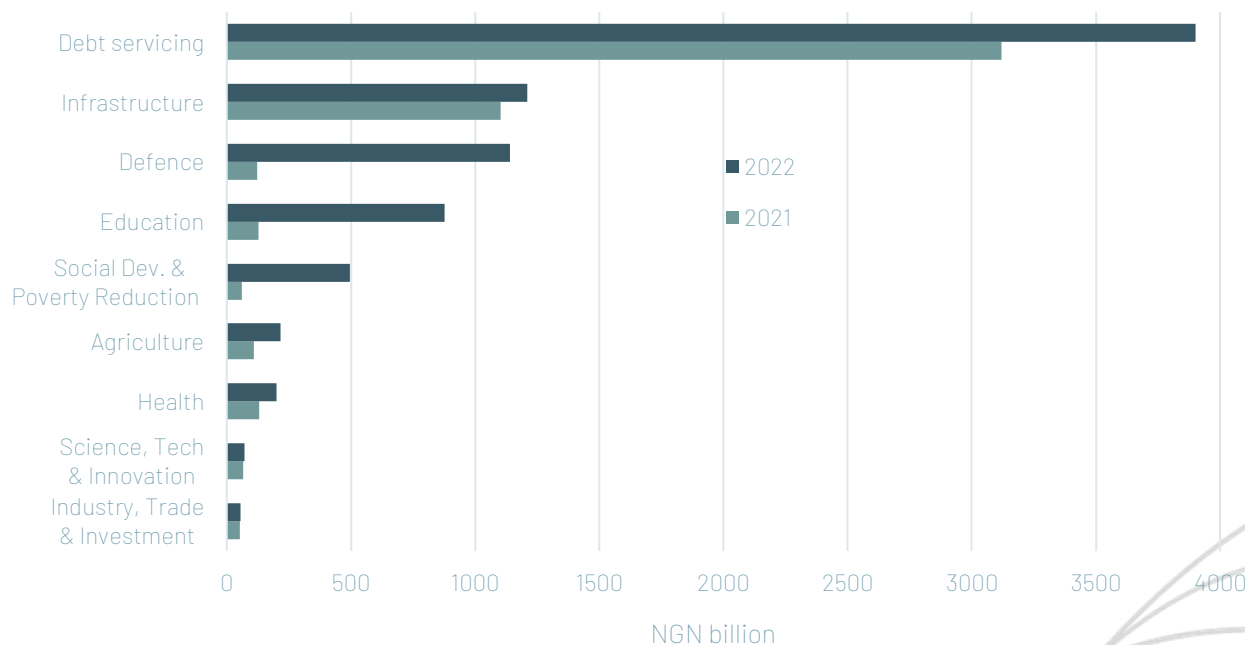
Francis, N. and Ekeghe, N., 2022. Fuel Subsidy May Hit N6trn in 2022, IMF Warns Nigeria. Retrieved from: <https://www.thisdaylive.com/index.php/2022/05/31/fuel-subsidy-may-hit-n6trn-in-2022-imf-warns-nigeria/>

<sup>19</sup> Nigeria's Crude Oil Price is sold using the Bonny Light.

<sup>20</sup> These results have taken into consideration changes in subsidy payment (using actual 2019 subsidy payments not projections) as a result of oil price changes.

same time, spending on defence, social protection, and education have grown significantly between 2021 and 2022 (see Figure 5).

**FIGURE 5. CAPITAL EXPENDITURE ON KEY SECTORS AND DEBT SERVICE PAYMENTS, NGN BILLION; 2021 AND 2022**



Source: Budget, 2021 and 2022

## High fiscal deficit has led to a debt build-up, particularly domestic debt

**As a result of continuous budget deficit, Nigeria’s debt level has increased considerably.** Although debt as a share of GDP is low, at only 37% in 2022 (against 64% on average in SSA), it is also growing at an unsustainable rate: by 7.9 percentage points from end-2021 to the second quarter of 2022, to reach US\$103.3 billion (see Figure 3). Furthermore, federal government debt service payment now represents 93% of government revenues in 2022, from 67% in 2017 (Figure 6). This is due to expensive borrowing sources alongside the limitedness of domestic revenue capacity. Those dynamics crowd out spending on sectors critical to growth and raise concerns about a debt default.

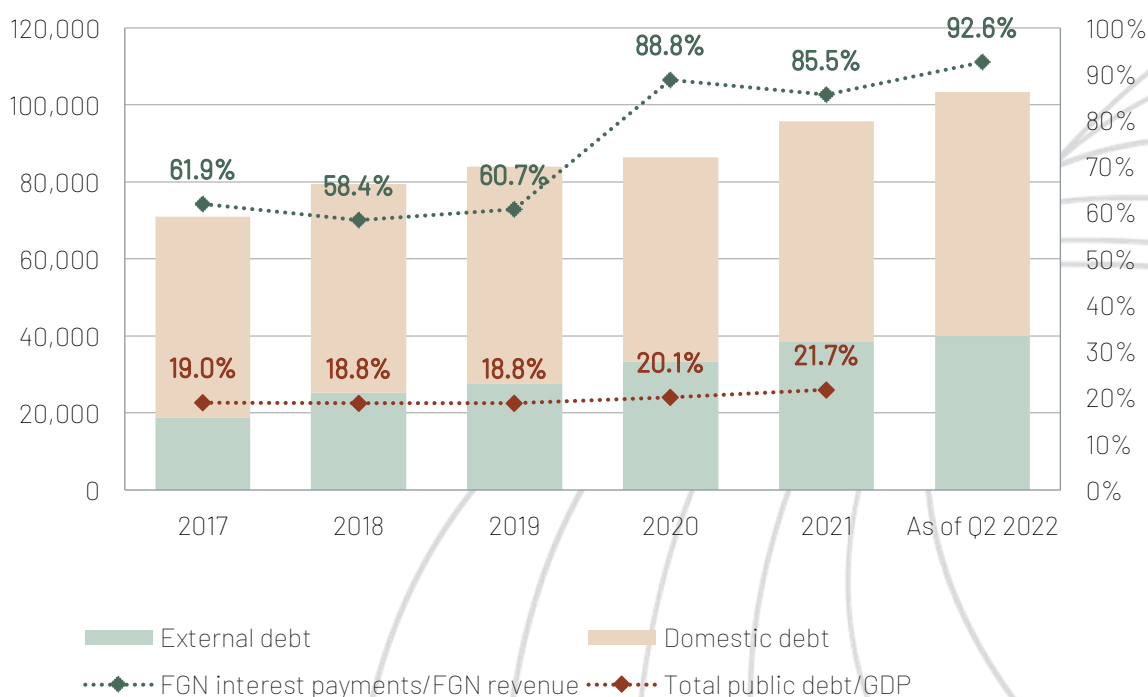
**The rise in debt is expected to continue all through 2022 and beyond: with higher fiscal deficit - in a context of increasing fuel subsidy payments and other expenditure - which will be financed by further borrowing.** Meanwhile, the Russia-Ukraine war has made external refinancing more stringent on international capital markets, with increasing interest rates in line with the US Federal Reserve rates hikes. For instance, as of February 2023, the 10-year Nigerian USD Eurobond trades at a yield close to 11.6%, as opposed to 8.2% in end-January 2022, before the beginning of the war<sup>21</sup>.

<sup>21</sup> Nigerian Debt Management Office, 2022. Nigeria’s Eurobonds Closing Prices and Yields as at Monday, October 03, 2022. Retrieved from: <https://www.dmo.gov.ng/fgn-bonds/eurobonds-trading/4056-nigeria-s-eurobonds-closing-prices-and-yields-as-at-monday-october-03-2022/file>

**While Nigeria issued a US\$1.25 billion Eurobond in March 2022, the additional financing needs and the stricter external financing conditions have led to an increased resort to domestic financing, with shorter maturities.** Hence domestic debt increased by US\$5.9 billion against a US\$1.6 billion increase for external debt, from end-2021 to the second quarter of 2022 (see Figure 6). Although Nigeria’s debt to GDP ratio remains below the 60% warning threshold put forward by the African Monetary Cooperation Programme (AMCP), liquidity and borrowing pressures as well as limited public revenues are expected to lead to further pressures on public finances.

**Public revenues are the lowest in the region and debt risks will rise if domestic resources mobilisation does not improve.** As of 2021, Nigeria had the lowest public revenues in Africa, at barely 7.3% of GDP<sup>22</sup>. With such low revenues, any level of debt is difficult to sustain: the fact that its debt to GDP ratio is relatively low, at 36% of GDP, the 5<sup>th</sup> lowest in Sub-Saharan Africa<sup>23</sup>, does not matter that much. Using debt to public revenues as a more informative indicator of the ability to repay, Nigeria is the fifth country with highest debt stock to revenues. In 2022, debt represented five years of government revenues, where this ratio was only 1 in 2011. No country in Africa, Zambia excepted, had similar dynamics. In addition, the Federal structure of Nigeria complicates fiscal dynamics and leaves a relatively small share of revenues to the Federal government compared to the States: the Federal government only receives about a third of public revenues but spends more than half of total expenditure.

**FIGURE 6. NIGERIA’S DEBT DISAGGREGATED BY SOURCES – DOMESTIC AND EXTERNAL (USD MILLION) DEBT AS A SHARE OF GDP (PERCENT); 2016 – 2022**



Source: Nigerian Debt Management Office, IMF WEO for GDP, IMF Article IV  
 Note – Total public debt covers only federal government and excludes sub-national debt

<sup>22</sup> IMF, 2023. 2022 Article IV Consultation – Press Release; Staff Report; Staff Statement, and Statement by the Executive Director for Nigeria.

<sup>23</sup> IMF, World Economic Outlook, October 2022

**Consequently, the IMF classifies Nigeria’s debt as sustainable but points out that threats exist over the medium run, in particular due to the high ratio of interest payments to public revenue<sup>24</sup>.** In addition, the country recently suffered from a credit rating downgrade as a result of its negative macroeconomic, fiscal, and debt outcomes, but this is occurring at a time when experts from the global South have raised concerns about the role of perception bias in traditional credit ratings<sup>25,26</sup>.

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<sup>24</sup> IMF, 2022. 2021 Article IV Consultation – Press Release; Staff Report; Staff Statement, and Statement by the Executive Director for Nigeria.

<sup>25</sup> Vizcaino, M. E., 2022. Nigeria’s Credit Rating Cut Deeper Into Junk by Fitch. Retrieved from: <https://www.bloomberg.com/news/articles/2022-11-11/nigeria-s-credit-rating-cut-deeper-into-junk-by-fitch>

<sup>26</sup> African Union, 2022. Ghana Supports The Establishment of The African Credit Rating Agency. Retrieved from: <https://au.int/en/pressreleases/20220720/ghana-supports-establishment-african-credit-rating-agency>

## 4. Consequences on growth and income distribution

### Nigeria's macroeconomic position has worsened since the crisis

Given this increasingly difficult environment, one would expect rapidly deteriorating growth. However, growth has remained low but stable – even improving from 3.1% in the first quarter of 2022 to 3.5% in the second quarter of 2022<sup>27</sup>. This improvement is largely a result of increased activities in the non-oil sector particularly the information and communication, finance, and trade sectors. Going forward, the World Bank has projected that growth rate in 2022 will be 3.1% while in 2023, it is estimated to be 2.9%.

The direct income effect of higher real income is expected to increase at the macro level as the prices of fuel, food and fertilisers rise; the rise in real income comes mainly from mineral fuels and petroleum as Nigeria gains from being a net exporter of these products.

**Products for which Russia and Ukraine are important suppliers including mineral fuels, gas, petroleum, coal, crude fertiliser, wheat, maize, oil seed, and barley have experienced a 20% increase in their price on average, between February and June 2022.** In investigating the impact of the war on real income, price change is interacted with the import per capita of each product based on a scenario analysis. The first scenario assumes that the prices of the nine highlighted products increase by the same magnitude seen between February and June 2022 termed as the 'actual price increase'. However, the second scenario assumes that the prices increase by '80% of the actual price increase', while the third scenario assumes that the prices increase by '120% of the actual price increase'.

**The analysis shows that real income at the macro level is expected to increase across the three scenarios. However, the scenarios that assume higher price increments will result in a larger increase in income.** In this paper, real income is defined as nominal income less inflation. For the first scenario, real income is expected to increase by 3.59% in 2022 while multi-year simulations find that real income will increase by 3.95% and 3.88% in 2023 and 2024 respectively<sup>28</sup>. The second scenario finds that real income will increase by 2.9% in 2022, while real income is expected to increase by 3.16% and 3.1% in 2023 and 2024 respectively. Finally, the third scenario shows that real income will increase by 4.3% in 2022, while real income is projected to increase by 4.74% and 4.65% in 2023 and 2024 respectively. Across all three scenarios, the observable rise in real income comes mainly from mineral fuels and petroleum.

**For the first scenario, these products are expected to increase real income by 2.24% and 1.15% respectively.** On the other hand, wheat contributes about 0.11% to a decrease in real income. Consequently, on average, Nigeria gains from being a net exporter of fuel and natural gas and loses on the basis that it is a net importer of food commodities such as wheat. Since the results summarise the effects on the average household, it is difficult to conclude that households in the lowest income strata are also experiencing an increase in their income.

<sup>27</sup> National Bureau of Statistics, 2022. Nigerian Gross Domestic Product.

<sup>28</sup> The multi-year simulations assume that Nigeria's total trade for the selected products would increase by 8% in 2023 and reduce by 2% in 2024 based on the National Development Plan.



**On the other hand, rising food prices are having adverse effects on households and are affecting vulnerable households more disproportionately.** Using the World Bank's Household Impacts of Tariffs (HIT) Simulation Tool, the paper provides estimates of the impact of changes in the price of wheat, maize, and oil seeds on the real income of households in different income strata. The impact is expected to vary considering that these households will consume different commodities and obtain their income from diverse sources. The results in Table 1 show that all households regardless of their income strata experience a decline in average real income (welfare gains are negative). However, the ultra-poor households are worst hit by the war – food expenses are taking a higher share of their income (3.32% relative to 1.35% for the top quintile) while they experience a decline in average real income (-0.36%). Despite comparable price increments, cost of food consumption is higher for the more vulnerable households (-0.66% relative to -0.49% for those in the second quintile). These findings support the argument made earlier in the paper regarding food price increments affecting the poor more disproportionately.

**TABLE 1. DISTRIBUTION IMPACT OF FOOD PRICE INCREASE ON HOUSEHOLDS**

<i>Income percentile</i>	<i>Welfare gains</i>	<i>Consumption gains</i>	<i>Income gains</i>	<i>Expenditure</i>	<i>Income</i>
<i>Bottom quintile</i>	-0.36%	-0.66%	0.30%	3.95%	3.32%
<i>2<sup>nd</sup> quintile</i>	-0.09%	-0.49%	0.40%	3.03%	4.41%
<i>3<sup>rd</sup> quintile</i>	-0.28%	-0.55%	0.27%	3.43%	3.07%
<i>4<sup>th</sup> quintile</i>	-0.44%	-0.59%	0.15%	3.63%	2.23%
<i>Top quintile</i>	-0.46%	-0.56%	0.11%	3.48%	1.35%

Source: Authors computation using the World Bank's Household Impacts of Tariffs (HIT) Simulation Tool

## 5. Improving governance and revenues is essential

### How has the Nigerian government mitigated the effects of the Russia-Ukraine war?

**Since the war began, there has been a shift towards prioritising the infrastructure, health, and social protection sectors.** One of the key infrastructure projects that is gaining attention is the [Nigeria-Morocco Gas Pipeline project](#) which is projected to deliver up to 5,000 cubic meter gas to African countries and beyond.

**As part of poverty reduction efforts, cash transfers, that were previously in place, continue to be provided to the most vulnerable households to aid in coping with high energy and food costs.** However, the government's response has been impeded by its worsening fiscal position. The 2023 budget allocation to nearly all sectors, except for health, has declined relative to allocations in 2022. In particular, defence (-86%), education (-72%) and agriculture (-36%) have seen a considerable decline in their budget shares<sup>29</sup>. Spending on these sectors has been crowded out by debt service payments which have increased to NGN6.31 trillion (US\$14.3 billion), representing a 62% increment from 2022.

**To encourage food-sufficiency in the long-term, the government has initiated programmes to provide soft loans to farmers and in some cases, offer a ready market for food produce (see [Anchor Borrowers' Programme](#)), which have been fairly successful.** For oil and gas, the rehabilitation of government refineries has not been successful, however, the participation of key private sector players in the sector such as the Dangote Group could push the country along the lines of energy independence in the future.

### What can Nigerian policy makers do better and how can international partners assist?

**Nigeria is in the midst of its oil sector governance reform programme particularly with the signing of the Petroleum Industry Act (PIA) into law in 2021.** The law prioritises improved transparency and commercial effectiveness as the National Oil Company – the Nigerian National Petroleum Corporation (NNPC) – will become partly privatised, listed on the stock exchange, and open to international competition<sup>30</sup>. In addition, the PIA somewhat addresses the issue of oil theft by specifying that the responsibility to protect oil pipelines will be borne by host communities.

**Despite these amendments, areas which have made the country susceptible to external macro shocks, in particular, sustainable revenue management and providing support for the non-oil economy have not been dealt with.** The Excess Crude Account, which saves oil revenue in excess of the oil price specified in the national budget, is not protected by strict withdrawal and accumulation rules which have made it subject to short-term exploitation<sup>31</sup>. In the same way, Nigeria's Sovereign Wealth Fund – which has an intergenerational investment fund as well as a stabilisation fund – is weakened by low contributions. These issues have undermined the country's capacity to ensure long-term prosperity

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<sup>29</sup> Budgit, 2022. The 2023 Proposed Budget Breakdown. Retrieved from: <https://yourbudgit.com/infographics/the-2023-proposed-budget-breakdown/>

<sup>30</sup> Nwuke, K. 2021. Nigeria's Petroleum Industry Act: Addressing old problems, creating new ones. Retrieved from: <https://www.brookings.edu/blog/africa-in-focus/2021/11/24/nigerias-petroleum-industry-act-addressing-old-problems-creating-new-ones/>

<sup>31</sup> Akinbode A. and Ununu, D., 2022. The Sovereign Wealth Fund – Has Nigeria lost the chance to save for the future? Retrieved from: <https://yourbudgit.com/the-sovereign-wealth-fund-has-nigeria-lost-the-chance-to-save-for-the-future/>

and in the interim, cushion the effects of periods of low revenue. They can be addressed if contribution rates are increased and withdrawals require additional oversight, including parliamentary approval.

**Broader economic governance in the form of public expenditure and revenue reforms, civil service reforms, commitment to tougher anti-corruption enforcement, and overall institutional development is also required.** Issues around revenue collection and management as well as the quality of spending extend beyond the oil sector to the entire public system. For instance, no dedicated body regularly monitors fiscal rules and as such existing rules are often ignored. A clear example is the case of the budget deficit as a share of GDP exceeding the 3% benchmark specified in the Fiscal Responsibility Act in most cases, as there are no well-defined expenditure ceilings or debt limits. The underlying factor responsible for low revenue collection is that poor public service delivery demotivates citizens from supporting efficient tax policies. Although the inability to collect sufficient tax is also a cause of the underdevelopment being experienced. Other revenue accretion problems include leakages and corruption.

**Political and regulatory capture of governance institutions is high; meanwhile, the judiciary does not penalise in such a way that it corrects dishonest behaviour and even when it does, court decisions are rarely enforced.** As a result, revenue in both government institutions and large public-private dealings have been unaccounted for in the past, but convictions are seldom made. Even in cases where convictions are made, they may not be served in their entirety. A clear case is the presidential pardon given to two former state governors who were convicted of misappropriating public funds up to NGN3.7 billion combined (US\$8.4 million) in April 2022<sup>32</sup>. On the other hand, the rise in government spending has been associated with the country's high cost of governance – in 2017, Nigeria's law makers were found to be one of the highest paid globally and a government committee has recommended that the size of government should be cut down by as much as 60% to enhance the efficiency in governance<sup>33,34</sup>.

**The evidence has shown that Nigeria has to build strong, efficient, and infallible fiscal, public service, and justice systems.** While policies and laws are not lacking, implementation is limited. Structural factors have shaped the incentives and interests of economic and political elites (and to some extent, citizens) such that they prioritise their personal interests and the distorted systems that protect them. However, the right leadership at the apex can achieve governance reforms but must be willing to invest adequate political capital. Nevertheless, reforms in governance should be sequenced, so that the capacity for implementation is available at each phase. They should be adaptive, so that the changing strategy of offenders is intercepted. Finally, they should be well-informed, so that there are no loopholes to be exploited.

**Success in reforming the fiscal, public service, and justice systems will lay the foundation for politically and publicly sensitive reforms including increasing tax rates, removal of fuel subsidies, and adoption of a single exchange rate system.** Although evidence has shown that these reforms are deeply unpopular (for instance, a survey carried out in 2020 found that 70% of Nigerians oppose the reduction

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<sup>32</sup> This Day, 2022. HURIWA Condemns Buhari's Pardon of Ex-Governors Jailed for Corruption. Retrieved from: <https://www.thisdaylive.com/index.php/2022/04/16/huriwa-condemns-buharis-pardon-of-ex-governors-jailed-for-corruption/>

<sup>33</sup> Mayah, E., Mariotti, C., Mere, C.E. and Odo, C.O., 2017. Inequality in Nigeria: Exploring the drivers. Oxfam International.

<sup>34</sup> Centre for Social Justice, 2014. Cost of Governance: Adjusting the Structures. Retrieved from: <http://csj-ng.org/wp-content/uploads/2018/06/Oronsaye-Cost-of-Governance-Adjusting-the-Structure.pdf>

or removal of fuel subsidies)<sup>35</sup>, they are less likely to receive criticism and cause an uprising when public spending is more efficient, public service delivery improves, and corruption is curbed.

**For the oil and gas sector, as part of its medium-term goals, the government will have to encourage private sector players to engage in oil refining and develop fuel storage infrastructure.** This can be achieved when the sector is supported by stable regulatory oversight and fuel subsidies have been removed, which will increase international competitiveness. Also, with increased competitiveness should come the removal of subsidies for international oil companies in the form of tax holidays/exemptions. In the same way, local fertiliser production can be improved through private sector participation.

**Similar issues undermine food production where agro-processing and storage capacity are limited.**

The government can assist farmers - who mostly operate on a small scale - to expand production and value addition by upskilling them on modern farming practices and value chain development while solving perennial issues around land tenure security and more broadly, land governance. Improvements in the formal registration of lands, enhanced transparency, and proper land mapping and documentation will significantly contribute towards promoting long-term investment particularly among small and medium-scale farmers. Furthermore, developing and implementing more robust food production policy frameworks to include food safety standards, tests, and certification will go a long way for local production to reach regional food markets.

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<sup>35</sup> McCulloch, N., Moerenhout, T. and Yang, J., 2020. Fuel subsidy reform and the social contract in Nigeria: A micro-economic analysis. International Center for Tax and Development. Research in Brief 51.



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