

**Nigeria: Poverty Reduction Strategy Paper—Progress Report—
Joint Staff Advisory Note**

The attached Joint Staff Advisory Note (JSAN) of the Poverty Reduction Strategy Paper Progress Report for Nigeria, prepared jointly by the staffs of the World Bank and the IMF, was distributed with the member country's Poverty Reduction Strategy Paper (PRSP) Progress Report to the Executive Boards of the two institutions. The objective of the JSAN is to provide focused, frank, and constructive feedback to the country on progress in implementing its Poverty Reduction Strategy (PRS).

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INTERNATIONAL DEVELOPMENT ASSOCIATION
AND
INTERNATIONAL MONETARY FUND

NIGERIA

Joint Staff Advisory Note on the Progress Report for the National Economic Empowerment and Development Strategy (NEEDS)

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and the International Monetary Fund (IMF)

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I. Overview

1. **This Annual Progress Report (hereafter, “the Report”) candidly reports on progress in implementing the National Economic Empowerment and Development Strategy (NEEDS)—Nigeria’s poverty reduction strategy paper.**¹ It highlights key accomplishments and shortcomings as well as outstanding issues. During the period under review, the authorities achieved macroeconomic stability and sustained a broad-based high growth underpinned by a range of deep structural reforms in most sectors of the economy. This Joint Staff Advisory Note (JSAN) was prepared in support of the authorities’ request for completion of the Third Review under the Policy Support Instrument (PSI) and focuses on staff comments on the effectiveness of the implementation of NEEDS and key areas meriting the authorities’ attention.

2. **2007 is the last year under NEEDS, and a draft new strategy—NEEDS 2 for 2008–11—is being prepared by the outgoing administration in parallel to this Report.** It is expected that NEEDS 2 will be reviewed and completed before year end by the new administration that assumed power on May 29. Hence, the Report does not discuss in detail the authorities’ future strategy, but focuses on a broad assessment of progress against previous targets. This assessment work should be carried forward in more detailed analyses for each sector to distill lessons learnt, design operational targets and observable indicators, prioritize and sequence the reform agenda, and support realism in setting challenging but achievable targets for NEEDS 2. The authorities are committed to finalizing

¹ The NEEDS and JSAN were circulated to the Boards of the IMF and the World Bank in October 2005, and were published as IMF Country Report 05/433 on December 1, 2005 and IMF Country Report 05/434, respectively.

NEEDS 2 through a broad participatory process that has already been initiated and is expected to sustain the high degree of ownership enjoyed by NEEDS.

3. **The homegrown NEEDS has been an effective guide to the authorities' broad and ambitious reform agenda.** Policies pursued have been in line with its priorities and strategies while some adjustments were made along the way. The macroeconomic policies were elaborated under the Policy Support Instrument (PSI) with the Fund. Sectoral policies were detailed in medium-term sector strategies (now available for 17 ministries) which also facilitate linkages between NEEDS and annual budgets.

4. **State-level SEEDS for all 36 states now complement NEEDS, which strengthens the potential for inter-government policy coordination.** With a view to enhancing the monitoring of SEEDS implementation and stimulating competition among states, a second round of SEEDS benchmarking was undertaken in 2006 (see Report Annex I).² The staffs commend the authorities for their efforts to support stronger state level performance as more than 50 percent of revenue is assigned to states and local governments. However, there are weaknesses in the existing arrangements for intergovernmental policy coordination, complicating the development and implementation of national policies, including in the Millennium Development Goals (MDG) sectors.

5. **NEEDS and SEEDS serve as an important vehicle for donor coordination.** Nigeria's development partners have been framing their assistance around NEEDS and SEEDS, including in the World Bank and DFID joint assistance strategy.

6. **NEEDS implementation and progress toward the MDGs have been closely monitored at the highest level, but reporting to the public could be more regular and comprehensive.** Most reporting and analysis is hampered by limited data (despite progress in strengthening the National Bureau of Statistics) and paper-based record keeping. A poverty report was prepared in 2006 (see Report Annex II), as well as reports on MDG-related spending financed from debt relief. No comprehensive update on poverty levels since the 2004 household living standards survey is available. Further strengthening of monitoring and evaluation, in particular through improvements in budgetary and administrative statistics and better accessibility of outcome indicators, remains a priority.

II. Macroeconomic Policies and Framework

7. **Key macroeconomic indicators improved during the last years, reflecting the authorities' attention to macroeconomic management, an improved policy framework, and favorable external environment.** Non-oil growth was robust, and despite unrest in the Niger Delta oil production could fully fill the OPEC quota. The budgetary oil price rule was

² Indicators to assess the strength of the budgetary and fiscal management considered by the National Planning Commission included the divergence of actual from budgeted expenditure, the comprehensiveness of the coverage of government activities and the strategy to monitor and reduce expenditure arrears.

an essential anchor of fiscal policy and limited the macroeconomic impact of increased oil revenue, while the 2006 non-oil fiscal deficit increased in part to accommodate important infrastructure projects. Inflation declined to single digits in 2006 due to a combination of increased confidence, favorable food prices, and exchange rate appreciation in conjunction with exchange market unification, even though monetary policy implementation was uneven and challenged by IT problems. In addition, the external position strengthened significantly as a large reduction in debt, resulting mainly from the Paris Club debt agreement, coincided with international reserve accumulation aided by high oil prices.

8. The Fund and World Bank staffs support the medium-term macroeconomic framework and the thrust of the macroeconomic policies outlined in the Report. The robust growth under the conservative scenario—broadly in line with projections under the PSI—hinges on sustained implementation of prudent macroeconomic policies and continued structural reforms. Deepening of structural reforms and an acceleration of their implementation, combined with major progress in resolving the unrest in the Niger Delta could lead to higher growth, described in the “high growth/policy reform” scenario, which would be crucial for significant progress toward the MDGs.

9. While macroeconomic prospects are favorable, there remain risks, including in particular the sustainability of fiscal expansion, the quality of budget spending, and the adequacy of inter-government policy coordination. Management and utilization of the oil wealth—which are addressed in the draft Fiscal Responsibility Bill³— could be strengthened further by defining the budgetary oil price rule in line with macroeconomic stability and extending its coverage to natural gas. Large spending needs and hence large non-oil fiscal deficits imply that monetary policy will have a crucial part to play in macroeconomic management. Recent steps to strengthen its implementation therefore need to be fully implemented. Trade liberalization achieved by the 2005 tariff reform should also be carried further by preparing a timetable for the removal of remaining import bans and eliminating the 50 percent tariff band in line with ECOWAS plans. Discussion with the staffs on macroeconomic policies are expected to take place later in 2007 in the context of the fourth review of the PSI and the Article IV consultation.

III. Public Expenditure Management, Governance, Transparency and Accountability

10. Significant progress has been made with increasing the transparency of the government budgets and accounts, reform the civil service and ministries, and reduce inefficiencies in government expenditure, but an extensive reform agenda remains. Continued procurement reform helped to reduce costs of government contracts and improve accountability of contractors. A comprehensive and detailed financial, process, and physical audit of oil and oil revenue flows from 1999–2004 has been completed under the Nigeria Extractive Industries Transparency Initiative (NEITI), reconciling virtually all payments but

³ The Fiscal Responsibility Bill was approved by the two houses of parliament and awaits harmonization.

identifying many process weaknesses. Also, the N-EITI bill has been enacted. Payroll verification and removal of ghost workers, disengagement of low-skilled officers, monetization of most allowances and adoption of a new salary structure, as well as reorganizations of ministries are important steps toward more effective service delivery. Many of these reforms however need to be consolidated and continued. It will be of particular importance to better link public service reforms to improvements in service delivery and develop an affordable long-term salary policy. To improve quality of spending funded from oil savings (particularly on infrastructure) all spending should be integrated into fiscal strategies and public financial management practices should be strengthened. The institutional framework would also be strengthened by the final approval of the Fiscal Responsibility and Procurement Bills. The introduction of modern computer systems for personnel, payroll, and budget management faced significant delays, and sustained efforts will be needed to complete their roll-out and ensure their effectiveness.

IV. Sectoral Policies

11. The Report notes several reforms the government has undertaken to improve performance of the agricultural sector. Important reforms include several presidential initiatives to boost production of a variety of agricultural commodities, including cassava. Also, the National Agricultural Development Fund bill which aims at ensuring adequate and consistent funding of agricultural development in the country has been approved by the National Assembly. In addition, the government has launched community-based rural development projects aimed at improving agricultural productivity and has made efforts to improve rural finance.

12. Building on these achievements, the government needs to sustain reforms in the agricultural sector to further enhance efficiency and strengthen competitiveness. In this context, it will be important that future strategy focuses on (i) expanding irrigation capacity; (ii) reforming research and extension systems; (iii) investing in rural infrastructure to improve market access for farmers; (iv) more clearly defining the roles of the private and the public sectors; (v) strengthening the input supply system; and (vi) enhancing access to financial systems.

13. The Report notes the significant accomplishments and ongoing reforms in the education sector and other sectors affecting the accomplishment of the Millennium Development Goals. Education spending (as a percentage of GDP) has significantly increased. School enrolment at all levels of education has risen, partly reflecting the enforcement of the policy on free education during the first 9 years of education. The authorities have also undertaken major institutional and structural reforms, including the reform of the Ministry of Education and the preparation of the National Framework and Federal Sector Plan for education. Importantly, in April 2007, the government approved the Education Sector Reform Bill, which, among other things, consolidates the 21 existing

education parastatals into 13 parastatals. Furthermore, Nigeria has adopted a strategic vision for post-basic education in the area of Science and Technology.

14. Comprehensive implementation of these initiated reforms will be important to achieve the objectives laid out by the government for the education sector. Key issues in the education sector include (i) low quality of learning and teaching at all levels; (ii) inequitable access to facilities; and (iii) inefficient use of resources. The staffs urge the authorities to improve the capacity of the administrative and management staff with a view to strengthening the accountability and improving the efficiency of the use of resources in education. In addition, federal monitoring of both educational outcomes and resource utilization in the sector needs to be strengthened, including through the broader use of tracking surveys. The staffs agree with the government's priority to improve the quality and relevance of tertiary education and urge the authorities to pay particular attention to better coordinate the design of the education system with the demands of the labor market.

15. The Report notes significant improvements in the health sector. Progress has been made in the development of sectoral policies, including the revision of the National Health Policy, a framework for achieving health-related MDG's, a draft National Health Bill and the formal launching of the National Health Insurance Scheme and the development of sub-sectoral policies. Also, federal government investment in the sector has continued to increase. Moreover, there are some indications that the treatment of a number of diseases, including guinea worm and malaria, has become more effective, partly reflecting the strength of community-based efforts.

16. These policies lay the necessary foundation to address the existing shortcomings in the sector. As noted in the Report, maternal and infant mortality has risen since 2004 and access to basic primary health care remains weak. To strengthen the performance of the health sector it will be important to clearly delineate responsibilities among the three tiers of government and ensure access to a basic package of cost-effective health services across all states.

17. The Report correctly notes the decline in the AIDS infection rate. This important achievement partly reflects the promotion of a behavioral change communications strategy by the government. While the decline in HIV prevalence is encouraging, it needs to be viewed with caution, partly in view of disparate trends in different parts of the country, and efforts at prevention and treatment need to be reinforced.

18. The Report underscores the progress that has been made in providing the necessary infrastructure for the private sector to thrive. Nigeria's ranking on the cost of doing business index has improved, reflecting improved contract enforcement and streamlined trade and licensing procedures. Also, government spending on physical infrastructure such as energy and transport has more than doubled since 2004. The Nigerian ports have been concessioned, leading to improvements in the quality of services and the

railway system is being refurbished. Furthermore, several laws aimed at establishing a comprehensive market-based regulatory framework are under consideration of the National Assembly.

19. Notwithstanding these accomplishments the business environment continues to limit the number of investments that can be profitably undertaken at this stage. Key issues include the unreliability of the electricity supply, poor physical infrastructure, as well as difficulties in obtaining long-term finance, starting a business and the administrative burden of paying taxes. The staffs recommend that greater emphasis be placed on better coordination of federal-state efforts to reform the investment climate, continued improvements in customs and tax administration, as well as greater attention to the binding constraints within specific industries and within the informal small-scale sector.

20. The Report underscores the importance of a well-developed and stable financial sector and notes the accomplishments. The successful completion of banking consolidation, the new microfinance policy and the establishment of a secondary market for government securities have helped improve the availability of finance for productive investment as well as the outreach of the financial system. Recent growth in private sector credit, secondary bond market trading and the entry of new international microfinance operators are signs of an increasingly active financial sector. This success needs to be sustained and supported by strengthened supervision and robust corporate governance frameworks.

21. The staffs fully support the efforts to develop the financial sector reform program through the recently-launched Financial System Strategy 2020 (FSS 2020). Reforms should aim at both stability, and deepening and developing financial markets. In addition, staffs urge the authorities to prioritize and appropriately sequence policies in the context of specific action plans.

22. The Report notes the unsatisfactory situation and the lack of progress in the energy sector. It outlines an ambitious strategy to raise generation capacity to 10,000 MW by end-2007 through public-private partnerships. Successful implementation of this plan will help alleviate power shortages in this sector of vital importance to Nigeria's future economic prospects. The staffs recommend that in parallel with this effort to raise generation, adequate attention be paid to improving transmission and distribution networks. The staffs also stress the importance of a credible and transparent process for privatization of the unbundled utilities. It will also be important to complete the ongoing commercialization of the Nigerian National Petroleum Corporation, privatize oil refinery complexes and develop a plan for the introduction of a market-based mechanism for setting petroleum product prices.

23. The weak financial situation of the power sector requires further government attention. The annual subsidy from the federal budget to cover financial losses and investments in the sector amounts to nearly US\$400 million, higher than the federal budget

for health. To improve the financial situation of the power sector, it will be important to establish electricity tariffs which allow cost recovery, while introducing adequate measures to protect vulnerable groups.

24. The Report notes a number of improvements in the transportation sector, while underscoring the continued shortcomings in this important area. The staffs support the key directions of the authorities' strategy for strengthening the transportation sector. At the same time, the staffs underline the need for broadening opportunities for private sector participation in the sector, including in railways. The staffs also recommend that the authorities develop specific institutional and policy reforms to facilitate improvements in service efficiency and sustainability, including drafting and enacting legislation to establish the proposed Federal Highway Authority, the National Roads Board and the Road Fund.

V. Conclusion

25. In sum, Nigeria's progress report on the implementation of NEEDS demonstrates the major accomplishments that have already been realized. Implementation of the macroeconomic aspects of the NEEDS in 2005 and 2006 has continued to be good. The authorities have taken bold steps to improve macroeconomic policy management, improve government operations, and to tackle corruption. Important reform steps in the areas of private sector development, energy, education and health have demonstrated the commitment of the authorities and laid the ground for future improvements in these sectors.

26. The staffs encourage the new administration to put in place expeditiously the NEEDS successor strategy to consolidate the reforms, and build on the momentum generated by NEEDS. Many of the challenges for generating growth and reducing poverty remain and have to be addressed through a further reform effort:

- to maintain sound macroeconomic policies and strengthen the links between NEEDS, sector strategies, medium-term forecasts, and annual government budgets;
- to strengthen the basis for private sector growth including by improving power and transport infrastructure;
- to improve transparency and accountability of the public sector, rationalize the public investment program, ensure value-for-money, and reduce corruption;
- to reinforce the focus on improvements in service delivery and accountability for outcomes and strengthen intergovernmental coordination including through stronger links between NEEDS and SEEDS;
- to update information on the incidence of poverty and improve information on key economic and social developments, among others through developing a poverty-related expenditure tracking and reporting system for all government levels.