

Nigeria Faces the Abyss

by

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Judging by the aggregate numbers, Nigeria, by far the largest country in Africa in terms of population, is showing signs of coming into its own in the new century. With GDP expansion averaging over 6.5 percent between 2000 and 2013, the economy has become Africa's largest. In the process, it has graduated to the World's Bank's list of lower middle-income countries, with a GDP per capita (in terms of purchasing power) above \$5,000.

But that was 2013. Today there is little cause for celebration, as the country no longer has the luxury of ignoring a host of long-festering problems that have been exacerbated by the recent collapse in the price of its cardinal export, oil. The government budget has been gutted. Wretched transportation and electric-power infrastructure sharply constrain non-oil growth, while high youth unemployment and the divide between the impoverished Muslim north and the relatively affluent Christian south bolsters the ultra-violent Boko Haram insurgency. Meanwhile, pervasive corruption makes every problem harder to solve and undermines civil society.

Each of these factors will present a daunting challenge to the next government – elections have been postponed to the end of March, after this article goes to press. Taken collectively, these concerns have prompted the U.S. National Intelligence Council (the public-private group that serves as a link between the intelligence and policy communities) to question both Nigeria's ability to sustain its economic growth and its long-term viability as a nation-state. In its 2005 "Mapping Sub-Saharan Africa's Future", the NIC warned Nigeria could collapse by 2020. In 2008, the NIC ranked Nigeria 13th on its list of most likely candidates for state failure. By 2012, Nigeria had moved "up" the list to 9th -- though the estimated date of its meltdown was extended to 2030.

The NIC's forecasts are based on a scenario in which Nigeria's slide toward communal violence in the face of weakening social and political institutions pushes the country over the tipping point. None of this is written in stone, however. And in their defense, Nigeria-boosters can point to trends running in the opposite direction. Gains in agricultural productivity, together with progress in governance reform and economic development at the state **level, have** the potential to offset the dispiriting dysfunctionality of leadership at the federal level.

When Nigeria faced an equally dangerous tipping point following its 1967-1970 [civil war](#) (based, no surprise, on ethnic conflict), the country survived -- thanks in part to the balm of oil-export revenues that followed the rise of OPEC. However, with a technological shift that threatens to depress fossil fuel prices for the indefinite future, oil is unlikely to serve as the glue again. Now, survival will largely depend on whether Nigeria has the societal strength to rein in rampant corruption, invest wisely in development infrastructure, and manage ethnic and religious strife.

Even in the best of times, Nigeria was extremely vulnerable to the volatility of the global oil market. Revenues from Nigeria's oil exports account for more than 90 percent of the country's export earnings and fund 70-80 percent of the federal government budget. As a result, Nigeria has been pounded by the 40 percent-plus fall in oil prices since mid-2014.

Not only is the country facing massive shortfalls in oil revenues due to sagging prices, but it has relatively little hope of offsetting the fall by increasing production in the near- or middle-term: With security issues in mind, foreign oil companies have invested little in exploration or development in recent years. Nigeria's currency, the naira, has been allowed to depreciate since oil prices started to fall. But the decline (on the order of 20 percent) won't do much to stimulate exports. Meanwhile, managing to sustain imports has badly depleted the country's foreign exchange reserves. As a result, the government has been forced to adopt a severe austerity program, even as expanded public expenditures are desperately needed to combat Boko Haram and make the infrastructure improvements required for both economic development and social stability.

Nigeria, like all oil-dependent economies, had plenty of notice that revenues could go down as well as up. And like some others, it established a buffer account to amass funds in boom times and disgorge them in hard times. By delinking government expenditures from oil revenues, the stabilization fund was intended to insulate the Nigerian economy from external shocks.

The idea of building cash reserves when oil revenues exceed a benchmark is sound. Unfortunately, when the fund was established, corruption was not factored in. As a result, Nigeria's president was left with the final say as to how funds would be disposed.

At the end of 2014, the ECA had a balance of just \$4 billion, compared to \$9 billion in December 2012. Moreover, the bulk of the withdrawals took place prior to the second half of 2014, when oil prices were still high and the account balance should logically have been rising. Much of the decline resulted from revenue diversion to assorted regional power brokers, whose support is crucial to the success of President Goodluck Jonathan's ruling party in the late-March 2015 elections. In 2013 alone, President Jonathan approved two \$1 billion transfers from the ECA to state governors.

With both the stabilization fund and foreign exchange reserves vanishing rapidly, the government had little choice but to propose spending cuts exceeding 10 percent in its 2015 budget. Most of the cuts will come from capital expenditures, meaning that critically needed infrastructure improvements will be shelved. The president, it seems, hasn't lost sight of which side his bread is buttered: the budget calls for increases in outlays for what can only be seen as patronage – notably, government salaries.

Further exacerbating the effects of the oil price shock is the government's failure to pass the 2008 Petroleum Industry Bill. As originally written, the PIB contained reforms that would have brought greater certainty to the rules regarding oil sector taxation, as well as altering the way in which oil revenues were transferred to the states, and restructuring the Nigerian National Petroleum Corporation (the place where foreign oil company royalties go to disappear). The resulting uncertainty over the rules of the oil game has predictably stifled foreign investment in Nigeria's oil sector,

thus limiting expansion in productive capacity that would partially offset the impact of the price drop.

One of the biggest casualties of Nigeria's falling oil revenues is the country's decaying infrastructure. Most Nigerian roads, refineries, railways, airports, power plants and water/sanitation utilities date to the oil boom in the 1970s. Since then, public investment has failed to keep pace with depreciation, let alone with rising needs in a country whose population has more than doubled since 1980. Today, infrastructure inadequacy, especially in transportation and energy, pose major constraints to sustained, broad-based economic growth.

A 2013 African Development Bank [report](#) was politely scathing in its analysis of these infrastructure deficiencies, estimating 40 percent of the federal primary road network is in poor condition, and only 18 percent of the country's 197,000 kilometer road system is paved. The backbone of the rail network is over 100 years old and, as of 2007, only 25 percent of its trains were operational.

But the imperative to protect political insiders trumps the needs of the commonweal. At 14 percent of the budget, government capital spending will be well below 2003 levels. And while Abuja has stressed that the sharp cuts in public investment are temporary, it hasn't explained where the money will come from until oil makes a comeback.

The one funding option that has been suggested is stepped-up borrowing, with a proposal already in the works to raise close to \$18 billion over the medium-to-long term, mostly from China. Currently, Nigeria's debt-to-GDP ratio is modest, thanks in large part to an international debt pardon in 2005. However, debt service costs could become problematic if the value of the Naira continues to fall, and oil revenues effectively remain the sole source of foreign exchange.

While inadequate funding has certainly contributed to Nigeria's infrastructure deficits, corruption may be equally to blame. The World Bank estimates corruption's direct cost to Nigeria to be as high as 12 percent of GDP, with much of it originating in the contracting, construction and provision of infrastructure services. Corruption has not only increased the

cost of construction, but also reduced its quality and siphoned off user fees needed to service debt – not to mention undermined lenders' willingness to fund the next projects and the next.

According to the World Bank's [Worldwide Governance Indicators](#), Nigeria's control of corruption, which showed dramatic improvement between 2003 and 2008, has deteriorated since President Jonathan took office. In 2008, Nigeria's control of corruption ranked in the merely dismal 21st percentile among nations; by 2013, the country had fallen to a kleptocratic 9th percentile.

Corruption is so ingrained that President Jonathan promptly dismissed the governor of the central bank for publicly suggesting that his administration was responsible for the approximately \$20 billion in "missing" Nigerian National Petroleum Corporation revenues.

Oil dependence polluted by rampant corruption – a pattern so common that economists refer to it as the "natural resource curse" – might alone be sufficient to explain Nigeria's failure to lift the majority of its population out of poverty or even to absorb the country's rapidly expanding workforce. According to the World Bank, nearly two-third's of Nigerians lived below the international poverty line of \$1.25 a day in 2010. In fact, Nigeria's cup of woes runneth over.

In contrast to the **East** Asian tigers, which turned their young redundant labor forces into an asset for rapid, sustained industrialization, Nigeria's restless and frequently unemployed youth are an becoming an increasing liability. More broadly, social instability has been fed by the federal government's inclination to use resources in ways that widen divisions along regional and religious lines rather than narrow them.

Economic development favors the country's Christian south over its predominately Muslim north. Poverty and unemployment are especially severe in the northeast, where the Boko Haram insurgency is based and finds the bulk of its recruits. In the northeastern states of Adawama and Yobe, poverty rates range as high as 70 percent, while unemployment is stuck in the range of 35 percent. Similarly, in the neighboring state of

Borno, where Boko Haram began, almost half the school-age population receives no formal education; youth illiteracy is in the range of 80 percent.

These numbers are all the more shocking when viewed against an [estimate](#) by New World Wealth (a global market research firm focused on the rich) that the number of Nigerian millionaires increased by nearly half in the six years between 2007 and 2013. Not surprisingly, the country's wealthy are concentrated in Lagos (the commercial capital), Abuja (the political capital), and the oil hub of Port Harcourt.

Barring a fundamental turnaround in governance – one that dealt directly with corruption, religious division and poverty – it's hard to see how Boko Haram (or successor groups) will be eradicated. Even the armed effort to contain the insurgents in the north has been hindered by endemic corruption. There are widespread reports that the Nigerian military has been demoralized because senior officers are appropriating their pay along with money intended to buy weapons.

It's not hard to see how falling oil revenues, infrastructure deficits, corruption, chronic poverty and the insurgency might lead to a vicious circle, creating a truly failed state out of this highly imperfect one. But not all the news coming out of Nigeria is grim.

Start with agriculture, which generates more than one-fifth of the GDP and nearly one-third of employment. Thanks for the most part to benign neglect on the part of Abuja, farm output has expanded at around 7% annually since 2000. Indeed, the Jonathan administration has been the first to show much interest in agriculture, introducing what may turn out to be its main policy achievement: The Agricultural Transformation Agenda.

Implemented in mid-2012, the ATA includes a series of initiatives aimed at reducing Nigeria's increasing reliance on food imports as the population grows and the country urbanizes. And none too soon: Nigeria currently spends over \$11 billion annually on imported rice and sugar, commodities in which it was self-sufficient during the 1960s.

A major component of the ATA is the Growth Enhancement Scheme. The GES specifically targets agricultural productivity by subsidizing the costs of

major inputs, such as fertilizer and seedlings. It is also providing free mobile phones to farmers, which help provide timely information on input and crop prices, and facilitate mobile banking to expand credit and payment options to this traditionally underserved group.

In 2013 alone, the ATA's first full year of operation, the government claims that nearly a half-million jobs were created – small change in a country of nearly 170 million, but a beginning. Success in raising productivity (though not reducing rural poverty) suggest that agriculture could giving the next government some breathing room in coping with the decline in the oil industry. In the mid-term, rising food production and declining food imports could help offset the most direct effects on consumers of oil-related volatility. And in the longer term it may dampen rising income and wealth inequality.

Just as the ATA has begun to demonstrate the economic potential of the Nigerian countryside, so the [recent transformation](#) of Lagos shows what ingenuity, hard work and improved governance can accomplish in an urban context. Composed of many separate municipalities, the Lagos sprawl of 12 million (or 20 million by some estimates) was once the most corrupt, crime-ridden, and public service starved Nigerian state. Then, in 1999, Bola Ahmed Tinubu, an ambitious state governor, began experimenting with ideas for beating back the chaos.

The initial stage of the experiment involved raising revenues. Those who owed most of the tax had always found it easier to grease the relevant palms than to pay. The reform government initially contracted with a private company to collect taxes, offering it percentage of the gain as incentive. And it subsequently cleaned its own house, replacing a compliant bureaucracy with one that owed allegiance to the reform governor. As a result, tax collections (adjusted for inflation) increased six-fold between 1999 and 2011. Nearly three-quarters of Lagos' revenues are now internally generated, leading other states to follow its example.

In exchange for getting residents to pay taxes, the Lagos state government expanded both public services and law enforcement. It has begun building and restoring basic infrastructure, with 60 percent of the expanded state

budget now earmarked for capital projects. To raise additional funding for infrastructure projects, the Lagos government has tapped bond markets and entered into a series of innovative public-private partnerships (PPPs). While each deal is individually negotiated, they generally involve a long-term contract in which a private party bears significant risk and management responsibility in return for substantial profit potential.

Several recent PPPs in Lagos have involved mass transit. In 2008, the bus system was re-launched under a PPP in which the state built the depots, terminals and dedicated road lanes, while private operators provided the vehicles and operated them. Today, 200,000 people use the system daily, making a dent in traffic delays in what was arguably the most congested city in Africa.

Building on the success of the bus partnerships, the Lagos government is moving ahead with an ambitious light-rail project. Under its terms, the giant China Civil Engineering Construction Company will design and build the tracks and terminals, while a private Nigerian consortium, Eko Rail, will supply the trains and operate the network for 25 years.

The transformation of Lagos shows that it is possible for a regional government – notably one without oil revenues to corrupt it -- to initiate a virtuous circle of economic growth and improved governance. In return for expanded tax compliance, the Lagos government has held itself accountable for increasing the scope and quality of state services. In turn, these inputs increase the viability of businesses, enabling them to pay additional taxes to be used for further investments and improvements.

Don't expect the Lagos miracle to change the way the federal government operates. Even in the unlikely case that DELETE of oil prices—and thus Nigeria's federal budget—rebounding soon, the country's sagging infrastructure, regionally skewed development, high unemployment rates and widespread corruption constitute structural impediments that would take decades to correct on the national level. If ever: there isn't much incentive for national politicians to hold themselves accountable for correcting them as long as oil revenues and foreign loans are available to buy support in the next election.

Moreover, don't expect business, foreign or domestic, to save the non-agricultural sector. The World Bank puts Nigeria at 170th (out of 189 countries) on its Ease of Doing Business [rankings](#) – just ahead of Zimbabwe, but behind the likes of Iraq, Burkina Faso and Tajikistan. In part, that's a reflection of the difficulty of doing business in an environment in which almost everyone in authority has a hand out. In part, though, it is infrastructure: Nigeria ranks a miserable 187th in business access to electricity.

Nigeria's best hope is that the example of Lagos will spread quickly to other localities. If a virtuous circle of improved governance and inclusive economic development can be duplicated by more Nigerian states and municipalities, it may foster a bottom-up process **that** places increasing pressure on Nigeria's federal government to put its house in order.