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INTERNATIONAL MONETARY FUND

NIGERIA

SELECTED ISSUES

March 17, 2020

Approved By
African Department

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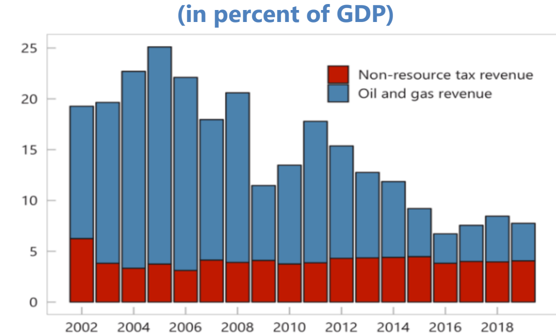
INTERNATIONAL ASPECTS OF THE NIGERIAN INCOME TAX[1]

Nigeria's limited domestic revenue mobilization is exacerbated by tax avoidance that exploit existing weaknesses in the international taxation regime. To limit the revenue loss from such schemes, Nigeria should consider leveraging automatic exchange of information to tackle tax avoidance by High Net Worth Individuals, removing the exemption of capital gains tax on the disposal of shares, and strengthening the taxation of payments to non-residents for services. The costs and benefits of existing incentive schemes for foreign investors should also be re-evaluated.

A. Nigeria's Weak Revenue Performance

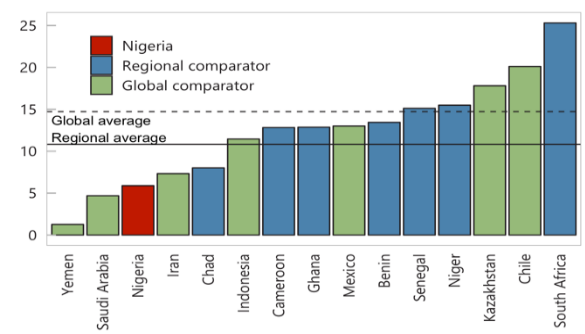
1. Nigeria's non-oil revenues have fluctuated between 3.5 and 4.5 percent of GDP for the past 15 years (Figure 1)**.** When contrasting the revenue performance against regional and global comparators, Nigeria underperforms in all tax instruments. Easy-to-collect taxes such as excises play a trivial role in Nigeria—unlike the relatively high reliance on excise revenues globally. Moreover, VAT revenue stands at less than 1 percent of GDP while taxes on consumption raise, on average, between 4 and 6 percent of GDP in countries in the region or other resource rich countries globally. Nigeria's total tax revenue collection, amounting to slightly above 5 percent of GDP in 2018, is below the regional average of roughly 10 percent and the global average of 15 percent (Figure 2). Narrowing tax avoidance opportunities in Nigeria's international tax arrangements could contribute to an improved outlook for domestic resource mobilization.

Figure 1. Oil and Non-oil Revenue (in percent of GDP)



Sources: Fiscal file, WEO, GFS, IMF Staff estimates.

Figure 2. Tax-to-GDP, 2018 (in percent)



Sources: Fiscal file, WEO, GFS, IMF Staff estimates.

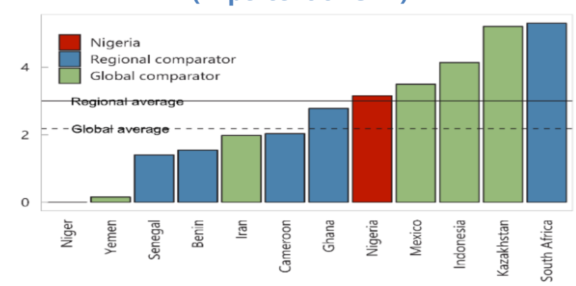
2. While Nigeria taxes resident and non-resident corporations at a rate of 30 percent, corporate income tax (CIT) revenue from non-resource companies is much lower than among comparators. The Education levy raises the effective statutory rate applied on profits to 32 percent, which is much higher than the regional average of 22 percent. Notwithstanding this, CIT collections are comparatively weak. Globally, resource rich countries with broadly similar macro-characteristics

[1] Prepared by Sebastian Beer and Martin Grote.

raise more than 2 percent of GDP (Figures 3 – 4). Regionally, this ratio is at 3 percent of GDP. Nigeria's CIT system raised slightly more than 3 percent of GDP in 2018, but more than half of these revenues derive from the taxation of Oil and Gas companies, which are subject to a statutory rate of 85 percent. CIT revenue only account for 1 percent of GDP in 2018 and 2019.

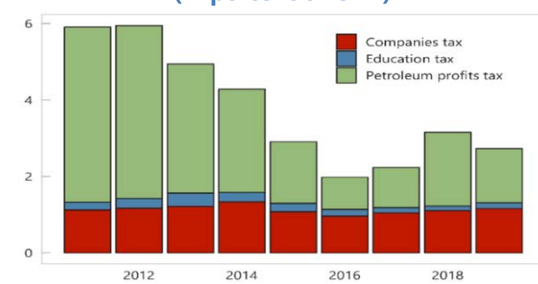
3. With a relatively robust anti-abuse framework, tax avoidance is unable to fully account for the disappointing revenue performance. Nigeria has a general anti-abuse rule that limits the most egregious types of tax avoidance and transfer pricing rules apply on both domestic and international transactions. The recently adopted Finance Bill 2020 (FB 2020) proposes an earnings before interest, tax, depreciation and amortization (EBITDA) rule that will restrict the deductibility of related party interest payments to 30 percent and the Transfer Pricing (TP) rules were updated in 2018, now capping the deductibility of payments for the use of intangible assets at 5 percent of EBITDA and complemented with a new safe harbor regime. Many of these features reflect international best practice, but some aspects could be improved:

Figure 3. CIT Revenue in 2018
(in percent of GDP)



Sources: Fiscal file, WEO, GFS, IMF Staff calculations.

Figure 4. CIT Revenue Decomposition
(in percent of GDP)



Sources: Fiscal file, WEO, GFS, IMF Staff calculations.

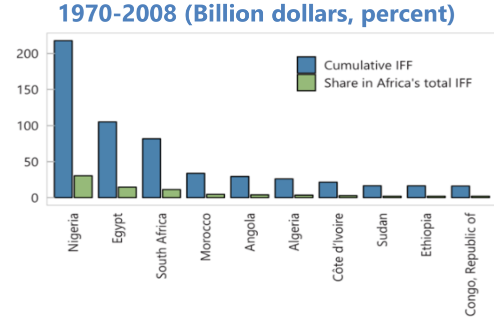
- **Transfer pricing (TP).** Nigeria's TP rules may both increase or decrease the tax liability. However, downward adjustments risk that some income is not taxed in any jurisdiction. To ensure compliance costs are not disproportionate, small businesses are typically exempt from documentation requirements, and often from declaration and disclosure requirements.
- **Simplified rules.** Presumptive approaches provide a middle ground between TP rules, which aim at approximating market transactions, and anti-abuse rules that apply mechanically. Increased reliance on presumptive approaches could support Nigeria in striking a balance between securing tax revenue whilst containing compliance and administrative costs.
- **Anti-abuse framework.** While the envisioned 30 percent EBITDA limit is common, applying the rule only to foreign connected party interest may reduce its effectiveness. Moreover, Controlled Foreign Company (CFC) rules could ensure the taxation of passive income abroad and provide a backstop to addressing loopholes created via the non-taxation of foreign-source income (addressed below).

4. Revenue leakage is likely a result of both domestic policy choices that invite abuse and of broader developments in the global economy, which have unveiled weaknesses of the international tax system. Nigeria provides generous tax incentives to a broad range of industries; it exempts capital gains on the disposal of shares and the foreign-earned income of its residents. These policies contribute to jeopardizing revenue mobilization and encouraging tax avoidance and evasion. In addition, the digitalization of the economy has raised significant challenges with respect to the taxation of non-residents. Nigeria is seeking to respond to these challenges through the FB 2020.

B. Confronting Tax Avoidance/Evasion by High Net Worth Individuals

5. Since the global financial crisis in 2009, there is a growing realization that international tax rules created the space for multinational enterprises (MNEs) and high-net worth individuals (HNWIs) to avoid and evade their tax obligations. Tax minimization schemes translate into under- or non-declaration of tax liabilities and these ill-gotten gains are transferred from the source countries to low tax jurisdictions. This tax leakage impacts detrimentally on developing countries' ability to finance on budget the development and maintenance of the physical infrastructure and appropriate sufficient funds to the health and educational programs. The High-Level Panel on Illicit Financial Flows (IFF) from Africa[2] established that Africa on average loses annually between $30 to $60 billion in illicit profit shifting out of the continent. Nigeria's share in this loss is about 27 percent (Figure 5). In 2013, Nigeria's illicit financial flows out of the country were 12 percent of GDP, pointing to material tax losses.

Figure 5. Selected African Countries—Cumulative Illicit Flows and Regional Share, 1970-2008 (Billion dollars, percent)



Source: UNECA, 2015

6. For tax authorities it is challenging to tax mobile wealth disguised in complex tax shelters that are established in offshore financial centers and which offer residence status to wealthy individuals and MNEs. In addition, international tax rules have offered unintended avoidance and evasion opportunities, that predominantly benefit wealthy individuals. This is accompanied by elaborate investment structures through trusts, shell companies, offshore financial centers, secret bank accounts, and legal arrangements that hide ownership of assets on its transfer or disposal. Yet, tax authorities in Africa can address these leakages by rationalizing tax expenditures, reducing discretionary powers, maximizing automatic exchange of information facilities with other countries, and by making use of mutual assistance in tax administration. This way, an improved tax compliance culture could be pursued.

[2] United Nations Economic Commission for Africa (UNECA), 2015. *Illicit Financial Flows: Report of the High-Level Panel on Illicit Financial Flows from Africa*, Addis Ababa.

7. There is evidence that HNWIs trigger tax losses from tax avoidance and evasion similar in size to those from MNEs.[3] Even the relatively small number of HNWIs own and manage a large share of national income in most countries.[4] The New World Wealth Report (2017)[5] estimates that there are approximately 145,000 HNWIs with $800billion in assets in Africa.

8. It is difficult to tax HNWIs as they are mobile and politically well-connected. Much of the offshore wealth has been held for a considerable length of time. Assets may have been whitewashed through real estate transactions. Thus, wealth is being disguised in countries without rigorous reporting requirements. There is frequent use of secretive bank accounts and the HNWIs are being advised by experienced tax practitioners specialized in offshore financial centers. Zucman (2013)[6] estimates that about $8 trillion of global personal financial wealth is held in offshore accounts, excluding tangible assets such as property or works of art. Other estimates of total wealth held overseas (Henry 2012[7] and Ryle et al. 2013[8]) are as high as $32 trillion, which is plausible given that much of foreign wealth is channeled into international property markets through shell companies.

9. Utilizing automatic exchange of information (AEOI), Nigeria could begin to tax its residents' worldwide income more effectively.[9] Bank of International Settlement statistics reveal the steady growth in Nigerian non-bank offshore deposits since the 1990s. Interestingly, these are closely correlated with rising oil prices. Seven of Nigeria's top ten destinations for offshore deposits are recognized offshore financial centers; the UK and Hong Kong being the most popular (Figures 6-7). Nigeria has implemented the common reporting standard (CRS) and will exchange information on the offshore deposits of residents automatically for the first time in 2020. Recent empirical work indicates that this step will likely reduce cross-border tax evasion,[10] bolstering Nigeria's revenues.

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[3] Moore, M., W. Prichard and O.H. Fjeldstad, 2018. *Taxing Africa—Coercion, Reform and Development,* in association with International African Institute, Royal African Society, and World Peace Foundation, ZED Books Ltd. London, 2018: 67 – 87.

[4] Forbes (August 26, 2018) reported that the ten richest people in Ethiopia had a combined net worth equal to 26.8 percent of Ethiopia's GDP.

[5] New World Wealth, 2017. *AfrAsia Bank Africa Wealth Report 2017*, Johannesburg.

[6] Zucman, G., 2013. "The Missing Wealth of Nations: Are Europe and the US Net Debtors or Net Creditors?", *The Quarterly Journal of Economics*, 128(3): 1321-1364, and Zucman, G., 2014. *Taxing across borders: tracking personal wealth and corporate profits*, Journal of Economic Perspectives 28(4): 121-48.

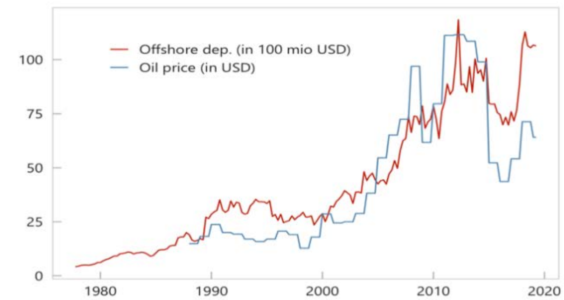
[7] Henry, J.S., 2012. *The Price of Offshore Revisited: New Estimates for Missing Global Private Wealth, Income, Inequality and Lost Taxes*. Chesham, UK: Tax Justice Network.

[8] Ryle, G., Guevara, M.W., Hudson, M., Hager, N., Campbell, D. and S. Candea, 2013. *Secrecy for Sale: Inside the Global Offshore Money Maze*, Center for Public Integrity.

[9] Of course, the Federal Inland Revenue Service will also need to develop the necessary administrative capacity to utilize the information obtained under the automatic exchange of information (AEOI) protocol effectively to detect cases of avoidance and evasion.

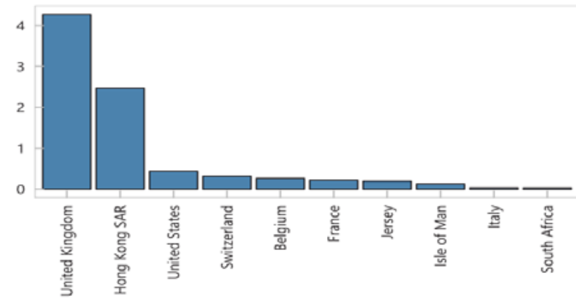
[10] Beer, S., M. Coehlo, and S. Leduc (2019) Hidden Treasure: The Impact of Automatic Exchange of Information on Cross-Border Tax Evasion

Figure 6. Offshore Deposits of Nigerian Non-Banks and Oil Prices



Sources: BIS, Federal Reserve Bank of St. Louis, IMF Staff computations.

Figure 7. Nigeria: Offshore Deposits in Top 10 Locations in 2018 (in billions of US dollars)



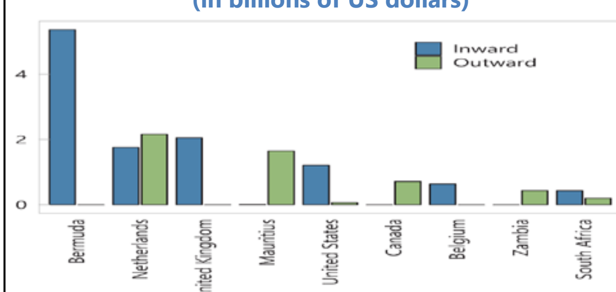
Sources: BIS, Federal Reserve Bank of St. Louis, IMF Staff computations.

The Exemption of Foreign-earned Income

10. While resident taxpayers are subject to tax on their worldwide income, earnings derived outside of Nigeria are exempt. The exemption applies on interest, royalty, dividend and rental income which is repatriated to Nigeria through government approved banking channels. The exemption applies whether the foreign income has been taxed by another country or not. This policy incentivizes Nigerian residents to stash savings in foreign low-tax jurisdictions and invites abuse through "round-tripping". For example, a local company conducting a business in Nigeria could fund a foreign controlled corporation with equity. That foreign corporation may then loan the funds back to the local's business. The business would pay interest on the loan to the foreign corporation and claim a deduction for the interest. The interest may be subject to interest withholding tax (WHT). Yet, the interest can then be distributed in the form of dividends to the Nigerian controller with no further tax liability. The only tax collected by Nigeria on the distributed funds is the interest WHT, which may be reduced under double tax treaties (DTTs) and which may be substantially less than what would have been paid if the controller had not engaged in such a scheme to reduce the tax base of the CIT.

11. Data from the coordinated direct investment survey illustrate risks of abuse. The primary destination for Nigerian investments abroad is the Netherlands and Mauritius (Figure 8). The magnitude of inward direct investments from the Netherlands matches the outflows to the financial center. While extreme cases of round-tripping might be dealt with through the General Anti-Avoidance Rule (GAAR), GAARs are difficult to apply and will not cover all possible scenarios. CFC rules could curb the most aggressive forms of round-tripping. From a revenue perspective it did not matter whether the income was brought into the country or not given

Figure 8. Direct Investments into and out of Nigeria (in billions of US dollars)



Source: Coordinated Direct Investment Survey, IMF, 2018 that passive income and income earned by a temporary guest, lecturer, teacher, nurse, doctor and other professional brought into the country in convertible currency, through government-approved channels and deposited into a domiciliary approved bank accounts are tax exempt. This repatriation incentive is, from a distributional perspective, unfair and should be scrapped as only high-income earners are benefiting from this.

12. A key concern is that the current tax legislation is ineffective in forcing residents to truthfully disclose foreign assets holdings. This was evidenced by the *2017 Voluntary Assets and Income Declaration Scheme*. If residents do not repatriate the income from offshore portfolios, WHT would be imposed annually on disclosed accrued income but if they repatriate it would be tax-exempt. Hence, non-disclosure is favored as wealthy Nigerian residents prefer keeping their wealth offshore. The previous OECD initiative of establishing a network of bilateral tax information exchange agreements (TIEAs) covered only a small number of low-income countries and the exchange of information was mainly managed "on request". A tax authority could request specific information about a specific taxpayer together with a clear justification; a more broad-based enquiry, such as requesting the total number of residents having portfolio investments in the other treaty partner country were not permitted. This made TIEAs a futile exercise, especially since low-tax jurisdictions were slow to respond or generally uncooperative. While the OECD model TIEA does not provide for automatic exchange of information (AEOI), TIEA partners may extend the scope of their existing TIEAs to cover AEOI by executing the model protocol agreement. The signing of the Multilateral Competent Authority Agreement (MCAA), which provides a multilateral platform for the efficient and standardized implementation of, *inter alia*, AEOI, does not preclude a country from entering into TIEAs that provide for AEOI on a bilateral basis with other jurisdictions that are not parties to the MCAA.

13. Thus, the cornerstone of renewed efforts in taxing HNWIs must be a strict implementation of automatic exchange of information (AEOI). The OECD's common reporting standard, implementing AEOI, was introduced in October 2014 together with the signing of the MCAA. By April 2018, five African countries (Ghana, South Africa, Nigeria, Mauritius and Seychelles) had implemented AEOI.[11] Adhering to this standard should be underpinned by further efforts by the Nigerian banking sector toward full compliance with new rules that seek to verify beneficial ownership of assets.

C. The Exemption of Capital Gains Taxation (CGT) on the Disposal of Shares

14. Nigeria taxes gains on the direct disposal of assets but exempts gains on the disposal of shares. This treatment exposes Nigeria to tax avoidance through indirect transfers of assets, whether domestically or internationally. Instead of holding an appreciating asset, such as a mineral

[11] Nigeria has implemented AEOI in the Income Tax (Common Reporting Standard) Regulations, 2019, which are effective from 1 July 2019.

right, directly, a person may hold an asset through a company. By selling the shares in the company, the asset can be disposed of free from tax. It is particularly problematic in respect of valuable immovable property (i.e., mineral rights) and certain other rights such as telecom licenses.[12] Many countries have taken measures to ensure their right to tax these transfers.[13]

15. Taxing the disposal of shares is a necessary first step to reducing arbitrage opportunities, but revenue leakage would remain. These would persist because trading stock or balancing charges on depreciable assets are subject to the full CIT rate of 30 percent while capital gains at the corporate level are only subject to tax at a rate of 10 percent. Indirect transfers of assets are one example of how ordinary business income can be transformed into capital gains for tax purposes. Another example is retained earnings of a controlled corporation that increase a firm's value and hence would result in capital gains if not distributed as a dividend, which are subject to the standard CIT rate. To eliminate arbitrage opportunities, it is a common practice—and strongly advised in the case of Nigeria—to treat all realized capital gains of companies as ordinary business income and tax them at the standard CIT rate or impose capital gains tax on companies at the CIT rate.

16. When capital gains are taxed as ordinary business income, tax planning for non-residents may move to a higher level in the corporate chain. A non-resident company holding a Nigerian company (which holds an appreciating asset) is often itself held by another company, commonly in a country that does not tax gains on disposal of shares. When the appreciating asset is to be sold, it is the shares in the non-resident company that may be sold. This is an offshore indirect transfer and such a sale is outside the scope of the Capital Gains Tax Act (CGTA) even if the exemption of share disposals were repealed. There are two methods for taxing gains from offshore indirect transfers:[14]

- **Option 1** deems the local entity to realize capital gains on its assets at market value when it suffers a change of control. This approach would require adjustments to CITA and CGTA to incorporate deemed realizations, but the taxing right could not be constrained by provisions of existing DTTs.
- **Option 2** seeks to tax the offshore capital gain made on the disposal of shares in a foreign company. CGTA would have to be expanded to cover capital gains made by non-residents, and the definition of a disposal of immovable property in Nigeria would have to clearly include

[12] For complex reasons, it does not seem to be such a problem with petroleum rights; see Baunsgaard, Harris, Luca and Watson, "Nigeria: Petroleum Fiscal Reform", FAD Technical Assistance Report, August 2018 (IMF) [148]-[151].

[13] The offshore gain usually reflects a future cash flow from the local asset that will be taxed in due course. If the gain is taxed at the point of indirect realization it should not be taxed a second time when the cash flow is directly realized. Preventing double taxation typically requires the recognition of capital losses, something that the CGTA currently does not do.

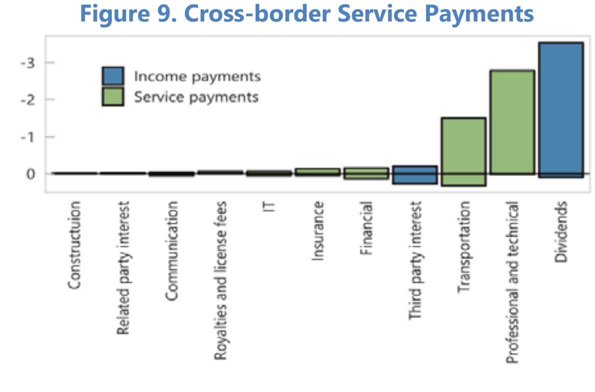
[14] See IMF, World Bank, OECD & UN (2018), "Taxation of Offshore Indirect Transfers of Assets", Platform for Collaboration on Tax; available at http://www.oecd.org/ctp/platform-for-collaboration-on-tax-invites-final-comments-on-a-revised-version-of-its-report-on-the-taxation-of-offshore-indirect-transfers-of-assets.htm

indirect disposal through offshore indirect transfers. This option only works if relevant double tax treaties include provision 13(4) of the OECD and UN's model tax treaties.

D. The Taxation of Payments to Non-residents for Services

17. Cross-border service fee payments pose major risks of tax base erosion. Just like interest payments, payments for services performed by related or non-related parties are deductible from the corporate tax base of Nigerian companies. However, while many countries have introduced rules that limit deductibility of interest payments, there are commonly no rules limiting the deductibility of payments for professional services, such as management and insurance services. With the increasing digitalization of the economy, many of these high value functions can be performed remotely from jurisdictions that tax profits at low rates. In Nigeria, the amount of cross-border payments for services exceeds the amount of related party interest by far, attaining levels closer to cross-border dividends payments (Figure 9).

Figure 9. Cross-border Service Payments



18. In the absence of targeted anti-abuse provisions, withholding tax can act as a second line of defense. Withholding taxes apply on gross payments and ensure that deductible payments are taxed at the level of the recipient even if the recipient is a non-resident. Withholding taxes can thus remove the tax benefits MNEs may enjoy from overpricing services provided from investment hubs to their domestic affiliates. However, withholding taxation requires precise definitions of (i) what type of payment is subject to withholding taxation and (ii) what factors determine the source of payment as it is international practice to only tax payments with a domestic source. Accordingly, the definition of a service fee should exclude fees for the provision or transfer of property and have a source in Nigeria when paid for by a resident person conducting business (not through a foreign PE) or through a Nigerian PE of a non-resident.

19. Nigerian regulations require withholding tax from an array of service fees, but the absence of comprehensive definitions of what constitutes domestic source have led to conflicting case law, creating a high level of uncertainty for business. The FB 2020 aims at expanding Nigeria's right to tax service payments by introducing two new rules. However, these rules overlap and might add to the patchwork of inconsistent and incomplete definitions of what constitutes domestic source:

- **Remote services rule.** The FB suggests treating profits of a trade of a non-resident company as derived from Nigeria if it provides "technical, management, consultancy or professional services outside of Nigeria to a person resident in Nigeria". While the aim to tax remote service providers is a positive move, the rule only applies to the extent that the non-resident service provider has significant economic presence in Nigeria and profits can be attributable to such activity. That would often not be the case.

- **Electronic services rule.** The FB suggests treating profits of a non-resident company as derived from Nigeria if they are attributable to electronic transmission of data "to Nigeria in respect of any activity". While there is some similarity between this proposal and a 2018 draft directive of the European Commission, the EU proposal is more targeted, narrowly focused on services provided through a digital interface, and includes a substantial de minimis exemption.[15] In contrast, the electronic services rule seems broad, ill-defined and appears to grant wide discretion to the FMoF and FIRS.

20. Double tax treaties limit Nigeria's right to tax service payments and invite abuse. The stated purpose of double tax treaties is to encourage trade and provide relief from double taxation, and more recently the avoidance of double non-taxation. However, the benefits of tax treaties come at the price of limiting source countries' taxing rights and some of the older treaties erode Nigeria's right to tax outbound service fees.[16] Estimations suggest that revenue losses due to this restriction might amount to 0.15 percent of GDP (Box 1). While the treaties are intended to reduce tax obligations on residents of the contracting states, other investors may restructure their business to enjoy low rates if Nigeria neglects to put proper safeguards in place. Here, the "principle purpose test" (PPT) introduced by the OECD's Multilateral Instrument may provide some protection and this is a reason for the legislature to move promptly in passing the implementation legislation.

21. Nigeria should monitor developments in the OECD's response to digitalization of the economy and focus its attention on more pressing issues where more revenue is at stake. The OECD is committed to develop greater details on its approach to tackling challenges of the digitalization of the economy within a year. Further work will develop the parameters of the "undertaxed payments" and "subject to tax" rules of Pillar 2, but the important feature seems to be the right to tax the "payment" and apply to the gross amount. However, the country of the payer would have to investigate the tax treatment in other countries (to determine if the minimum tax is reached) before it can impose the tax. This is not the case with regular WHTs and may add complexity to the administration of the rules.

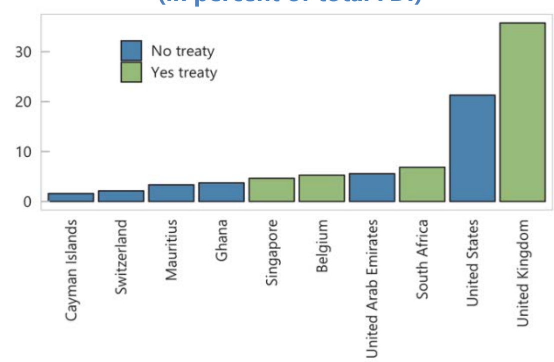
[15] It is not clear whether the new e-commerce rule will be subject to a WHT and it would be administratively difficult for a WHT to cover all payments that might fall within its scope. Further, unlike the remote services rule, any WHT applied to e-commerce is not expressed to be final and so in principle the new e-commerce rule involves net based taxation and requires the allocation of both income and expenses.

[16] More recent treaties do include Article 12A of the UN Model Convention (technical services fees), which is one option to secure the taxing rights for such technical services fees.

Box 1. Estimating Revenue Losses Due to Treaty Shopping

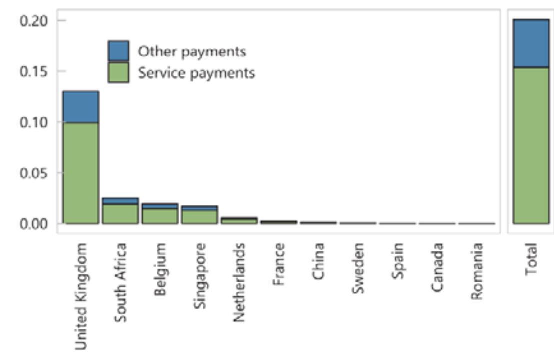
DTTs imply revenue losses where there is a difference between WHT tax rates applied on cross-border flows with treaty countries and non-treaty countries. Data from the Nigerian Central Bank suggests that service payments crossing the Nigerian border have increased substantially since 2016 and now account for over 7 percent of GDP while income payments, including dividend, interest, and royalty payments, account for 4 percent of GDP. When these payments are directed to countries Nigeria has not concluded a treaty with, withholding at a rate of 10 percent applies. In contrast, when the payments are directed to a treaty partner, Nigeria may not withhold on service payments while interest, dividend, and royalty payments are restricted at 7.5 percent.

FDI by Treaty Status
(in percent of total FDI)



Sources: WEO, GFS, IMF Staff calculations.

Estimated Revenue Losses



Sources: WEO, GFS, IMF Staff calculations.

Central Bank of Nigeria (CBN) capital importation data suggests that 60 percent of Nigeria's total capital stock originates from treaty partner countries in 2018 (Figure 10). The capital importation data is used to infer the (unknown) destination of cross-border payments. While this assumption is simplistic, it provides a natural benchmark in the absence of other bilateral information that would allow approximating the allocation of payments.

The approximations suggest total WHT revenue forgone due to treaties amounts to 0.2 percent of GDP in 2018. The estimate assumes that additional revenue would be 10 percent of service payments and 2.5 percent of dividend, interest, and royalty payments directed to treaty partner countries. More than 75 percent of total revenue losses, or some 0.15 percent of GDP, are related to service payments (Figure 11).

E. The Costs and Benefits of Existing Incentive Schemes

22. Nigeria offers a multitude of tax incentives to a wide range of businesses and activities, many of which are explicitly targeted at, and enjoyed by, foreign investors. Set out in 4 different laws,[17] the different provisions do not have an overarching strategy, which has resulted in duplication of tax expenditures. The most important provisions are provided under two schemes:

- **The Pioneer Status.** The Pioneer status provides activity- and company-specific income tax holidays to 99 products and industries – including e-commerce, software development, mortgage-backed securities, manufacturing, mining, and real estate investment schemes – for up to 5 years. Losses incurred during the period and capital allowances arisen are deemed to accrue on the first day after termination of the tax-exempt period, thereby extending the

[17] Industrial Development (Income Tax Relief) Act, CITA, Nigeria Export Processing Zones Act, Oil and Gas Export Free Zone Act.

effective exemption. Moreover, dividends paid out of pioneer profits, either during or after the CIT holiday, are exempt from WHT.

- **Export-oriented companies.** Export-oriented companies enjoy a wide range of direct and indirect tax exemptions, some of which are granted indefinitely. Specifically, the Free Zone Status grants 7 industries the right to operate in an export processing zone (EPZ) and provides for a complete exemption of federal, state and local taxes and levies, except for personal income taxes. Other export-oriented companies and their suppliers may enjoy unlimited CIT exemptions if at least 75 percent of export proceeds are repatriated.

23. Tax incentives commonly aim at compensating for other government-induced obstacles, such as poor infrastructure, tax uncertainty, corruption, or red tape. For example, the tax exemption granted to export-oriented companies eliminates the need to provide timely tax credits for VAT paid on intermediate inputs. While a targeted reduction in a company's tax liability is easier to achieve than addressing structural impediments to growth, empirical evidence suggests that tax incentives tend to be ill-designed to generate additional investment (Klemm and Van Perry, 2008).

24. When reviewing the necessity of tax incentives, Nigeria should contrast potential benefits against both direct and indirect cost (Box 2).[18] Direct costs are the revenue foregone by not taxing business that might have invested even in the absence of the incentive. In addition, taxpayers will respond by either adjusting real investment decisions or by artificially changing structures and transactions to benefit from a reduced tax burden. Tax incentives reduce the cost of capital for a subset of firms, thus introducing an uneven playing field which hinders an efficient allocation of capital. Furthermore, limiting abuse of incentives increases the cost of tax administration.

25. Global efforts aimed at curbing profit shifting and ensuring a minimum level of taxation will further limit the effectiveness of tax incentives in attracting foreign investment. Countries are increasingly implementing CFC rules, where interest, royalty and dividend income, of foreign affiliates is taxed in the headquarter jurisdiction if this income is taxed at a low effective rate. In November 2019, the OECD published a consultation document discussing the potential of a global minimum tax on outbound investment, which would expand the scope of CFC rules to also cover active business income. [19] While the specifics of the proposal remain unclear, it is likely that any type of minimum tax would reduce tax savings foreign investors enjoy from any profit-based tax holiday in Nigeria.

[18] See Platform for Collaboration on Tax (2015) "Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment".

[19] OECD (2019), 'Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two', Public consultation document, 8 November 2019; available at https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf

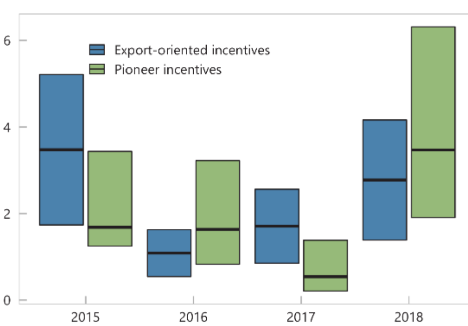
Box 2. Evidence on the Direct Costs and Potential Benefits

Different data sources allow approximating revenue forgone due to the major incentive schemes. For the Pioneer Status, historic tax expenditure estimates for non-oil firms are available, which allows predicting current tax expenditures based on approved investment volumes in a linear regression framework. For export-oriented companies, it is assumed that all non-oil exports are exempt from CIT, with profit margins on gross sales ranging between 5 and 15 percent.

The new estimates suggest the direct cost of Nigeria's income tax exemptions granted to non-resource companies amount to around 5 percent of CIT revenue in 2018. Revenue forgone on CIT in the non-oil sector has increased since 2016, amounting to 5 percent of CIT revenue in 2018 (Figure 12). Accounting for a margin of error, the tax expenditure might lie in between 2 and 9 percent of CIT revenue. Incentives granted under Pioneers Status account for slightly more than 50 percent of total direct tax expenditures in 2018. The indirect costs related to abuse are difficult to gauge but likely substantial, especially for the EPZ regime, as no WHT charge applies on any payments from taxable entities to entities in the free zones. As a result, related parties in the regular tax regime can make tax deductible payments, such as for interest expenses, to a financing affiliate in the free zone and thereby reduce the group's consolidated tax payments at a rate of 32 percent.

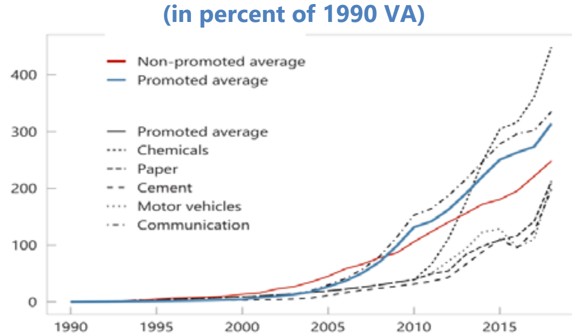
Data on value creation in promoted sectors does not substantiate expectations on the effectiveness of these expenditures. The petro-chemicals, paper and pulp, cement, motor-vehicles, and telecommunication sectors are considered success stories of the Pioneer Status. Since 1990, value added (VA) in these industries increased, on average, by a factor of three. Sectoral value added in other industries has increased slightly less, by a factor of 2.5, apparently providing evidence for the incentive's success (Figure 13). However, a comparison of investment volumes and sectoral value added over time suggests that investments followed sectoral productivity increases, rather than the other way around (Figure 14). A vector auto regression substantiates the suspicion of reverse causation: Pioneer investments increased on average by 0.3 Naira subsequent to a 1 Naira increase in value added. Conversely, value added in promoted industries tended to decrease by 0.25 Naira following a 1 Naira increase in Pioneer investments.

Tax Expenditure Estimates in the Non-oil Sector (in percent of CIT Revenue)



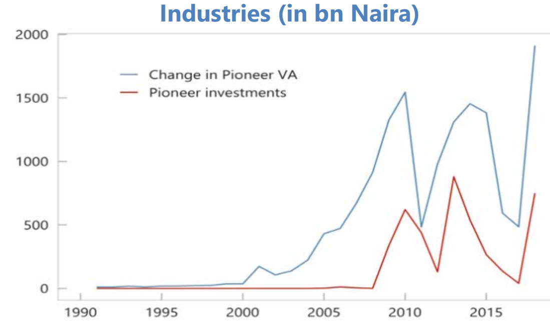
Sources: NIPC, CBN, IMF staff computations; Blue bars show tax expenditure for 5, 10 and 15 percent profitability margin, respectively. Green bars show predicted tax expenditures for Pioneer Act, with middle bar showing point estimate and upper and lower green bar showing 50 percent confidence intervals

Increase in VA in Promoted Industries (in percent of 1990 VA)



Sources: CBN, NIPC, IMF staff estimates.

Change in VA and Investments in Promoted Industries (in bn Naira)



Sources: CBN, NIPC, IMF staff estimates.

F. Conclusion

26. Strong policy actions are needed to address weaknesses of Nigeria's international tax system. AEOI will be critical to tackle tax avoidance by HNWIs, while removing exemption of capital gains tax on the disposal of shares and strengthening the taxation of payments to non-residents for services are also priorities. The costs and benefits of existing incentive schemes for foreign investors should also be re-evaluated under the context of ongoing global efforts to curb profit shifting and ensure a minimum level of taxation.

CLIMATE CHANGE IN NIGERIA: TREND, IMPACT, AND SOLUTIONS[1]

1. **Climate change is the defining challenge of the 21st century**. It has an overarching impact on various aspects of the economy and society ranging from economic growth to financial vulnerability and from population growth to social stability. No country can escape unscathed from the negative consequences of climate change. Understanding the risks from climate change is therefore important. Designing policies that help mitigate and adapt to climate change is crucial for sustainable economic development.

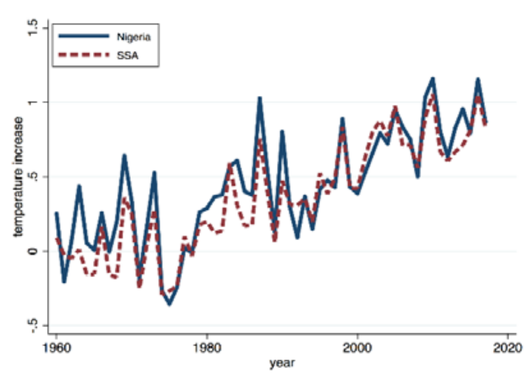
2. **This paper documents the basic patterns of climate change for Nigeria, analyzes its impact and suggests policy actions to cope with climate change.** The rest of the paper is organized as follows. Section A describes broad climate trends in Nigeria. Section B discusses the impact of climate change on economic activities. Sections C and D explore challenges in commodity markets, financial markets, and the security situation that arise from the changing climate. Building on work done by the World Bank, the IMF and Nigeria's Federal Ministry of Environment, Section E reviews and proposes mitigation and adaptation policies.

A. Climate Change in Nigeria: Basic Patterns

3. **The climate is changing globally and Nigeria is no exception.** Key stylized facts that emerge include:

- **Increasing temperature**. The global temperature has been on a rising trend for at least half a century. Many leading studies in climate science estimate that temperature has risen by 1℃ above pre-industrial levels and will reach 1.5℃ towards mid-21st century if no policy action takes place (IPCC, 2018). Over the past 60 years, annual average temperature in Nigeria has increased by almost 1℃, in line with the average in sub-Saharan Africa (Figure 1).

Figure 1. Temperature Increase in Nigeria



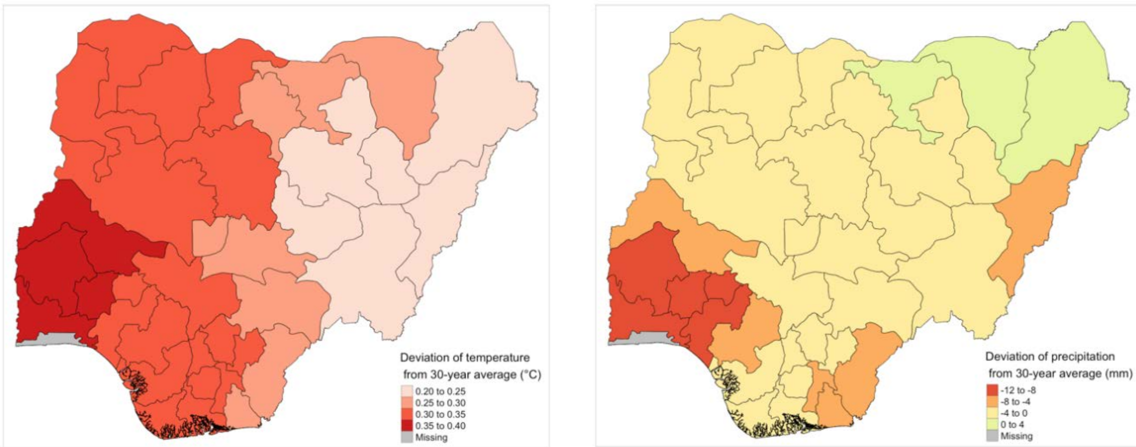
Sources: University of East Anglia Climatic Research Unit and IMF staff calculations.

- **Uneven distribution across regions**. Compared to the past 30-year average, while all regions in Nigeria has experienced a rise in temperature, the southwest region has seen temperatures rise by almost twice as much as in the Northeast. The distribution of the change in precipitation is

[1] Prepared by Jiaxiong Yao. This chapter has benefited from discussions with and comments from the Ministry of Environment in Nigeria, the World Bank, the Economic Cooperation and Energy Delegation of the European Union to Nigeria and ECOWAS, DFID, Embassy of Norway, UN, and the IMF.

similarly uneven, with decline in the Southwest region and slight increase in the Northeast region.

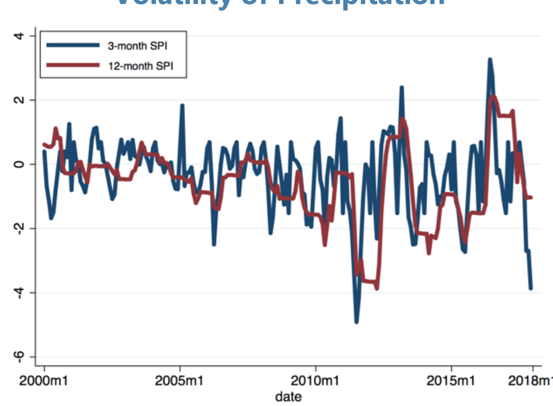
Figure 2. Change in Temperature and Precipitation in Nigeria



Sources: University of East Anglia Climatic Research Unit and IMF staff calculations.

- **Increasing volatility**. Increases in extreme weather events, including more intensity and frequency of droughts and floods in some regions, are often associated with rising temperature. For example, measured by the standard precipitation index (SPI)[2], the Adamawa state has been witnessing more volatile weather conditions (Figure 3), which is contributing to tensions underlying the conflicts between Fulani herdsmen and farmers in the state. In fact, among events classified as natural disasters, floods rank second in Nigeria and there is evidence that their intensity and frequency has increased in the past two decades (Figure 4).

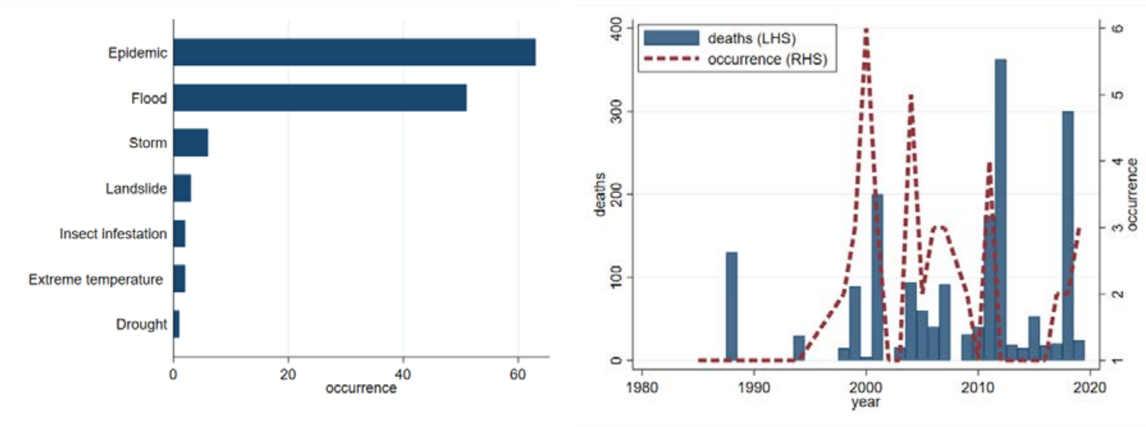
Figure 3. Adamawa, Nigeria: Heightened Volatility of Precipitation



Sources: University of East Anglia Climatic Research Unit and IMF staff calculations.

[2] SPI> 2 indicates extremely wet weather conditions and SPI< −2 extremely dry weather conditions.

Figure 4. Nigeria: Natural Disasters

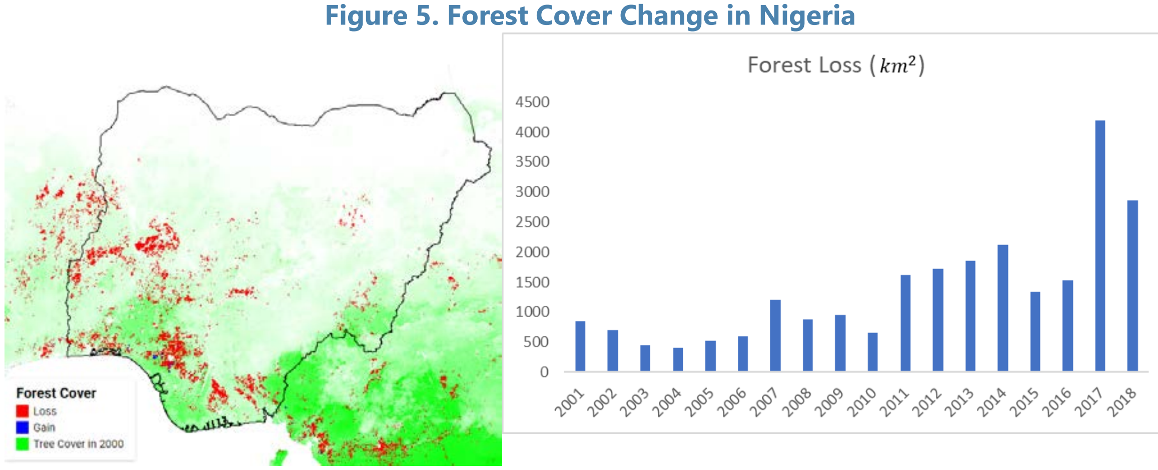


(a) Frequency of Natural Disaster between 1960 and 2018 (b) Flood Occurrence and Resulted Deaths

Sources: EM-DAT and IMF staff calculations.

- **Environmental degradation.** Global warming poses threats to biodiversity and ecosystems. There are already worrying signs of environmental degradation as a consequence of human activity. For example, forest loss has occurred in vast swaths of land in Nigeria since the turn of the century and there is evidence from satellite images that such loss is accelerating (Figure 5). Soil degradation may affect agricultural productivity directly. The smoke spreading from burning forests may hamper people's health and lower productivity. Environmental degradation also reduces the potential for sustainable development and leaves less room for policy errors.

Figure 5. Forest Cover Change in Nigeria

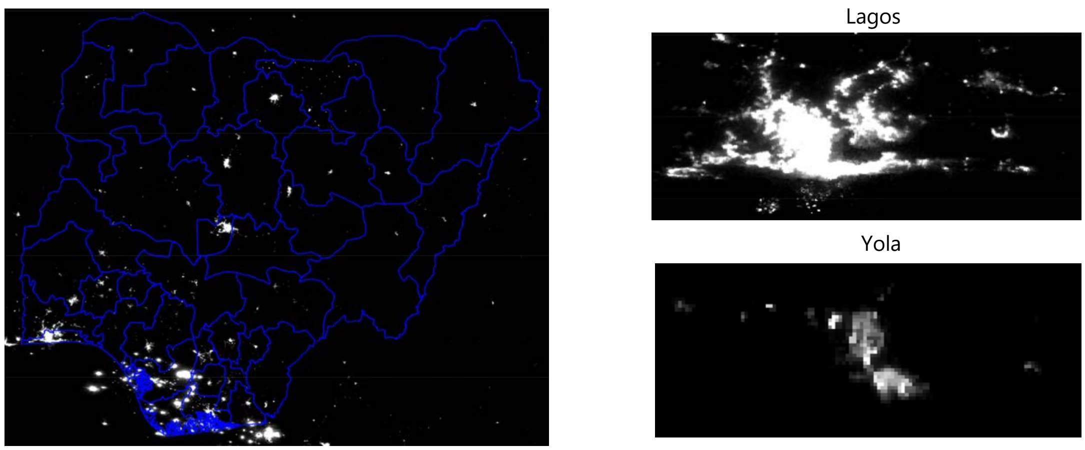


Sources: Hansen/UMD/Google/USGS/NASA and IMF staff calculations.

B. Climate Change and Economic Activity

4. Quantifying the economic impact of climate change requires high resolution gridded data for temperature and precipitation. This data is necessary to address analytical challenges linked to slow-moving climate change, localized impact, and lack of economic data at subnational levels. The time span of over a century (1901-2017) allows for construction of deviations from long-term averages, which represent shocks to climate variables. Meanwhile, satellite-recorded nighttime lights—which are highly correlated with gross domestic product (Hu and Yao, 2019)—can be used to proxy for local economic activity (Figure 6). The granularity of the data allows for analysis at subnational levels. In particular, the unit of analysis in this study is the first administrative level (state/province).

Figure 6. Nighttime Lights in Nigeria



Note: Figures above examples of night lights in Nigeria. Numerical values of luminosity for all pixels are aggregated for each state at a point in time to obtain the total sum of nighttime lights as an indicator of economic activity.
Sources: National Oceanic and Atmospheric Administration and IMF staff calculations.

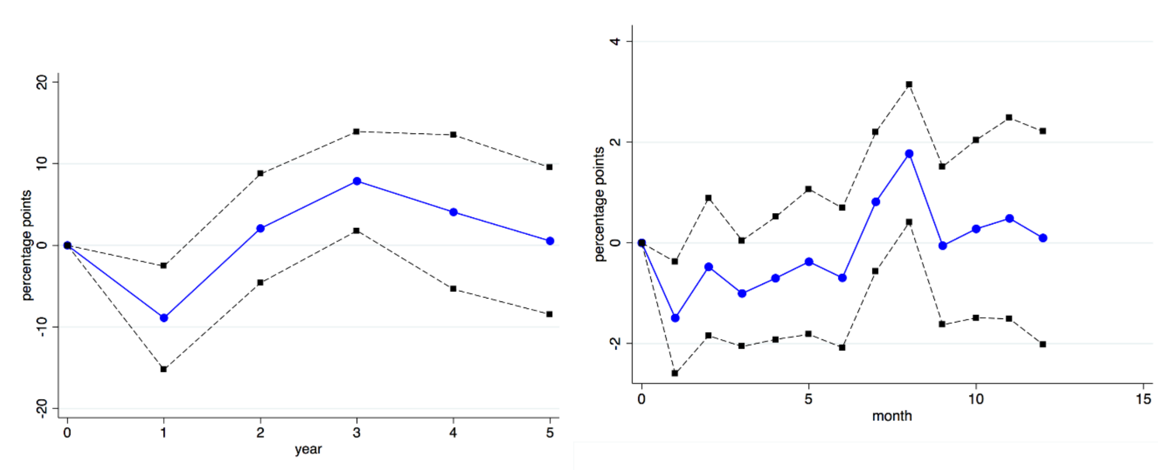
5. Rising temperature hampers economic activity in the short run. Based on panel data between 1992 and 2013, staff estimates that a 1℃ increase in annual average temperature reduces local economic growth by 5-7 percentage points[3] in the same year in Nigeria, although the impact seems to be temporary (Figure 7, left). This is consistent with the literature studying temperature and economic outcomes over a longer period of time and in a wider cross-country setting: higher temperatures substantially reduce economic growth (Dell, Jones, and Olken, 2012; IMF, 2017).

6. Anomalies in precipitation adversely impact economic outcomes. A 10 mm increase in monthly precipitation reduces economic growth by about 0.5 percentage point lasting for at least three months (Figure 7, right). There are a number of channels through which higher-than-usual rainfall could stall growth. For instance, excessive rainfall could be damaging to crop yields in areas with poor drainage systems; it could also disrupt transportation systems, preventing efficient flow of goods and services.

[3] The elasticity of night lights to GDP is about 2 for lower middle-income countries. See Hu and Yao (2019).

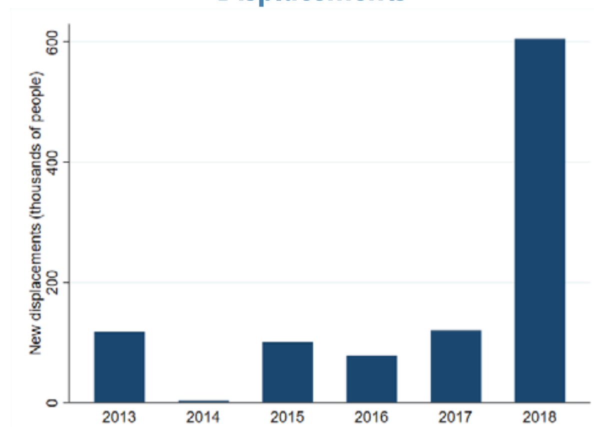
Figure 7. Nigeria: Impact of Temperature and Precipitation Shocks on Economic Activity

Impact of 0.5°C Temperature Shocks | Impact of 10mm Increase in Precipitation



Note: Impact on economic activity is measured by nighttime lights growth (vertical axes, annual for temperature and monthly for precipitation). Dashed lines are 95 percent confidence intervals.
Source: IMF staff calculations.

Figure 8. Nigeria: Floods and Internal Displacements



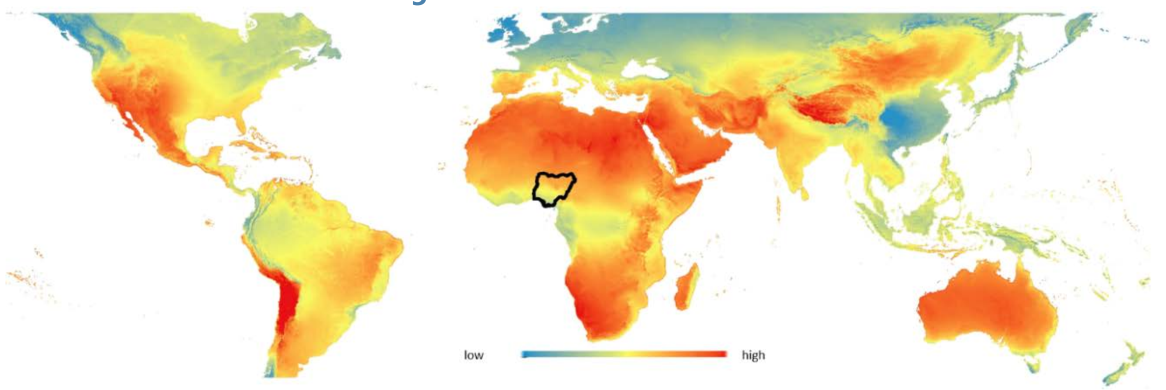
Note: Each bar represents people newly displaced by flood in a year.
Sources: Global internal displacement database and IMF staff calculations.

7. **Natural disasters disrupt local labor markets.** As one of the most frequent natural disasters, floods have displaced a sizeable share of the population in Nigeria recently (Figure 8). With climate change implying even more frequent occurrences of extreme weather conditions and natural disasters, such displacement is likely to increase, creating challenges of local labor supply shortage, rising unemployment, and productivity loss, especially when displaced people move to different types of jobs in new settlements. A conservative estimate of the output loss is 0.2 percent of GDP when 600,000 people are displaced, as was the case in 2018.

8. **Climate change also impacts poverty, inequality, trade and public investment**. Underdeveloped areas tend to have less resilient infrastructure to withstand extreme weather; poor households are typically disproportionately affected by climate change. Poverty and inequality are thus at risk of being exacerbated in a changing climate. Changing climate conditions also shift regional comparative advantage within Nigeria, implying new regional trade patterns in the future. Climate change therefore is a new dimension along which national strategies on public investment, social inequality, and regional trade should be considered and developed.

9. Despite being an enormous challenge, climate change is also an opportunity for the economy to leapfrog. For instance, Nigeria, especially its northern region, has one of highest solar potential in the world (Figure 9). However, it is lagging behind the rest of the world in developing solar energy (IEA, 2018). Meanwhile, lack of access to and unreliable supply of electricity are key constraints to doing business in Nigeria (IMF, 2019a). In an environment where the world is increasingly committed to reducing carbon emissions, seizing the opportunity to prioritize developing renewable energies has the potential to pay off both economically and politically.

Figure 9. World Solar Potential



Sources: SOLARGIS and IMF staff calculations.

C. Climate Change, Commodity Markets, and Financial Markets

10. Climate change poses both physical and transition risks to the commodity and financial markets. Physical risk arises as climate-related changes interrupt business operations, destroy capital, and disrupt economic activity. Transition risk emerges from a shift toward a lower-carbon economy as policy, consumer sentiment and technological innovations impact the value of certain assets and liabilities.

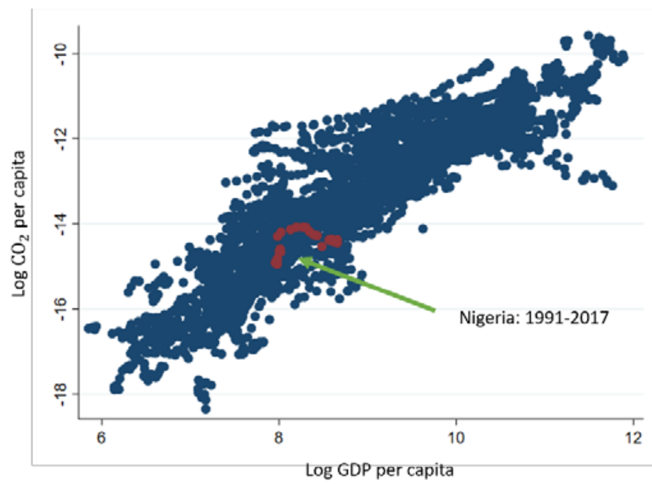
11. A hotter and less stable climate implies more volatility in Nigeria's commodity and financial markets. Disruptions in oil production and trade routes by extreme weather conditions not only affect oil supply but impact the financial performance of firms along the production chain. The reliability of oil supply will likely be factored into commodity prices while the profitability of firms that are exposed to climate change will be increasingly priced in financial markets. More broadly, additional transitory and permanent shocks to firms' revenue and cost streams arising from climate change portend more volatility for financial markets.

12. Nigeria's economy is vulnerable to transition risks, especially given its reliance on oil. Recent history has shown that carbon emissions are closely related to economic development (Figure 10). Being a lower middle-income country, Nigeria's future economic growth implies much higher carbon emissions if business is conducted as usual. However, the current global trend toward a low-carbon economy asks for new development strategies as countries move up the economic ladder. Technological innovations in the energy sector will therefore change prices in commodity and financial markets. Given Nigeria's heavy reliance on oil, such price changes will have broad implications for its fiscal and external balances, which in turn affect financial markets. In addition, the global trend toward less carbon emissions will bring about shifts in risk aversion toward and financial costs of green assets and brown assets[4], implying valuation changes in firms' and banks' balance sheets.

D. Climate Change and Conflict

13. Climate change worsens conflicts. There is mounting evidence from various disciplines that intensifying climate change would increase future risk of conflict, although the precise mechanisms of climate-conflict linkages remain uncertain (Mach and others, 2019). In particular, deviations from normal precipitation and mild temperatures systematically increase the risk of conflict, often substantially. Each 1-standard-deviation change in climate toward warmer temperatures or more extreme rainfall increases the frequency of interpersonal violence by 4 percent and intergroup conflict by 14 percent (Hsiang, Burke, and Miguel, 2013).

Figure 10. Economic Development and Carbon Emissions 1991–2017



Note: Each dot represents a country-year observation.
Sources: The Global Carbon Project, World Bank, and IMF staff calculations.

14. Rising temperature in Nigeria is a key factor behind more frequent clashes between herdsmen and farmers. Climate-related conflict[5] accounts for an increasing share of total fatalities from conflict (Figure 11). Resource scarcity, a key reason behind such conflict, is intricately linked to rising temperature. Examination of herdsmen/farmers conflict locations over time reveals that competition for water resources seems to be an important factor in the increase in conflict (Figure 12).

15. The tension between warming temperature and high population growth is likely to grow. On the one hand, being close to the Equator, the geographic location of Nigeria implies that average temperature is already high (around 27°C annual average). Further temperature increases will put additional strains on Nigeria's economy, especially its agricultural sector. Burke, Hsiang, and Miguel (2015) estimate that overall economic productivity peaks at an annual average temperature of 13°C and declines strongly at higher temperatures, implying that the problem will become more

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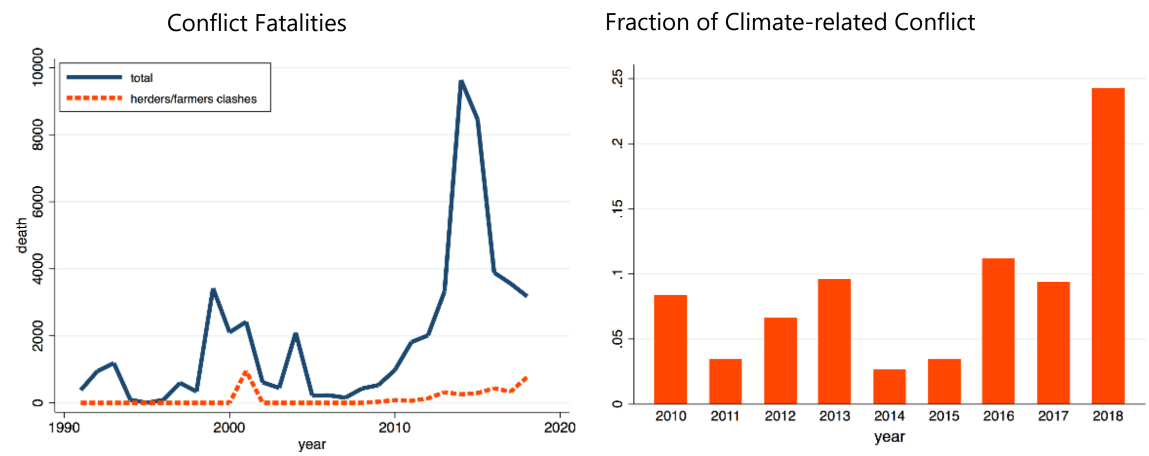
[4] Green assets refer to assets that contribute to climate mitigation and adaptation, such as green bonds or solar projects; brown assets refer to assets that support carbon-intensive projects or activities, such as coal power plants.

[5] The Uppsala Conflict Data Program Georeferenced Event Dataset is used for calculating conflict fatalities. For each event, there is an estimate of fatalities and a news headline describing the event. If the news headline contains key words such as "nomadic", "Fulani", "herdsmen", and "farmer", the conflict is categorized as climate related.

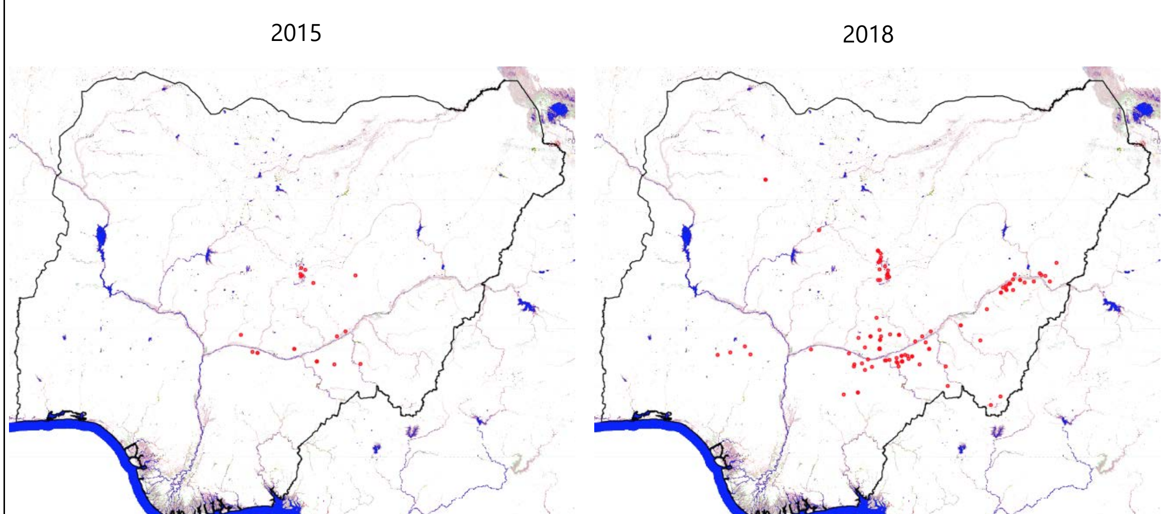
important for Nigeria as global warming continues. On the other hand, rapid growth of Nigeria's young population—more than half of the population is below 20 years of age—places mounting pressure on resources. The confluence of these two prominent trends increases the likelihood of conflict and the risk will only increase over time.

Figure 11. Nigeria: Climate and Conflict



Sources: UCDP Georeferenced Event Dataset (GED) Global version 19.1 and IMF staff calculations.

Figure 12. Nigeria: Locations of Herdsmen/Farmers Conflict

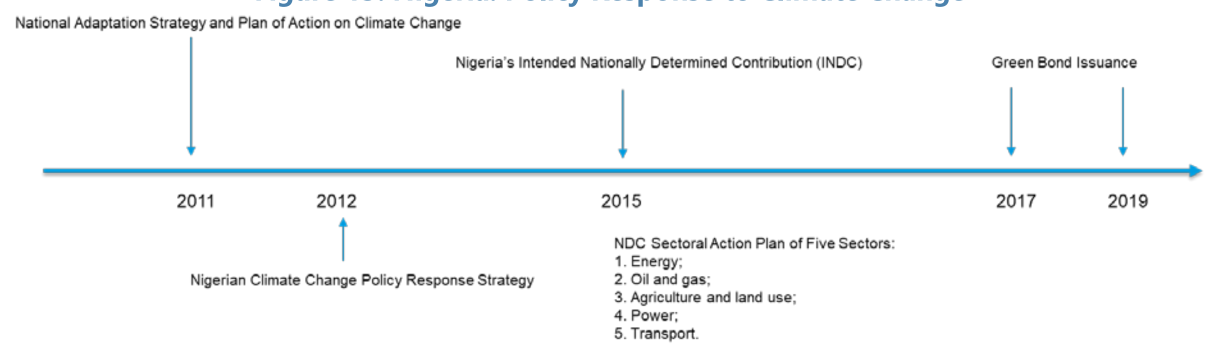


Sources: UCDP Georeferenced Event Dataset (GED) Global version 19.1 and IMF staff calculations.
Note: Red dots are locations of conflict. Blue/purple areas are surface water (rivers, lakes, etc.).

E. Mitigation, Adaptation, and Policy Recommendations

16. Given the complexity and profound implications of climate change, many mitigation and adaption policies have been put forth in Nigeria. These include the National Adaptation Strategy and Plan of Action of Climate Change for Nigeria (2011) and Nigeria's Intended Nationally Determined Contribution (2015). Figure 13 depicts the timeline of flagship policies put in place in the past decade. More recently, the Ministry of Environment in Nigeria has been actively engaged in raising public awareness of climate change through sensitization workshops, simultaneously creating jobs and mitigating future environmental damage through tree planting initiatives, developing early warning systems to reduce the impact of climate change, and working on a climate change bill to coordinate mitigation actions of ministries. Historically not a major contributor to global carbon dioxide emissions, Nigeria has mainly focused on adaptation.

Figure 13. Nigeria: Policy Response to Climate Change



Source: IMF staff calculations.

17. The adaptation and mitigation policies take a sectoral perspective on the response to the challenge of climate change. For example, the adaptation policy framework in the Intended Nationally Determined Contribution (INDC) highlights policies for key sectors: agriculture, forests, energy, transportation and communications, industry and commerce, with a focus on reducing vulnerability and increasing resilience. Mitigation measures, in addition to focusing on sector-specific actions, often set quantitative targets related to carbon emissions, renewable energies, and efficiency gains. Currently, Nigeria is on its way to meet some of the targets set out in the INDC.

18. While sectoral policies and objectives are important, more attention should be paid towards economy-wide policies. Fiscal, monetary, financial, and structural policies all play a role in combating climate change. Importantly, as the world transitions to a lower-carbon economy, such economy-wide policies will help boost the competitiveness of the Nigeria economy. Concretely,

- **Mitigation**.
  - *Certain subsidies—particularly on fuel products—distorts the market price of carbon-intensive products* and goes against the global trend of pricing carbon to mitigate climate change. Reducing/removing such subsidies and taxing carbon-intensive products will have an economy-wide impact, shifting people and firms towards greener energy and less energy-

consuming products or capital. Care should be taken to protect vulnerable households impacted by the fuel subsidy removal.

- *Developing fiscal tools to encourage economic activity* to move away from carbon emissions would contribute to mitigation. IMF (2019b) compares four alternative *mitigation* tools, including carbon tax, emissions trading system, feebates (fees on products and activities with above-average emission rates and rebates on those below average), and regulations (such as standards for the emission rates of vehicles).

- *Fostering green investments with financial sector policies*, such as issuance of green bonds, would reduce borrowing costs or barriers of green projects and enhance energy and resource efficiency.

- **Adaptation**.

  - *Climate change adaptation and poverty reduction often go together*. Expanding access to finance, enhancing social safety nets, diversifying household income, promoting education and raising climate change awareness all go in the direction of increasing the economy's resilience to the impact of climate change (Hallegatte and others, 2016). Therefore, taking the challenges of climate change into consideration in pursuit of Nigeria's sustainable development goals would help with adaptation.

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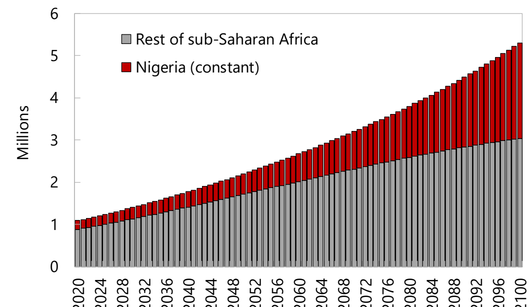
NIGERIA: DEMOGRAPHICS, SPENDING AND GROWTH[1]

An increasing work force presents large opportunities, provided the relative size of the out-of-the-labor-force population (dependency ratio) declines and workers enter the labor market skilled and healthy. Such an outcome calls for policies that boost human capital, including those requiring higher health and education spending. However, simulations for Nigeria suggest that even keeping currently low health service coverage in place would double to triple the public cost of health expenditures under different long-term population projections. Given the young age structure, the cost implications under the current pension system are less severe. Realizing the demographic dividend requires mobilizing significant additional savings and action in the education, social protection and health sectors.

A. Motivation and State of Play

1. **Demographic trends are set to shape sub-Saharan Africa's outlook, with global implications and substantial regional opportunities.** By 2035, the net number of sub-Saharan African people entering the labor market will exceed net entries from the rest of the world combined (IMF 2015). These developments could be a game changer for the global labor market and migration patterns and urge integration of the region's markets into the global value chain. History suggests that these dynamics present a significant opportunity: Many developing countries in South and East Asia that saw large increases in their working age population and subsequent declines in dependency ratios, witnessed rapid growth through a demographic dividend (Aiyar and Mody 2011) in cases in which job creation and increases in human capital through education and health complemented these developments. Higher levels of education have been associated with lower fertility rates, especially at the adolescent level, accelerating the demographic dividend—the increase in economic growth resulting from increases in the share of the working age population relative to the inactive population—and in itself strongly linked to higher savings, education levels and female labor force participation.

Figure 1. Sub-Saharan Africa: Population Developments (Billions of People)



Sources: United Nations Population Division,
Assumptions: medium fertility assumption for sub-Saharan Africa, constant fertility for Nigeria.

Note: Medium fertility assumes median fertility and mortality based on the median of a probabilistic trends of these variables, while under the constant fertility assumptions further projections assume fertility levels as at the average of 2015-2020 in Nigeria, (see United Nations Population Division projections for more detailed explanations).

2. **Nigeria's population trends are a significant contributor to these global dynamics.** Currently, every fifth person in sub-Saharan Africa is Nigerian. This share could increase rapidly if

[1] Prepared by Monique Newiak and Liam O'Sullivan.

Nigeria were not to follow the fertility transition that other countries have achieved in the past (Figure 1), making Nigeria's demographic transition a global issue.

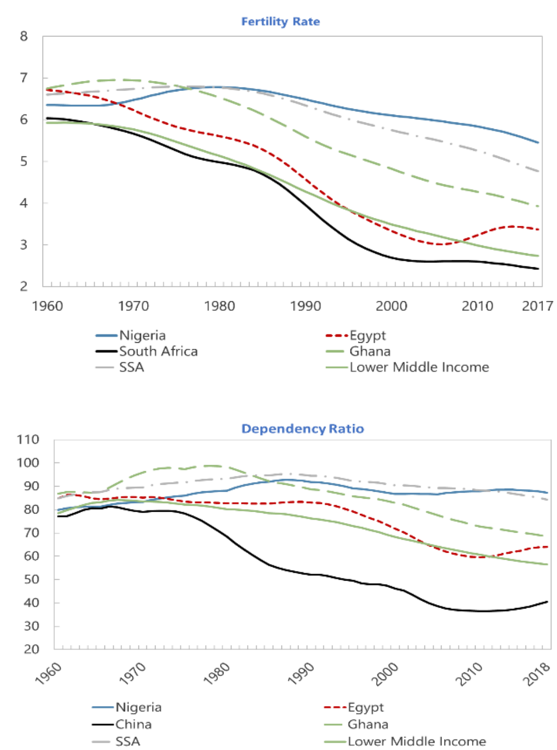
3. **The demographic dividend has a positive impact on growth.** Recent international experience with the demographic dividend underlines its importance for economic development, explaining 40 to 50 percent of per capita growth for India since the 1970s (Aiyar and Mody 2011), and one-fourth to two-fifths for East Asia between 1965 and 1990 (Bloom and others 2003). It has two distinct components (also subject to a degree of endogeneity between them):

- the **demographic transition**, characterized by a drop in the fertility rate to an average of 2 to 3 children per woman to slow the rate of population growth. It is considered a precondition for the demographic dividend by reducing the dependency ratio (the ratio of the non-working-age population to the working-age population).

- ensuring that the abundant labor supply resulting from **existing population dynamics is absorbed by the job market**. The combination of high productivity and abundance of labor ensures that unit labor costs remain low, creating the conditions for further business expansion. Wider issues in the transition process, such as flight from land, rapid urbanization and requirements for industrial expansion, are beyond the scope of this paper but need to be considered carefully in policy planning.

4. **Nigeria is lagging in its demographic transition.** At 5.4 children per woman according to the latest available data (2017), Nigeria lags both its peers and sub-Saharan Africa—as the measured fertility rate for lower middle-income countries is below 3 children per woman while Ghana and Egypt are already below 4. As a result, Nigeria's dependency ratio has remained around 80 percent—substantially higher than the 60 percent average for lower middle-income countries—which implies substantial resources in basic health and education service provision that increase the financial burden on the working age population.

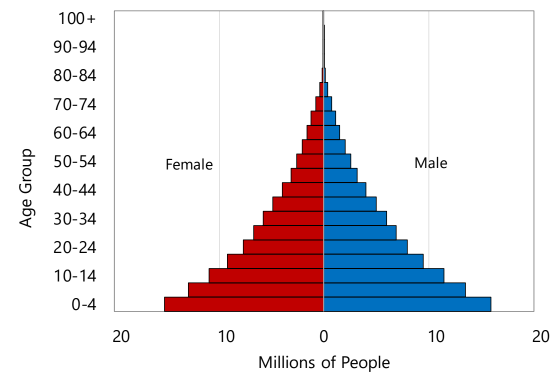
Figure 2. International Comparison of Fertility and Dependency Ratios (1960–recent)



Source: United Nations Population Division

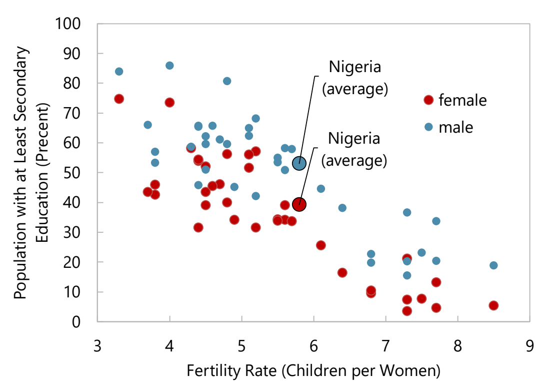
5. Demographic trends in Nigeria could challenge social security and public systems that face strains even at current population levels. Nigeria's youth (up to 19 years of age) account for more than half of the country's population, 4 in 9 Nigerians are less than 15 years old (Figure 3), exhausting current public education and health facilities (IMF 2019). Country-wide, the correlation between education and health outcomes and demographics (Figures 4 and 5) suggest that challenges are particularly daunting where the number of children is highest. For instance, while the share of the male and female population that completes at least secondary education is relatively low (more than five in ten men, less than four in ten women), completion rates drop to one in five and one in 20 for men and women in Jigawa (average fertility of 8.5 children per woman) and Kebbi (average fertility of 7.7 children per women), respectively. Likewise, on average, high infant mortality rates are peaking in Nigerian states with highest fertility rates. With continued high population growth, this implies an even heavier strain on current public service systems.

Figure 3. Nigeria: Current Age Structure
(Millions of People)



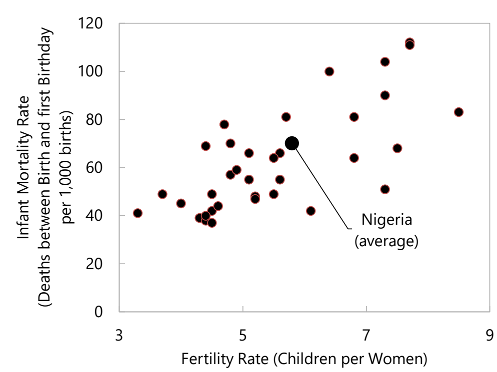
Source: United Nations Population Statistics.

Figure 4. Fertility and Education Level, Nigerian States



Sources: National Bureau of Statistics, MICS 2016/17.

Figure 5. Fertility and Infant Mortality, Nigerian States



Sources: National Bureau of Statistics, MICS 2016/17.

6. Against this background, this paper: (i) presents Nigeria's population projections under different scenarios; (ii) estimates possible growth and spending trajectories based on these projections going forward; and (iii) provides selected policy recommendations, building on the analysis of other development partners.

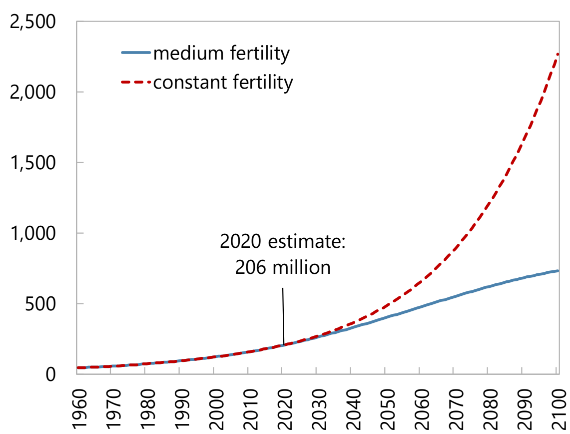
B. Implications of Different Future Population Trends

7. Demographic pressures are likely to continue in Nigeria in the medium to long term. At population growth rates of close to 3 percent and fertility rates of 5.4 children per woman on average, Nigeria faces significant demographic pressures going forward. The United Nations

Population Division's shows that, under the assumption of constant fertility, Nigeria's population could more than double over the next 25 years (Figure 6). In such a scenario, the overall dependency ratio would continue hovering around 85 percent (Figure 7). Even under moderating fertility—assuming the median trend of countries that have been in a similar demographic cycle (medium fertility assumption)—Nigeria's population would increase by almost 77 percent to almost 365 million people, though the dependency ratio would start to moderate below 70 percent by 2045. Within these assumptions, the medium fertility and mortality assumption are based on the median of a probabilistic trend of these variables, while under the constant fertility assumptions, projections assume fertility levels at the 2015-2020 average in Nigeria, (see United Nations Population Division projections for more detailed explanations).

Figure 6. Nigeria: Population

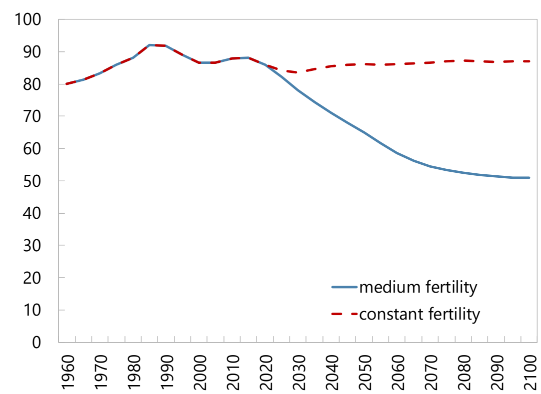
(Millions of People)



Sources: United Nations Population Division.

Figure 7. Nigeria: Dependency Ratios

(Population younger than 15 or older than 64 as a percentage population aged 15-64)



Sources: United Nations Population Division.

8. Linking the United Nations projections to expenditure and factor input assumptions helps derive growth projections under different scenarios. Historical averages of real GDP growth, gross fixed capital formation (and standard capital depreciation rates of close to 6 percent), labor force participation and employment inform the inputs for the production function going forward and allows a growth decomposition for the outer years. This paper uses pre-2015 averages to not bias the results with the episode of the recent oil price shock and 2016 recession, which still makes this assumption slightly optimistic as it still includes the period of high growth experienced during the oil price boom (real growth rates of up to 6-7 percent). To capture the structure of the current labor market, male and female labor force participation rates (World Development Indicators) and employment rates (National Bureau of Statistics) are set to their 2013/2014 value, instead of averages over a longer horizon. Based on the implied shares from labor force participation and employment, the detailed population structure projections until year 2100 under different scenarios (United Nations Population Division) informs "Labor" entering the function. With large fluctuations of Total Factor Productivity (TFP) over the past decades (and an implied negative average), projections assume zero TFP growth for simplicity.

9. **The results suggest that the labor force structure would strongly shape future growth prospects.** Absent TFP improvements and with the same assumptions on other inputs, the population scenarios determine the main input into the production function:

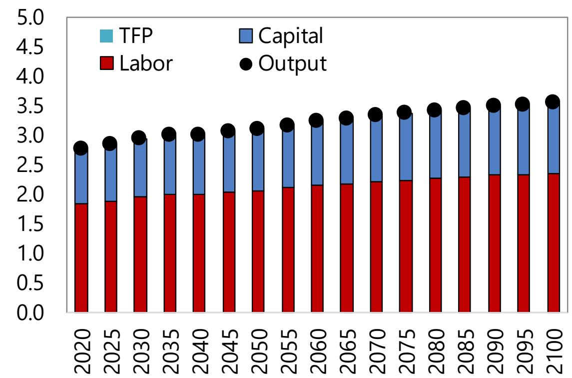
- ***Higher GDP growth in the constant fertility scenario:*** In the constant fertility scenario, entry of younger people into the labor market would increase GDP growth by about 1ppt in the long term, while declining mortality rates would also imply increased population growth of the same order of magnitude (Figure 8). In contrast, the medium fertility assumption, while implying a similar trend over the first 15 years, would yield declining real GDP growth, in line with lowering growth in the labor force and associated declines in the contribution of capital (Figure 6).

- ***Higher GDP per capita growth in the medium fertility scenario:*** Overall GDP growth rates mask the demographic dividend of lower dependency ratios and increases in per capita incomes. Taking into account population growth, the medium fertility assumption outperforms the constant fertility assumption by 0.2 to 0.6 ppt in per capita GDP growth each year, implying—all else equal— faster improvements in the standard of livings under medium fertility dynamics (Figure 9).

- ***Both scenarios highlight that TFP improvements are necessary to significantly change the growth trajectory.***

Figure 8. Nigeria: Growth Decomposition, Constant Fertility Scenario

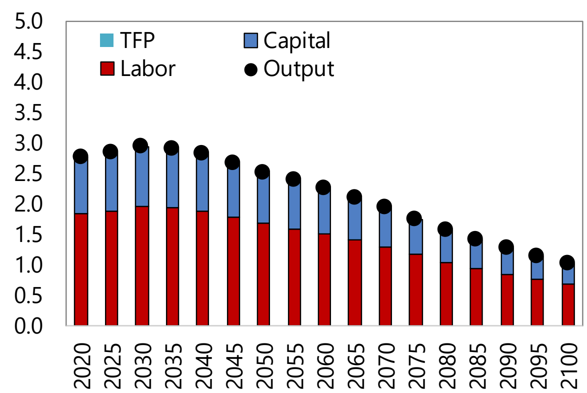
(Annualized, percentage change)



Source: IMF demographics tool; IMF staff estimates.

Figure 9. Nigeria: Growth Decomposition, Medium Fertility Scenario

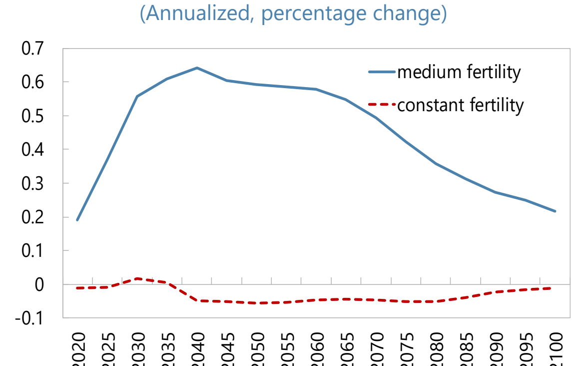
(Annualized, percentage change)



Source: IMF demographics tool; IMF staff estimates.

Figure 10. Nigeria: Real GDP per Capita under Different Scenarios

(Annualized, percentage change)



Source: Authors' calculations.

10. The demographic structure and health cost assumptions also allow to make health and pension cost projections. The following scenarios assume that health spending for individuals above age 65 is about twice as high as expenditure for younger individuals (compared to 3.5 times found for studies in the OECD) within the current health spending envelope. Both scenarios also take into account the projected age structure of the Nigerian economy that makes quantification of health expenditures possible going forward. Similarly, the projected share of the population above age 65 helps extrapolate pension expenditures from current levels.

11. Both fertility scenarios imply the need for increased health, and, to a lesser extent, pension expenditures, with larger requirements under constant fertility.

- ***Health expenditures:*** with high dependency ratios under the constant fertility scenario, health expenditures increase faster than GDP, mainly driven by the share of the population that is not yet contributing to the labor force and thus production. As a result, public health expenditures-to-GDP triple towards the end of the projection horizon. Under the medium fertility assumption, dependency ratios decline over the long term, and the resulting increase in GDP can better support the increased demand for health services. However, even under this scenario, health expenditures in percent of GDP would need to double to about 1 percent of GDP to support current service delivery.

- ***Pensions:*** The overall constant dependency ratios in the constant fertility scenario are driven by the younger-age population, while the share of the older population only significantly increased towards the end of the projection horizon, implying roughly flat pension expenditures in percent of GDP under the constant fertility scenario. In contrast, with overall lower GDP in the medium fertility scenario, pension expenditure levels would increase quickly, more than doubling in terms of GDP in over the projection horizon.

- In **both scenarios**, increased spending would maintain the status quo of service delivery, while further spending is critical to improve access and quality of services, something that earlier IMF work has shown is urgent to boost human capital (IMF, 2019).

Figure 11. Nigeria: Health Expenditures

(Percent of GDP implied by constant fertility)

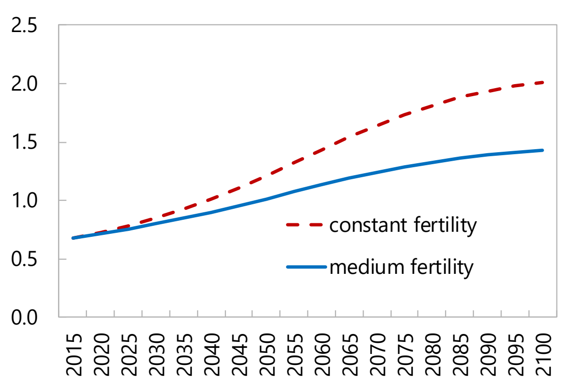
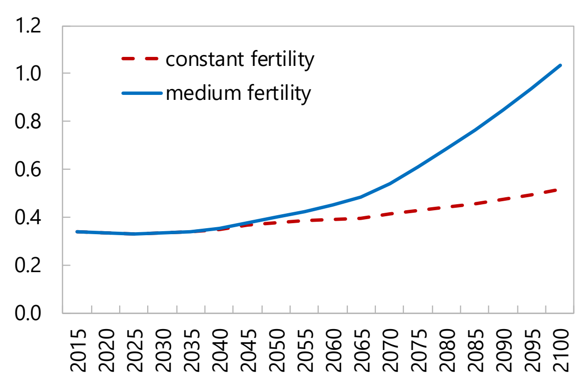


Figure 12. Nigeria: Pension Expenditures

(Percent of GDP implied by constant fertility)

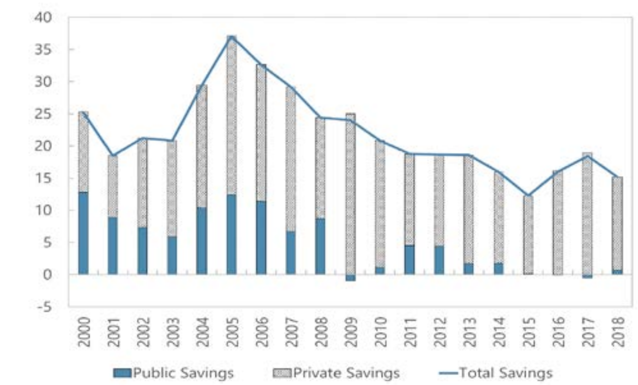


Source: Authors' calculations.

C. Mobilizing Savings

12. Financing Nigeria's social infrastructure spending needs will require significant additional savings. By exerting upward pressure on the dependency ratio, Nigeria's demographic trends result in lower savings even if the absence of adequate social safety nets increases the incentive to save. Nigeria's savings have fallen considerably in the past two decades, with the decline in public savings, mostly reflecting lower revenue mobilization—explaining much of the decline in the overall ratio. Private savings have also fallen in recent years, from an average of 17 percent in 2000-2008 to 15 percent of GDP in the period 2011-18, mostly as precautionary savings declined in response to the recession following the oil price shock of 2015. The overall implication from these overall saving trends is that there is insufficient funding available to meet investment needs, including in the health and education sectors.

Figure 13. Nigeria: Public and Private Savings 2000–18 (Percent of GDP)



Source: National Bureau of Statistics, IMF Staff calculations

13. Efforts to boost savings to finance higher investment should address both demand and supply constraints. In the absence of a public pension scheme, Nigerians will *ceteris paribus,* tend to save more for retirement and old age. Broadly speaking, efforts to increase savings will need to focus on enhancing financial inclusion and increasing the availability of saving instruments. Traditional financial inclusion efforts have focused on access, such as opening bank accounts for the unbanked. This is a necessary first step but is not enough to encourage formal saving to the extent required. The authorities' Financial Inclusion Strategy includes many innovative features, which would help to address both supply and demand issues but needs to be implemented in full. In scaling up investment spending, care should be taken to ensure that high quality projects are appropriately selected, appraised and costed at favorable borrowing terms and conditions. If availing of foreign savings is considered a viable alternative to increasing domestic financing, the accompanying exchange rate risk should be fully taken into account.

D. Policy Recommendations

14. A continuation of current demographic trends bears a number of risks, calling for a strong set of policies. If Nigeria continues along its current path of demographic growth alongside insufficient investment in women's health, it will result in increasingly inadequate basic services and higher unemployment. Further, it will result in a higher dependency ratio, leading to more households in poverty. The average child will have only 8.2 years of schooling, but this is equivalent to only 4.2 learning-adjusted years of school because of quality deficiencies. A lack of skills is the third most binding constraint for private sector firm expansion, after lack of access to electricity and finance. These risks call for a comprehensive policy package now, with the following paragraphs providing the main elements.

15. Comprehensive policy reform would improve growth to the level needed to absorb the massive upcoming influx of labor market entrants into productive employment. Nigeria could transition from lower-middle to higher middle-income status in 40 years by investing in girls' education, encouraging more ambitious family planning, and adopting a coherent economic policy framework. Achieving this transition requires action in education, social protection and health sector policies. Policy recommendations focus around three broad areas: boosting human capital, addressing fertility directly and financing (both public and private), in line with recommendations by a range of development partners (Canadian High Commission to Nigeria, GIZ and others; Bill and Melinda Gates Foundation, among others):

- ***Addressing fertility (IMF 2018; IMF 2019), including through investments in human capital (health and education).*** Making available family planning methods—to those families who desire to use them—will help families making their economic choices, will spillovers to lower fertility, while lowering harmful traditional practices, such as child marriage, would in addition protect both maternal and child health. Such policies would also help reduce maternal death ratios, in particular in young age, and address high adolescent fertility rates that are adversely linked to child health. Investments in education, in particular for girls, are another way of opening the virtuous cycle between increasing gender equality, lowering fertility, higher productivity, and development. Here, investment in electricity and sanitation facilities for schools will not only advance general development goals but help close gender gaps in the labor force and education.

- **Improving public and private financing:**

  Public

  - Ensuring appropriate budget allocations for a package of basic education inputs—school infrastructure, furniture, and books—to meet the needs of Nigeria's growing population for an improved quality, accessible education.

  - Increasing budget allocations for health, ensuring regular and timely release of funds, and increasing domestic mobilization of resources to fund basic health services at the state and federal levels;

  - Improving delivery of basic health services through increased efficiency of existing health services; prioritization of lower-cost, higher-impact areas such as primary health care; and improved collaboration with private sector actors.

  - Institutionalizing effective coordination and alignment of various social protection programs among the three tiers of government. Capacity building to deliver at scale is a major priority at the state level. Scaling up state-level social protection service delivery, is particularly important to enhancing long-term productivity so as to benefit from the demographic dividend, as will integrating social protection programs with efforts to promote access to finance, skills and employment opportunities.

- Additional domestic borrowing to finance the increase in social investment spending envisaged by this analysis can be considered but would require careful project selection and monitoring as well as prudent debt management policies being put in place.

- Increased foreign borrowing can be a viable alternative to domestic borrowing or saving but would require judicious management of the accompanying exchange rate risk.

Private

- The increase in social investment spending, would require a considerable increase in domestic savings. Financial deepening will help address some of the shortfall but full implementation of the national financial inclusion strategy—including innovative features such as mobile banking—will be required to bring about the required increase in national saving.

- Transforming Nigeria's economy to generate the high productivity employment necessary to absorb the rapid forthcoming increase in the labor supply and reap the demographic dividend will require urgent reforms in macroeconomic and structural policies.

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RULE OF LAW, THE ENFORCEMENT OF CONTRACTS AND MARKET TRUST[1]

The efficiency of contract enforcement impacts economic growth. For Nigeria, while the court system has some comparative strengths, market trust is low, in part because of the delays in the process. This is most apparent in the relatively modest number of filings of debt enforcement cases and in the way firms side-step the formal enforcement process. While challenges call for a broader reform strategy, automated and fast track procedures, special procedures for bulk claims (credit cards, utility companies etc.), and better monitoring of bottlenecks are needed in the interim to enhance contract enforcement and market trust.

A. Background

1. Weak contract enforcement impacts economic activity. Stable financial and economic markets depend on regulator laws being effectively upheld and enforced, including for the banking sector, capital markets, land rights, procurement and insolvency, in which credible and effective legal procedures and enforcement are a critical component shaping relations between market actors and how they behave. The rapport between effective contract enforcement and investment is well established. Specifically, in the area of weak contract enforcement in debt recovery, the literature identifies the following growth impact:

- ***Interest rates*** will increase to factor in the high cost of debt recovery and upholding property rights, as investors must expend cost, time and effort to maintain these. Risk premiums will also increase to factor in the cost. (Visaria 2006).

- ***Investments*** will be reduced as firms become more risk averse and move to more attractive places (Tareq, Hassan et al (2018), Nkoa & Song (2017)).

- ***Firm growth*** will be stunted. As investment lags and costs increase, firm growth will be stunted, with attendant impact on employment. (Laeven & Woodruff (2004) Giacomelli & Menon (2013), Lichand and Soares (2014))

- ***Access to credit*** will be impaired because of shallow credit markets and underdeveloped credit facilities, such as trade credit or bank cards (Ponticelli and Alencar (2016) Zhu et al (2018)). Specifically, banks and other credit companies will cut back on unsecured lending, with other lending marked by high down payment requirements, high guarantees, and high interest rates to factor in recovery cost and low caps.[2] Prepay systems will prevail, with attendant restrictions on growth, including in the technological domain.

[1] Prepared by Sebastiaan Pompe (LEG) with assistance from Weronika Synak.

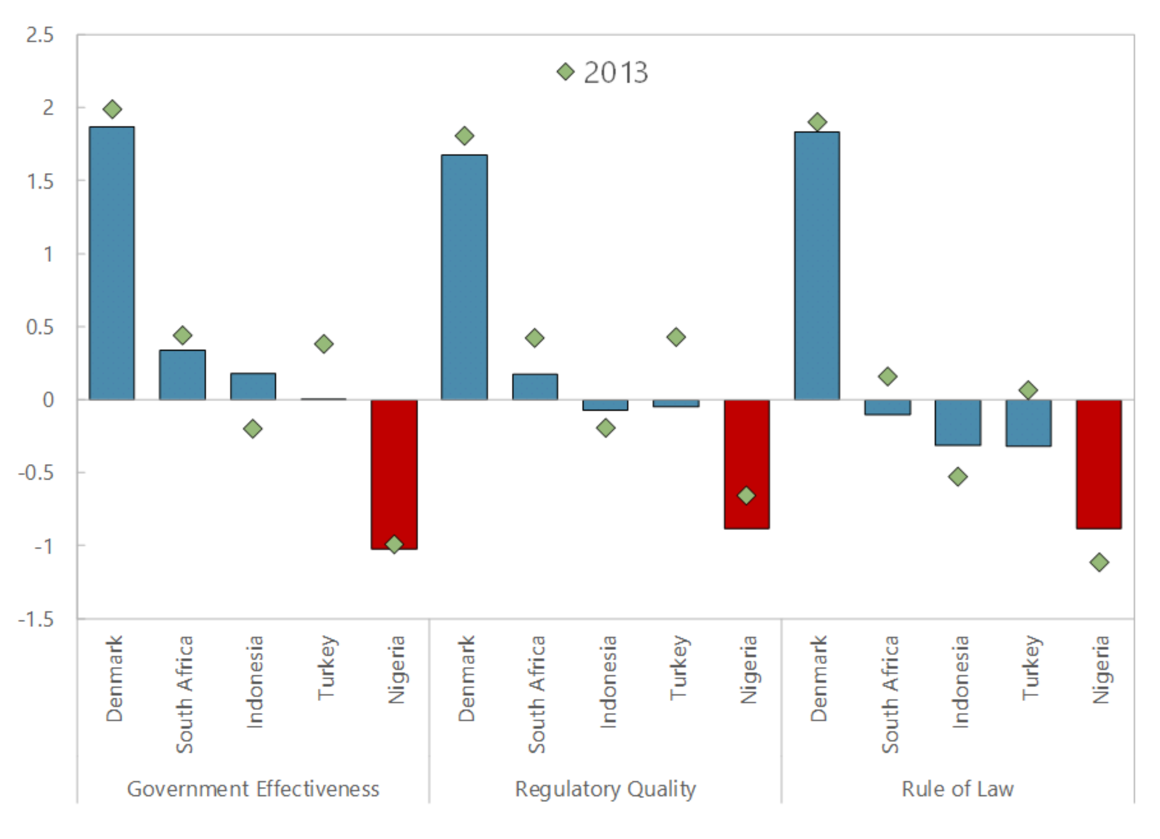
[2] T. Jappelli et al (2005) establish that the variations in enforcement speed in Italian regions impact on the availability of credit and on interest rates. M Chemin (2009) finds that the introduction of new efficient enforcement procedures in India resulted in fewer breaches of contract, higher investment, improved credit and expanded rental markets.

B. Stylized Facts—How is Nigeria's Judicial System Faring?

2. Prior to discussing Nigeria's contract enforcement performance, it is important to first assess Nigeria's governance indicators, which score low albeit with an improving trend. According to the WGI (2018), Nigeria scores low on Rule of Law and government effectiveness. However, even though the figures remain low, the indicators show a steady improvement since the last round (2013). This weak overall assessment is confirmed by other indicators, such as the Global Competitiveness Report of the World Economic Forum, which gives Nigeria an equally poor overall ranking. Against that background, the anti-corruption efforts of the anti-corruption agencies, notably the Independent Corrupt Practices Commission (ICPC) and the Economic Financial Crimes Commission (EFCC)—through a higher number of prosecutions/cases files in courts and asset recoveries—have helped improved the trend in governance.

Figure 1. Selected Worldwide Governance Indicators 2018

(Score: -2.5 to 2.5)



Sources: Worldwide Governance Indicators.

Note: There is some uncertainty around any point estimate.

3. Disaggregated indicators point at a more nuanced picture, with the country showing a somewhat strong performance in the area of the rule of law/contract enforcement:

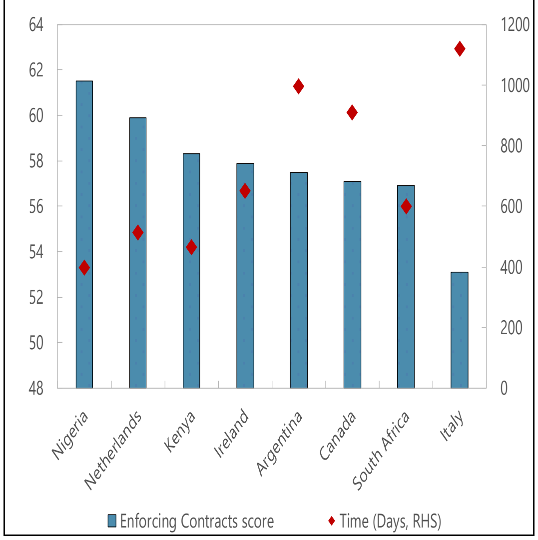
- The **Mo Ibrahim Index on Rule of Law** shows the country to be amongst the top scorers on the continent on sub-indicators of the Rule of Law—such as independence and transparency of the judicial process, where Nigeria ranks 5th out of 54 countries on the continent, with a significant improvement of the country score over the past three years. However, the protection of property rights remains challenging, with Nigeria scoring 37th out of 54 countries and country performance declining in the last three years.

- The **World Bank's Doing Business Index 2020** similarly gives Nigeria a poor overall score, but the country ranks well on contract enforcement, outscoring countries such as the Netherlands, Kenya, Ireland, Canada and South Africa.[3] A persistent challenge in the area of contract enforcement is delays, as noted in the World Justice Project for Nigeria. Since speed is a key factor for the market, this may carry broader implications.

- The **World Justice Project** shows that the sub-set of civil justice in Nigeria is ranked in the mid-section (rank 79). The indicator further flags that the civil enforcement in Nigeria is better than the other country groups on accessibility and affordability, discrimination, corruption, government influence. In this indicator, Nigeria outperforms other prominent middle-income countries such as Turkey, India, Indonesia and Mexico.

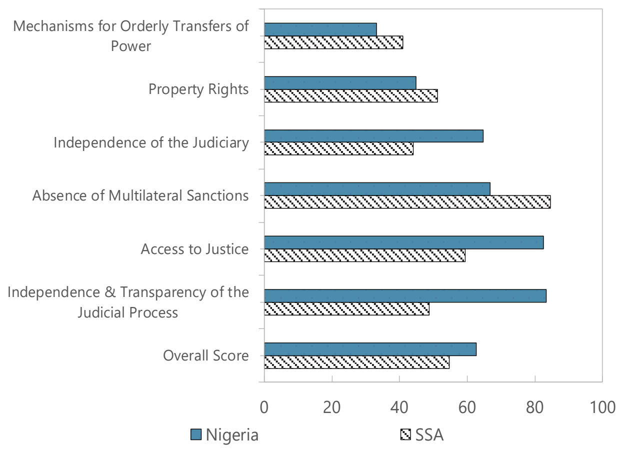
Figure 2. Enforcing Contracts: Score and Average Time in Days

Sources: World Bank Doing Business Index 2020.



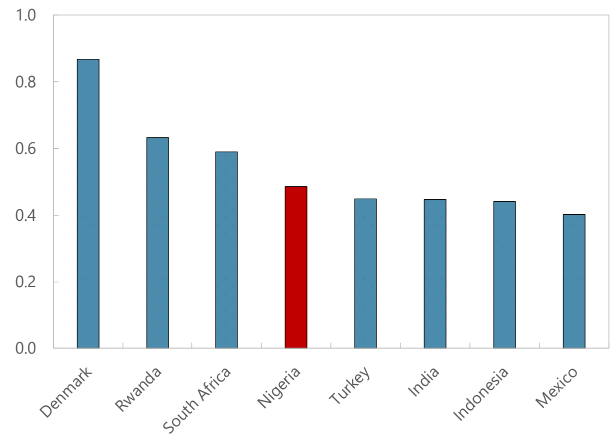
[3] The Doing Business Index focuses on the enforcement of a specific claim of comparable value. For Nigeria it was a claim of approx. Naira 1.4 million in the Lagos Small Claims Court and Magistrates Court. It measures such aspects as the duration of the procedure, its cost and quality. The Index therefore focuses on the processing of cases once these are filed, and not on the obstacles to filing.

Figure 3. Ibrahim Index of African Governance 2017: Rule of Law



Sources: Mo Ibrahim Foundation: Ibrahim Index on African Governance.

Figure 4. Civil Justice Score 2019



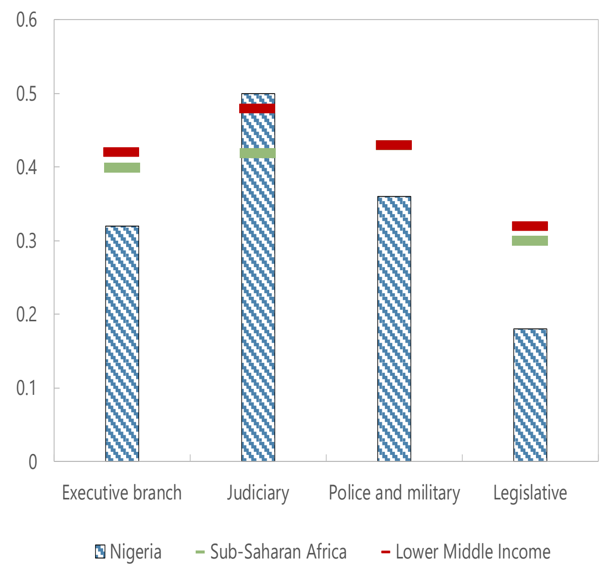
Sources: World Justice Project database.

4. Looking at corruption indicators in the court system, Nigeria also exhibits scores above the region's average:

- The **World Justice Project** (2019) finds that Nigeria outscores Sub-Saharan Africa (SSA) and Lower Middle-Income countries on the judiciary, while trailing on corruption in the executive branch, the police and the legislature.

- The sub-indicator on corruption in the **Enterprise Survey** finds that 44.8 percent of the firms consulted find corruption to be a major constraint (above the SSA average of 41 percent). However, this does not include the courts, an institution that firms view more positively (only 4 percent against an SSA average of 17.7 percent).

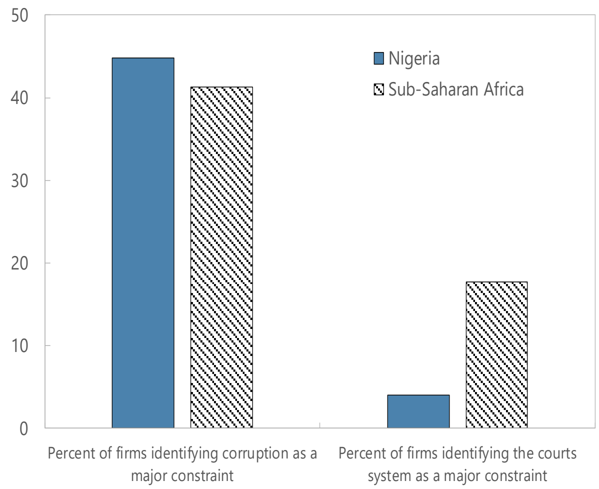
Figure 5. Absence of Corruption Score 2019



Sources: World Justice Project database.

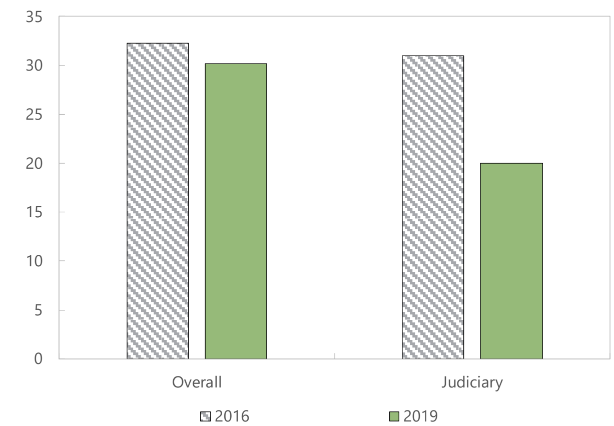
- The **2019 UNODC** report finds that the judiciary belongs to the agencies which have made most progress against corruption in recent years (a 30 percent improvement in household experiences with court corruption between 2016 and 2019). Even so, as noted in the report, one in five court users are confronted with corruption in the judicial process, which remains high.

Figure 6. Firms' Views on Corruption



Sources: Enterprise Survey 2019.

Figure 7. Nigeria: Prevalence of Bribery
(percent)



Sources: United Nations Office on Drugs and Crime Report.

5. **Recent qualitative reports and expert inputs tend to confirm these indicators**. There are frequent reports of incidents of corruption within the judiciary (and the court administration), but it would appear that these cases are concentrated, with certain case types (notably election cases) and court levels (notably magistrate courts) being more exposed. Contrary to claims often made in Nigeria, the Cleen Foundation in its analysis of 520 corruption trials (2017-2019) found no compelling evidence that anti-corruption prosecutions and court decisions were lopsided or focused on the opposition.

6. **However, low case load and filings reinforce the perception of lack of market trust in Nigeria.** Contrary to common perception, the number of civil and commercial cases filed in Nigerian courts is small, standing in stark contrast to the size of the economy and the population. The caseload of all Superior Courts in Nigeria in 2019 amounted to 154,270 cases, which is significantly smaller than all cases in Ireland (with a population of 6 million– 233,058 cases) or Singapore (with a population of 5.6 million - 359,000). The number of civil cases (including debt enforcement) filed in the most active commercial area of the country (Lagos), number around 40,000 annually.[4] In comparative terms, that is a negligible number for a population of about 20-25 million people in the State of Lagos, which is home to a sophisticated economy of $136 billion (more than a third of the entire country GDP) and 3.2 million firms (Adanu 2017).

7. **The low case load partly reflects firms purposely side-stepping courts and legal enforcement.** This limits access to their own products and services, which exhibit high transaction costs through high market rates and prices. Two examples serve to illustrate the dynamic:

- **A lengthy process** may be one reason that firms avoid going to courts**.** While litigation is an instrument of last resort for banks anywhere, their business nonetheless relies on effective

[4] Lagos State Government, Digest of Statistics 2019 (for 2016) lists 19,983 civil cases for the magistrate courts and 20,535 civil cases for the High Courts. The FCT data (for 2018/9) are 12,963 and 16,396 respectively but these cover all cases (both civil and criminal), as case categories are not split up.

recovery mechanisms. Banks assuredly will file cases in court to recover loans, and to ensure contract compliance, also as a broader signal to the market. That dynamic is very weak in Nigeria, as shown by the small number of court cases filed by credit institutions in Nigeria. One prominent bank, with more than 150 offices in the country, has as of January 2020 only 9 court cases. Another bank pointed out that it had a handful of cases sitting in court, some for 17 years, and was reluctant to resort to courts. In comparison, the special banking courts of Pakistan—a country comparable to Nigeria in terms of demography and legal system—had 46,000 cases pending in 2019.

- **Use of pre-pay system**. Firms with a large customer base, such as utility, Telcom or credit card firms will typically have a steady percentage of defaults; these will be modest claims on a case-by-case basis but can add significant costs. In Nigeria, the industry tends to sidestep the inefficient enforcement system by relying heavily on prepay systems (99.9 percent). Firm managers acknowledge the competitive advantages of post pay systems but feel they cannot afford it because of the default risk. Even for the post-pay clientele (which is 0.1 percent of the total clientele), default enforcement through courts is prevented as much as possible. Thus, one firm with 15,000 customers in default did not report having a single case in Court.

Firms with a Large Customer Base Projected Defaults

Comparative experience shows that an annual default rate of 0.5 percent of the customer base is standard for firms with a large customer base. Some Nigerian firms have a customer base of 50 million, and this would translate into 300,000 defaults annually (in case of post-pay contracts). Assuming half of those are filed in court, this would mean 150,000 cases for a single company. There are at least 5 such companies in Nigeria. While a speculative example, these figures show how efficient markets operate, and the figures debt recovery procedures typically must accommodate.

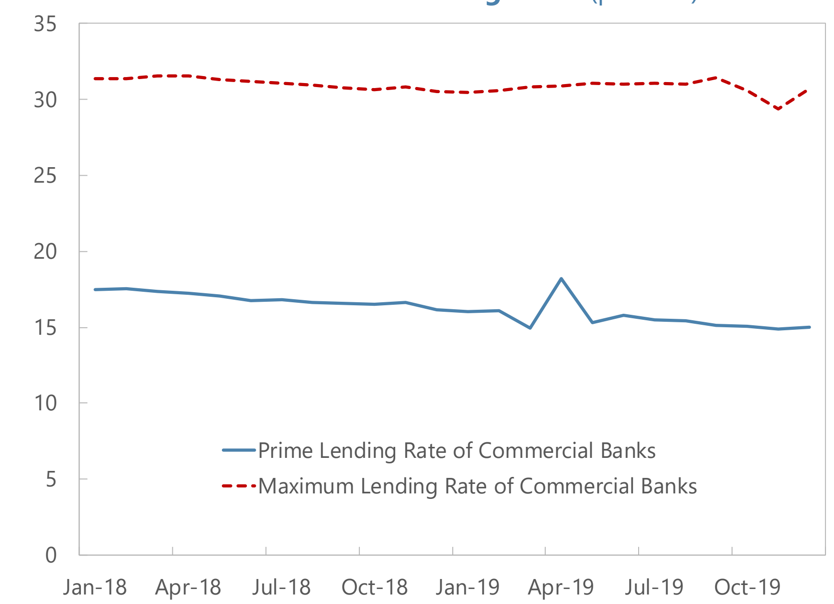
(Based on Fund data from Portugal, Greece and Kosovo)

Box 1. How Lengthy Court Processes Translate into Reduced Access to Credit

Court delays make it harder for financial institutions to recover debts, increasing both costs and constraints to credit access. For example, unsecured lending remains limited to a small portion of bank loan portfolios (typically 10 percent of the total portfolio) in Nigeria and is only extended to a narrow market band (investment grade rating, BBB or better). Secured lending is also limited, largely as high interest rates factor in high transaction costs for recovery (rates range between 7-10 percent for the Federal Mortgage Bank of Nigeria (FMBN) and, until recently, between 15-25 percent for commercial mortgage institutions).

High rates can also explain the country's low mortgage penetration, as court cases "can drag for up to 10 years".

Commercial Banks Lending Rates (percent)



Source: Central Bank of Nigeria.

8. Despite the modest inflow, courts are struggling to meet their case load. While aggregate data are lacking, the average duration for a first instance decision is estimated at 582 days while a case routinely takes 10 years before all appeals are exhausted. The judiciary views the slow process as mainly a resource issue, and its standard response to calls for enhanced efficiency is to appeal for more resources, to which the current administration has given a receptive hearing.[5]

[5] See e.g. https://allafrica.com/stories/202002210614.html The President at the opening of the 2019 All Nigeria Judges' Conference of Superior Court announced that "...we have worked closely with the Chief Justice of Nigeria to ensure that judicial budgetary allocations are enhanced in view of the needs of the judiciary. I have strongly supported the increase in number of judges at High Courts, Appeal Courts and the Supreme Court in order to reduce the burden of the work placed on judicial officers."

C. Main Challenges

9. The debt enforcement system remains slow and struggles to meet market demands. Inefficiencies persist as the process remains principally paper-based, with judges often continuing to work in long hand, taking many hours to read verdicts, with automation continuing to struggle even with the more elementary steps. Three examples illustrate the point, even if these are not by any means exhaustive:

- ***Slow recovery process even for "simple debts"***"[6]. These are debts for a specified amount, such as consumer bills, or straightforward loan settlement from credit agencies, which in many countries constitute the bulk of the market debt claims (about 85 percent of all claims).[7] The international practice for such debt is to introduce a highly expedited form of processing, with decisions either taken by court clerks or fully automated. In such instances, the case will go to court only if the debtor objects. Nigeria has retained the traditional procedure as the creditor must submit evidence and the judge must decide the case, even if the debtor does not object.[8] This process burdens courts in Nigeria with a large number of trivial disputes not challenged by the debtor.

- ***Inability to process bulk claims***. These procedures allow firms with mass clientele to file large numbers of comparable claims (such as non-payment of water or electricity charges) through single files, which are then automatically triaged into individual filings through a court computer system. However, in Nigeria the debt recovery process remains individualized, meaning that debts must be filed on a case-by-case basis against individual debtors. This increases transaction costs to the point that the cost-benefit ratio is prohibitive: the creditors may spend more in costs than they will recover. This is a major market constraint for firms with a mass client base, such as credit card companies.

- ***Inefficient liquidation process after a court decision is issued***. For example, the recovery of debts from bank accounts, which is the easiest form of debt recovery, requires a protracted process. Instead of making full use of advanced technology, including through the Biometric Verification Number (BVN), banks[9] are compelled to turn up in courts to respond to claims while

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[6] General Report for the XV World Congress of Procedural Law (2015), Relief in Small and Simple Matters in an Age of Austerity.

[7] Special Eurobarometer 395: European Small Claims Procedure.

[8] These procedures are governed by the Order 11 procedure in Nigeria, which permit creditors to file a claim and apply for summary judgment for enforcement. The claim should include the evidence. The debtor is notified. If he fails to turn up the court issues a default judgment. If the debtor does file a notice of intention to defend, including attached affidavits, the case goes to trial. Up to 50 percent of the debtors object. The process therefore remains evidence based and retains the role of a judge, when the emerging international practice for simple claims procedures minimizes or dispenses with the evidence altogether and dispenses with the judge in cases where the claim remains uncontested.

[9] The Bank is not a party to the underlying dispute. It just holds the accounts of the debtor – if it does. There are many cases where commercial banks holding debtor accounts are drawn into protracted litigation in the courts

debtors are given wide powers to object, resulting in extended and costly delays in case processing.[10]

10. The absence of a strong central statistical system in the judicial system represents another key weakness. Nigerian courts struggle to generate statistics on the justice system generally. Most notably, the data which are generated are not sufficiently granular and lack the critical indicators to properly assess the court process.[11] In the absence of these basic data and tools, it is impossible to know what courts do, how efficient the business process is, what the workload of the judges is and where the bottlenecks sit. The direct consequence is that it is impossible to define institutional needs and develop grounded budgets that addresses the specific bottlenecks.

D. Past reforms

11. Cognizant of challenges faced by corporates when dealing with the judicial system, the authorities have launched various initiatives over the past few years:

- ***Modifications in civil procedure and court management**,* aimed to enhance in-court efficiency and performance. This has allowed aggrieved parties to submit motions at the commencement of trials (allowing for these to be processed upfront), which restricts their use as a delaying tactic once the trial proceeds. Rules have also been established so that judges issue decisions within firm timelines (for certain case types) and are assigned performance targets with regular reporting to ensure timely delivery. Judges also have the power to impose costs for frivolous claims, which the Chief Justice encourages them to use. These reforms have yet to show an impact.

- ***Alternative systems of debt recovery to better answer market needs***. The authorities in 2002 set up mediation and arbitration centers attached to courts (the so-called "Multi Door Court (MDC)"), mainly aimed at siphoning off cases from regular courts. After 15 years in operation, these MDCs are struggling to attract cases and make a dent to the inflow of cases in regular courts, notably on debt enforcement. Thus, the MDC for Abuja (FTC) has only 100 cases annually, with the Lagos MDC showing comparable figures. The reasons for this weak impact merit further exploration. Other specialist mediation centers have more success, notably in rental

between debtor and creditor, to safeguard their interests and notably ensure that the whole judgment sum does not make them liable. Banks incur enormous expenses in the process.

[10] What typically happens is that as banks get served a court order to disclose whether a debtor has an account in his bank. ('Order Nisi"), the debtor bank accounts are frozen. The Banks must come to court with an affidavit "to show cause", i.e. whether or not such accounts exist, with details. The debtor can object to the Order, such as by asserting the original court judgment was obtained by fraud. The court must then first decide whether this claim is valid, causing the delay.

[11] The Nigerian court statistics typically lack case clearance rates and disposition times. These are the most commonly used indicators to calculate case flow in court systems. Clearance rate assesses how courts handle the inflow of cases (by dividing the number of resolved cases with the number of incoming cases), and disposition time how long it takes to resolve a case type (by comparing the number of resolved cases with the number of unresolved cases).

disputes in the CMC center. However, for the general purposes of debt enforcement, these alternative venues have yet to develop into realistic alternatives to courts.

- ***Various IT initiatives to expedite the court process***. These include an automated case management system transferred from the US state court system (the NCSC[12]) and comparable projects at state level. E-filing has been introduced in several courts but has yet to take full effect.

E. Recommendations

12. The initiatives taken by the judiciary are a step in the right direction, but more transformative reforms are needed with adequate resource support. The judiciary reform process would need to look at what the market needs and should legitimately expect, in terms of service delivery. Reforms should also address the judiciary's institutional and organizational weaknesses on central management and steerage, including inadequate data. To bring that change, it is important that the Nigerian judiciary—supported by the Nigerian government—undertake:

- **A full diagnostic of the constraints facing the judicial system through:**
  - *A market analysis of actual and projected demand for debt enforcement*, with the objective to identify the specific types of debt enforcement which the market actually needs and the current cost of failure to efficiently enforce such debts.
  - *A gap analysis of the current enforcement system*, with an analysis of actual performance, and inventory of key administrative constraints, regulatory constraints, and constraints in the judicial institutions and enforcement stage.
  - *A comprehensive reform program*, based on international best practices and country experiences, which builds on the two prior analyses.
- **Pending the outcome of the diagnostic, measures that increase institutional performance and responsiveness to existing market needs should be pursued**, notably through:
  - *Introducing a central statistical service*, which publishes on a website, in standard format and on a quarterly basis, performance data of courts, both aggregate and disaggregate by court unit and case type, and considering disposition time, clearance rate and backlogs. All federal court decisions should also be published on a website that is publicly accessible for free.
  - *Establishing an automated procedure for moneyed claims,* comparable to Money Claim Online (MCOL) in the UK, or the automated Payment Order procedures in other countries. The objective must be to largely by-pass the adversarial in-court process for simple debt enforcement cases while giving a debtor the opportunity to contest a claim in court if there is ground for contestation.

[12] The National Centre for State Courts.

- *Automated bundling for bulk claims* by purchasing/implementing available software that allows for bundled filings of large volumes of comparable claims and automated unbundling in the court process.

- *Instituting a nation-wide fast track process for debt recovery claims,* as is currently the case in the UK and building on the experiences in Lagos. This would allow for expedited processing of such claims, reducing possibilities of filing spurious appeals, and allowing for expedited court decisions.

- *Enhanced liquidity recovery for the enforcement of court decisions on debt recovery*, through garnishment and recovery from bank accounts, rather than through seizure and liquidation of physical assets. The regulations and infrastructure on garnishment should be enhanced to allow for precise identification of bank accounts and prevent creditor trawling expeditions, which are burdensome to courts and banks alike. Full use of the existing automated systems allowing for easy identification of bank accounts should be made.

- *Procedural rules should be amended to allow for easy and automated notification of debtors*, which would help minimize evasive debtor behavior.

- *Issuance of guidelines on what constitutes a backlog in Nigerian law and court practice*. Such guidelines should state that the resolution of such cases should be expedited. The procedural instrument of "showing cause", which would allow for dormant cases to be struck off the record, should be explored.

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