

## Nigeria: Financial Sector and Public Financial Management Development Policy Credit (DPC)

### SUPPORTING NIGERIA'S EFFORTS

Accelerating economic reforms and mitigating the impact of the global economic crisis.

### Overview

With the onset of the most recent financial crisis, **Nigeria** was threatened by a loss of market confidence as its budget position slipped from strong surplus to substantial deficit from 2008 to 2009. By providing the first budget support to Nigeria in 30 years, the International Development Association was able to help the government arrest the slide in market confidence, support ongoing economic reforms, and help address key financial transparency issues that will buffer the country from future shocks.

### Challenge

Ahead of the international financial crisis, Nigeria's economy had grown strongly through a combination of sound macroeconomic management and rising oil prices. With the crisis, the drop in oil prices and consequently in government revenues, the economy started experiencing tremendous pressure. Although good oil revenue management had generated savings in previous years, falling oil prices, production problems, and the deteriorating fiscal outlook reduced international confidence. Large portfolio outflows also triggered a decline in the stock market with increasing pressure on the currency and liquidity constraints in the banking system.

Nigeria was faced with the task of taking steps to address the immediate erosion in market confidence while addressing some of the key structural weaknesses that contributed to the onset of market instability.

### Approach

A US\$500-million development policy credit from IDA helped provide fiscal space at a time when government's budget shortfall and borrowing requirement increased dramatically, primarily as a result of the global financial crisis and the concomitant fall in oil prices from a peak of US\$147 to US\$38 per barrel. The dramatic fall in government revenues in a period of slowing global demand created enormous fiscal pressures as the overall fiscal balance turned from a surplus of 5 percent of gross domestic product (GDP) in 2008 to a deficit of 8 percent in 2009, threatening Nigeria's currency stability and confidence in the banking sector.

The IDA operation provides budgetary support to the Nigerian government to offset the fiscal impact of the on-going global financial crisis. It also supports the government in maintaining its current economic reform path in the financial sector, fiscal policy, management and governance. The three program objectives are: (i) maintaining confidence and stability in the

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**75%**

implementation rate of the 2009 federal capital budget

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financial system; (ii) strengthening the banking System; and (iii) supporting the objectives of the 2009 budget, which focused on raising government investment spending to accelerate non-oil growth.

The credit identified a set of medium term actions required to achieve regulatory reform in banking, pensions, insurance and capital markets sectors. Key activities include the adoption of International Financial Reporting Standards (IFRS), implementation of risk-based banking supervision, improving collateral and land registries, and strengthening and enforcing creditor rights. IDA's support also aims to help the government expand access to finance through innovative SME and MFI instruments for small and medium enterprises (SME) and microfinance, and improving transparency and investor choice in pension and capital markets. These actions were crucial to maintaining the momentum for reform and to achieving longer-term structural outcomes. Such reforms were closely aligned with the government's overall medium-term reform agenda and its seven-point agenda program as well as the World Bank's 2009-2013 Country Partnership Strategy (CPS).

Nigeria, with IDA's backing, was able to maintain confidence in its financial markets, although Nigeria's sovereign rating slipped a notch in the process to B-. The main areas supported by the development policy credit are: (a) maintaining confidence and stability of the banking system, and (b) sustaining growth through sound macroeconomic policies and budget priorities. The Central Bank of Nigeria successfully supported the recapitalization of eight banks in 2009 but remaining banks are healthy. Non-performing loans declined steadily from over 18 percent in 2005 to 6.2 percent at the time of approval of the IDA facility in 2009. Credit to the real sector has increased since the crisis from N3.0bn to N4.5bn between July 2009 and May 2010. IDA's credit is supporting the central bank in strengthening the capacity for risk-based supervision, in introducing International Financial Reporting Standards and improved transparency, and greater disclosure of financial reporting that will reduce the likelihood of such banking crises in the future.

Sound macroeconomic fundamentals have helped Nigeria sustain growth despite a weak global economy. Non-oil GDP growth accelerated to 8.2 percent in the first quarter of 2010 from 7.9 percent from the year-earlier quarter.

The operation represents a good example of a rapid response to the client's request for support in light of particularly difficult economic circumstances, caused by the global economic downturn. IDA was able to approve the development policy credit within six months of the request from the Nigerian government.

## Results

IDA's assistance to Nigeria in this instance highlights how a well-designed operation can help a government push through difficult but critical reforms to support its long-term goals. Examples of achievements supported by the facility include:

- Adoption of IFRS in Nigeria's financial sector is currently in progress. This was essential in the authorities' program to make the Nigerian financial sector more transparent. Although the banking crisis that followed in August 2009 was already brewing at the time of the IDA credit, the introduction of internationally-accepted accounting and reporting standards remains a major aspect of the financial authorities' plan to improve transparency and governance in order to put the system on a more solid footing.
- Improved implementation of the 2009 federal capital budget. Nigeria reached a 75 percent implementation rate of the 2009 federal capital budget, thereby supporting the government's goal to build critical infrastructure necessary for sustained economic growth.
- Employment opportunities generated. By supporting necessary and shovel-ready capital projects, such as a program of road maintenance, IDA also helped the government in its

efforts to mitigate the impact of the crisis on the poor by generating increased employment opportunities. This has been followed up with a government commitment to diversification away from oil and the encouragement of six key sectors including: entertainment; information communication technology; tourism; wholesale and retail trade; construction; and meat and leather. The government is targeting at least 100,000 new jobs in these promising sectors.

- Contributed to non-oil growth and macroeconomic stability. Overall, the IDA credit helped support continued high non-oil growth in Nigeria of about 7.7 percent. The currency has been stabilized at around N 150 per US\$1, inflation has come down from 15.5 percent in 2006 to 11 percent in 2010, and interbank rates have plummeted from a high of 20 percent in late 2008 to 3-4 percent in September 2010.

## Bank Contribution

The operation was based on extensive analytical work undertaken by IDA in the preceding years, particularly in support of the authorities' Financial System Strategy 2020 and on public financial management. The development policy credit itself provided US\$500 million of IDA financing.

## Partners

The IDA credit was the first budget-support operation in Nigeria in almost 30 years and reinforced the progress made by the Nigerian authorities in strengthening the financial sector and its budget management. It also prompted the African Development Bank to begin discussions and to grant budget support to the country following the IDA operation.

## Moving Forward

Continued support is being provided by the Bank, in conjunction with development partners such as the UK's Department for International Development (DFID) and Germany's GTZ, to strengthen financial sector regulators, enhance competition and transparency, and promote financial inclusion.

Continued technical assistance is being provided by the Economic Reform and Governance Project and the project preparation facility for the Growth and Employment Project. The government has also requested a new technical assistance operation, the Financial Authorities Strengthening Technical Assistance Project, to support capacity-building and institutional change in the financial sector.

## Beneficiaries

The IDA credit potentially prevented a broader collapse of the banking system in Nigeria. The Central Bank of Nigeria has since moved to improve the banking system's management, transparency and protections for investors and depositors. The Nigerian people as a whole are beneficiaries of IDA's support to the government as these actions averted a major meltdown of the financial system, and depositors in banks have been guaranteed, preventing huge losses to ordinary people. Last but not least, the improvements in public financial management let everyone benefit from improved transparency and better use of public resources.